By Vivek Agrawal and Guillaume de Gantes

Life Journey Asia – How life insurers in Asia can grow value

Asian life insurers on average deliver returns below their cost of capital, but a few carriers create significant value. What do they do differently?

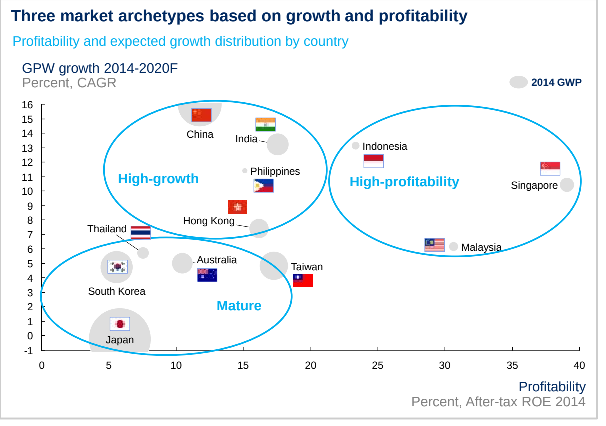
Impressive premium growth rates across most of Asia hide an industry challenge: many life insurers in the region are not creating value. Their returns over extended periods of time are well below their cost of capital. But against this challenging background, three opportunities are arising that could help companies regain their luster.

Strong growth, weak returns

Asia is the driver of world growth in insurance. Between 2009 and 2014, the global life insurance market grew from $698 billion to $891 billion, and 54 percent of that growth originated in Asia. Driven largely by strong demand in the region's emerging markets, premium growth in Asia is expected to continue to outpace the global average for the foreseeable future.

But Asia is far from a homogeneous market. The region is a mosaic of countries in varying phases of development. Each presents a unique collection of consumer needs and behaviors, demographics, regulations, and market environment. Yet amid this diversity, three general types of life insurance markets can be discerned: mature markets that feature slow and steady growth, high-growth markets where premium volume is increasing while profits lag, and high-profitability markets in which premium and profits are both growing strongly (Exhibit 1).

Exhibit 1

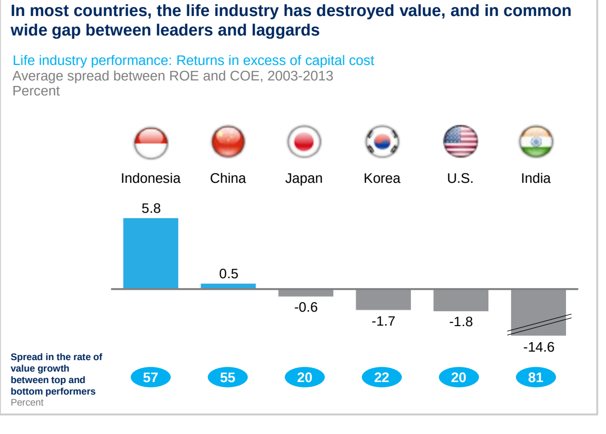


SOURCE: McKinsey Global Insurance Pools

In some countries, particularly China and India, premium growth expected through 2020 will be largely pushed by tens of millions of new consumers joining the market. Indeed, by 2019 China should be the world's second largest market for life insurance. In the high-profitability markets, notably Indonesia, the projected growth is likely to be driven by increasing penetration of insurance for an emerging middle class.

But these growth and profitability measurements obscure the struggle insurers are facing in most Asian countries. From 2003 to 2013, the Asian insurance industry's total returns did not cover the cost of capital. Only Indonesia posted comfortable returns over the period, while China barely covered cost of capital (Exhibit 2).

Exhibit 2



SOURCES: McKinsey Life Journey papers on the US, Japan, South Korea, Indonesia, China and India

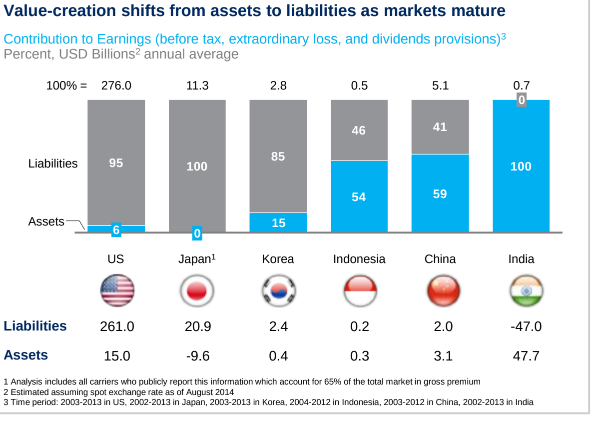
However, beyond market average, the spread in performance was substantial in each market, even as some insurers have created value in every single market. In India, for instance, there was an 81-point difference in the rate at which insurers grew value between the best and the worst performers over the period. China and Indonesia also showed a significant performance gap between the best company and the worst. In Japan, the spread narrowed to 20 points, comparable to results in the United States.

As markets mature, liabilities take precedence

To help understand the dynamics behind these differences, we analyzed dozens of the largest life insurers in five markets: China, India, Indonesia, Japan, and South Korea. We looked at company growth using the metric adjusted growth in surplus, which allows comparable assessment of public carriers and mutuals, and interviewed industry analysts and executives in each market.

The analysis showed that market maturity is a strong predictor of what creates value. In mature markets like Japan, South Korea, and the United States, the best performers focused on superior liability management, while the leaders in emerging markets relied partially or largely on investment management (Exhibit 3).

Exhibit 3



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As markets mature, we believe life insurers are forced to shift from investment management to liability management as a source of value creation. Insurers in emerging Asia are still building capabilities in managing liabilities, such as risk pricing, risk selection, and claims management, and are not adequately prepared to make this shift effectively. Indonesia, for example, appears in the midst of a transition from investment to liability management as the primary driver of profitability, while investment management is the dominant source of profits for India.

Growth areas could counter doldrums

To grow value, life insurers in Asia should focus on several significant pockets of profitable growth that are emerging. Three, in particular, stand out:

- Health insurance: We expect gross written premiums for health policies in Asia to continue to grow at double-digit rates, with annual growth of around 5 percent in mature markets. Among the more interesting markets, we expect medical spending to reach about $1.4 trillion in China by 2020, $240 billion in South Korea, and nearly $20 billion in Indonesia. Demand for medical policies, which require liability management capabilities that life insurers are uniquely positioned to provide, will rise in tandem with increased health expenditures.
- Retirement solutions: Aging populations, especially in maturing economies, will create demand for retirement solutions. With lowering savings rates and reduced government benefits, several markets – starting with Japan and South Korea – are facing retirement funding challenges. Even in an emerging market like China, the government is encouraging private retirement plans. Life insurers are uniquely positioned to package and underwrite this risk in a profitable manner.
- Growing middle class: In emerging economies, an affluent middle class is expanding on the heels of rapid economic growth. McKinsey research shows, for example, that China's mass affluent segment will grow by 20 percent a year, account for 40 percent of households by 2020, and contribute about 60 percent of liability-risk focused gross premiums for life insurers. Similar dynamic growth is expected in other Asia emerging markets.

To capture these growth opportunities, life insurers must understand how demand will shift as wealth increases and consumers demand better experience, more choice, and personalized service. For those carriers that plan ahead – investing in strengthening their risk management capabilities and upgrading service infrastructure the meet the changing needs of demanding Asian consumers -- returns will be well worth the effort.

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