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Innovate or Evaporate : Redefining Channels of Distribution in Insurance Sector

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Abstract

Insurance is in a manner of speaking the last frontier in the financial sector to open. It is also a sector which will lead to benefits across the full spectrum, from the individuals who will now have wider choices, to the economy which will see increased savings, to the infrastructure sector which can look forward to long term funding being available. In an under-insured economy, newer channels of distribution will have to be utilized to intensify the reach of insurance both in urban and rural markets. This will create huge employment opportunities not only within insurance companies but also as agents and consultants of insurance companies. The present article discusses the various innovative models of distribution channels used by insurance companies to penetrate into the opportunistic market segments and also the cost considerations in operating various distribution channels.

Key words: *Spectrum, Innovate, Insurance Market*

Introduction

In the business of insurance you should always "Innovate" or "Evaporate." and to create a space in the consumer's mind insurance companies have maximized their innovation skills. From creating provisions where returns are tied to index linked funds or a specific basket of equities to drawing options where buyers are allowed to switch funds before annuities begin and invest different amounts at different times, marketing and packaging of insurance products is taking a new route everyday.

With the changes in the approach, the target audience and channel of distribution were also changing from time to time. The strong 200 million middle class now becomes the pick of a majority of the companies. Tapping this segment is also creating niche target segments like- pensions, women, children- each enjoying customized products, designed with careful attention given to the need and other economical factors. Insurance marketers and agents are restricted from using traditional sales promotional tools like free gifts, coupons, contests etc. However, they may use riders, which are add-on features of an insurance policy to customize the product for the customer. The inclusion of riders may provide a larger cover and other instant benefits in times of risk.

Trends in Indian Insurance Market

The Indian Insurance industry has seen it all, from being an open competitive market to being nationalized and back to being a liberalized market. Indian insurance industry has moved into competitive and exciting times with private players gearing up to woo the customers. The entry of private players in 2001 changed the dynamics of the industry and set new parameters for success. Today the number of private players is 16 in life insurance and 11 in general insurance. Indian general insurance market is valued at Rs.14,000 crores. It is growing at a rate of 20% and is expected to reach Rs.45,000 crores in next 10 years.

The Indian insurance sector is on a bull run. The average Indian now spends 5.4 times as much on life insurance as what he did seven years ago when the industry was yet to be opened up for private participation. India's life insurance sector is the biggest in the world with about 36 crore policies which are expected to increase at a compound annual growth rate (CAGR) of 12-15 per cent over the next five years. The insurance industry plans to hike penetration levels to five per cent by 2020, and could top the US$ 1 trillion mark in the next seven years. The total market size of India's insurance sector is projected to touch US$ 350-400 billion by 2020 from US$ 66.4 billion in FY13.The general insurance business in India is currently at Rs 77,000 crore (US$ 12.41 billion) premium per annum industry and is growing at a healthy rate of 17 per cent. The Rs 12,606 crore (US$ 2.03 billion) domestic health insurance business accounts for about a quarter of the total non-life insurance business in the country. Investment corpus in India's pension sector is anticipated to cross US$ 1 trillion by 2025, following the passage of the Pension Fund Regulatory and Development Authority (PFRDA) Act 2013, according to a joint report by CII-EY on Pensions Business in India. Indian insurance companies are expected to spend Rs 117 billion (US$ 1.88 billion) on IT products and services in 2014, an increase of five per cent from 2013, as per Gartner Inc. Also, insurance companies in the country could spend Rs 4.1 billion (US$ 66.11 million) on mobile devices in 2014, a rise of 35 per cent from 2013. Clearly, the scope for growth is enormous.

India is an under-insured market and is still in the early stages of development. This is reflected in the low penetration rates and low premium percapita (premium as percentage of GDP 3.2%, of which life is 2.6% and Non-life is 0.6%). India ranks 19^{th} in the global stage of insurance coverage representing only 0.66% market share The global insurance majors points out that the industry will touch a growth upto $50 billion in the next 10 years, with individual life insurance accounting for almost $40 billion. Despite low penetration on insurance, the trends in India remain positive.

