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Research Paper

Demystifying Life Insurance Industry Profitability

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ABSTRACT: *With more than 35,000+ crore deployed as capital and over 11003 branches becoming operational Life Insurance companies are still grappling to wipe out accumulated losses. Going slow on expansion Insurance companies are attempting to take an evaluated risk. Commencing operations without grasping the determinants of profitability is bound to be fragmentary and incomplete. Because of long term nature of Insurance business there is no predetermined criterion to measure the effectiveness of operating companies. Hence for accounting purpose insurance companies rely on bookkeeping practices to land at profit for the financial year. This may offer us fractional info and will not provide us the factual viewpoint. Concept of embedded value where we examine the future cash flows at present moment is also not extensively received as it lacks accepted criterion. During initial years Insurance companies were investing heavily to build distribution but the ROI took unusually long time. Companies are adopting standard practices thanks to regulatory interventions at frequent intervals which only reiterate a point that cost effective products need to be offered to customers to gain their confidence and market share.*

I. INTRODUCTION

Life insurance is a business with higher duration products and services whose profitability cannot be defined without a futuristic approach. Insurers measure and monitor performance on an ongoing basis since life insurance policies continue to be in force for many years and the final profitability of the business is known only after years later when all policy obligations have been met. Interpreting profitability of insurance companies in India is not only confounded but perplexed since insurance companies enter into long term contracts and continue to hold elongated liabilities.

To understand effectiveness and operational efficiency, different stakeholders rely on innumerable ways and means thus making the entire communication difficult to comprehend. To comprehend the profitability in life insurance is not only significant but also a perplexing endeavor for many of its stakeholders.
To achieve this, the insurance industry is expected to be financially solvent and strong through being profit making in operation. Hence, not only gauging the financial performance of insurance companies but also complete understanding about factors influencing financial performance in the industry is the problem to be analyzed.

The profit of the insurance companies is generated by impressive underwriting profits and investment income. The industry has registered higher profit from an underwriting perspective. Change always creates openings for those with the most insight as to the drivers.

While the constituents that impact the profitability are myriad the most prominent ones are growth in Total Premium, moderating operating expense and surge in Asset Under Management.

II. OBJECTIVES AND METHODOLOGY

The main objective of this paper is to understand the factors that influence the profitability of Life Insurance Companies in India.

The methodology of this study is based on public disclosures, IRDA Journals and Insurance Company websites and we had taken data pertaining to Life Insurance Industry between 2005-2006 and 2015-16.

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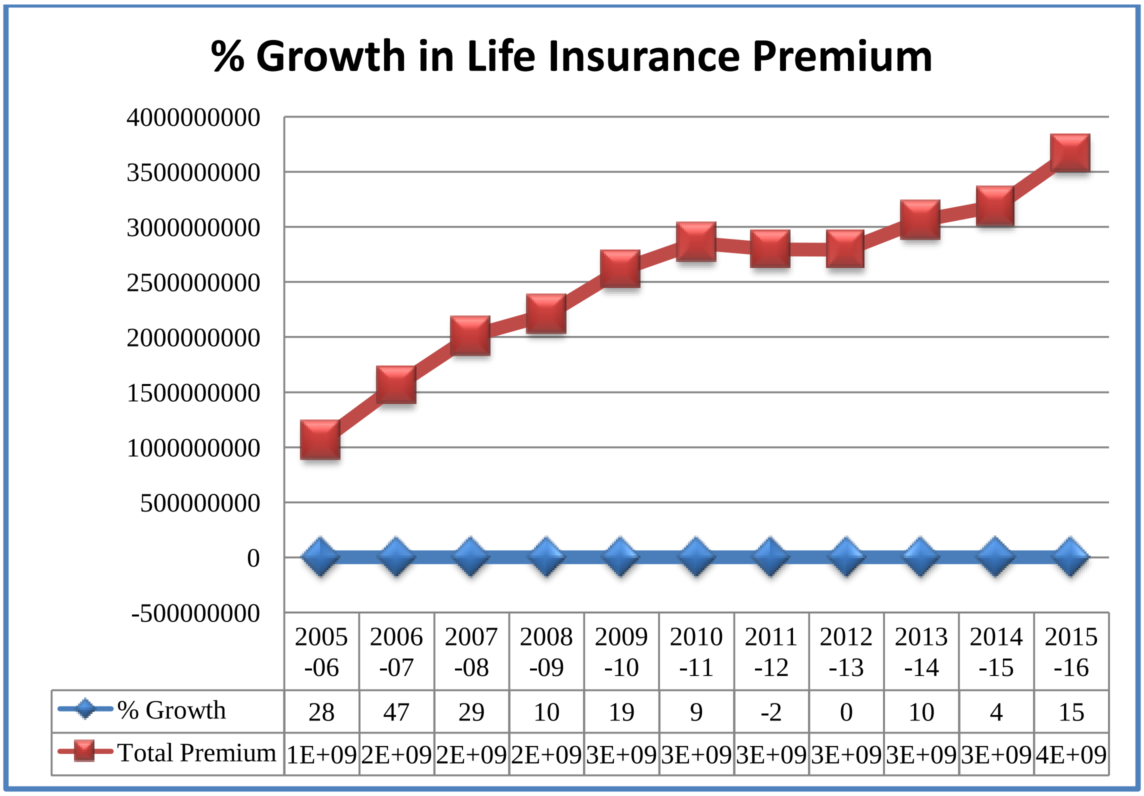
Demystifying life insurance industry profitability

I) Total Premium

Total Premium collection is the critical parameter in the profitability of Insurance companies. Total Premium will include both the new business and renewals. Hence top line may not culminate to bottom line. Since Total Premium is the major inflow for insurance companies it remains the most critical factor influencing profitability of insurance companies.

Insurers determinedly invest in distribution and branding of their products to entice probable customers. This is the prime source which permits the insurer to annul their operating expenses. Growth in premium of the company is essentially dependent on distribution network and the brand equity of the insurer. Insurance companies compete to grab the market share and get a major pie in new business premium. New business premium is certainly a business strain for the insurance companies. However they would continue to write with the expectation of larger renewal base at a later stage. Companies with 10+ yrs of vintage have a renewal base size of 55-60% and we will find that they are profitable in spite of not writing any new business. Growth in premium will surely lessen the operating expense which in turn leads to higher profitability. Insurance companies were focusing more on topline i.e. Growth in premium initially but shifted the gear to bottom i.e. profitability. Hence more than writing quantity of business they started focusing on quality of business which is a major shift in the industry.