The improved performance in the domestic economy is also reflected in the insurance industry. Higher per capita income, domestic savings and availability of more instruments for parking surplus funds have facilitated growth in the activities of financial services. Savers' risk appetite has also been increasing which can be seen by the growth in unit linked products (ULIPs) provided by the life insurers. The premium underwritten in India and abroad by life insurers in 2013-14 has grown by 47.38 per cent as against 27.78 per cent in 2005-06. First year premium including single premium accounted for 48.45 per cent of the total life premium, whereas renewal premium accounted for the remaining.

Dynamics of Channel Development

Four key drivers will shape the industry in the years ahead - competitive activity, evolution of the distribution channels, growth of the pension sector and the necessity of moving away from guaranteed products. The entry of new players has brought in an increased product range including insurance and pension products and therefore more choices for the customer. There has also been a significant improvement in the level of customer service by the existing player on account of the high level of service from new companies. All of this has benefited the customer. The changed regulatory and competitive environment will lead to significant changes in the retail distribution channels. Unlike other financial products, insurance is a complex product and one which plays a key role in the long term financial well being of a customer. Before the agents can advise their clients on which insurance solution is most appropriate for them, they will have to understand the financial standing of their customer, his financial commitments, his risk profile, etc.

Alternate Channels

The distribution system is composed of the traditional and the alternate channels. The private insurance companies were utilizing ever opportunity to penetrate into various market segments using alternate channels like business partnerships, tied agencies, insurance brokers, bancassurance, apart from using their own expanding branch networks. In recent time companies like Tata-AIG Life, Bajaj-Allianz Life insurance, Reliance Life insurance were expanding their branch networks and recruiting direct sales force to penetrate into semi-urban and rural areas to reach the bottom up pyramid.

Direct Sales Force

The fact that greater reliance is laid on the traditional channels of distribution is due to the nature of the life insurance products, which requires personal interaction. The direct distribution channels adopted are the direct sales force appointed by the company, insurance agents, and the branch network of the insurers. Agents and the sales force play an important role in both the promotion and the distribution of life insurance products to various customer segments in the market.

Cross-selling Life Insurance Products

Cross-selling and bancassurance are alternate channels of distribution. Cross-selling is a mutual agreement between two companies to sell each other's products as a part of their distribution process. Bancassurance involves the selling of insurance products through banks. Bancassurance is suitable for the insurer if it can achieve cost effectiveness, avoid over-dependency on a single bank, increase the level of market penetration, and enhance the service quality of the marketer.

Network of Agents and Brokers

Different companies may however choose different channels and different geographies to focus on. The channel options are - tied agency force, corporate agents and brokers and this is an area where different companies will make different choices. Many companies like HDFC Standard Life are focusing on all channels whereas companies like Max New York Life are focusing on the tied agency force only. Customer interface will be a key challenge for life insurance companies and includes every interaction that the customer has with the company, such as sales, new business underwriting, policy servicing, premium payments, and claim processing and so on. Technology can play a crucial role in delivering the highest standards of service set by the company and it will be imperative for any serious player to excel in all of these areas.

Selling Security Cover through agents

Among the key challenges in reaching potential insurance clients in small towns in India, the foremost is building knowledgeable and competent distribution channels. Given the established role played by the individual agency force in selling insurance products, and its particular relevance in small towns, it is essential to fortify this channel with a set of new inputs. Insurance agents remain the key figure in the insurance industry. The profile of the insurance agent too has undergone a transformation with the private players like Tata-AIG in the market. The private players have strengthened their internal regulatory training programs. Agents spend 100 hours of training in insurance and further 50 hours are spent in securing higher education. This covers the claims, policy protection and to study the background of the insurance industry. Later these agents are trained to interact with the customers. The task on hand is not merely selling policies, instead it is up to the agent to gauge the customers' needs and guide them towards making a right choice. LIC has close to 10.0 lakh agents where as Tata-AIG has over 1,00,000 and planning to grow over 7,00,000 lakh by the end of 2015. In sharp contract to LIC, the private players have invested in multiple and innovative distribution strategies, such as internet and direct mailers to reach out to its customers the easier way. Bancassurance or distribution of insurance products through the branches and multiple communication channels of banks including ATMs, tele-banking and internet banking, is slowly gaining popularity.

Bancassurance – an innovative business model

According to a recent sigma study, bancassurance is on the rise, particularly in emerging markets. Worldwide, insurers have been successfully leveraging bancassurance to gain a foothold in markets with low insurance penetration and a limited variety of distribution channels. Bancassurance, the provision of insurance services by banks, is an established and growing channel for insurance distribution, though its penetration varies across different markets. Europe has the highest bancassurance penetration rate. In contrast, penetration is lower in North America, partly reflecting regulatory restrictions. In Asia, however, bancassurance is gaining in popularity, particularly in China, where restrictions have been eased. The research shows that social and cultural factors, as well as regulatory considerations and product complexity, play a significant role in determining how successful bancassurance is in a particular market.

Bancassurance – a win-win approach

Insurance is now sold by various intermediaries, not necessarily by insurance companies. In the UK for example, retailer Marks & Spencer now sells insurance products. Brand loyalty could now shift from the insurer to the seller. Such trends are visible in the Indian market too; bancassurance has taken off in India. With banks entering the insurance business, a loose network alliance between insurers and banks is visible. In the UK a KPMG survey found that 96% of banks and building societies surveyed dealt with insurers as providers of products, as early as 1995. We have also been watching such trends emerging in India where 27 public sector banks account for almost 92 percent of the entire network. This network has 33,000 rural and 14,000 semi-urban branches where insurance penetration remains untapped. The linkup saves the insurance company distribution costs and helps increase the customer product offering for the bank. The credibility of the bank makes it easier to win customers. The market share of various channels of distribution used by the insurance companies reflects the effectiveness of the channel strategies to penetrate in the market. The table below shows the market share of various intermediaries in life insurance.

Delivery Channels - Rural Market Dynamics

The rural obligations of all insurance companies will also drive the evolution of a rural delivery channel. The third key driver will be the pension plans. There will be a lot of innovation on this front for both type of pension products i.e. products for individuals and products for groups. In the absence of a national safety net, it is important that individuals are encouraged to provide for their retirement income. Given the low percentage of people covered today and the social changes like breakdown of the joint family system and increasing life spans of people, this is very important. While all the uncovered working force will not come under coverage immediately, the percentage of people covered will certainly go up. The pension market is expected to grow at a faster rate than the life insurance market over the next few years at a rate of 25-30% compared to the life insurance market's growth rates of 18-20%.

Rural Distributions strategies

Majority of the India is rural. This market cannot be ignored. In small markets, the credibility of the Indian partner goes a long way. However the level of awareness among rural consumers is much lower than the urban India, the distribution strategy has to be different. Distinct strategies have to be formulated for cash collection and medical facilities. In the absence of this, companies tend to offer simple and easy to buy and sell policies in most centers. This market demands tailor made and dedicated products. Insurance for them is a matter of secure savings for the future. The mind sets of the consumers are changing but the purchase patterns are not changing as far as insurance services are concerned. The months of February and March still are the busiest at LIC. But these trends are changing in the recent times. The traditional belief of hooking oneself to tax savings will take a long time to change. The private players need to step up their selling in terms of need and protection. There is also a sea change in the network of expanding branch offices of various public and private insurance companies especially in semi-urban and rural areas.

Cost-benefit Analysis of Distribution Channels

One of the important factors for channel development is the cost of establishing a channel partners, corporate agents and tied agencies. Due to severe competition among the public and private players there was a sign of increasing costs and thinning of margins year after year.

Conclusion

The reforms in the insurance sector leading finally to the opening of the insurance sector for private participation have brought in its wake major changes not only in the design of the products available in the market but also the manner in which they are marketed. We have today a host of products coupled with a large number of intermediaries who market them. The post-liberalized insurance industry panorama in India is witnessing dramatic changes in terms of a slew of latest products and services, new channels of distribution, greater use of I.T. as a service facilitator etc. There is also the phenomenon of noticeable shifts in consumer preferences impacting the product mix being offered by insurers. Greater attention is also being bestowed on the areas like Agricultural Insurance and risk coverage of export - import trade. Insurance underwent rapid and massive changes in all aspects of their business: product and services, sectoral structure, market segmentation, competitive environment. It is believed that the information sharing has not taken its expected shape in the insurance industry for the purposes of practices, research and education. The future looks interesting for the life insurance industry with several changes in regulatory framework which will lead to further change in the way the industry conducts its business and engages with its customers. Demographic factors such as growing middle class, young insurable population and growing awareness of the need for protection and retirement planning will support the growth of Indian life insurance.

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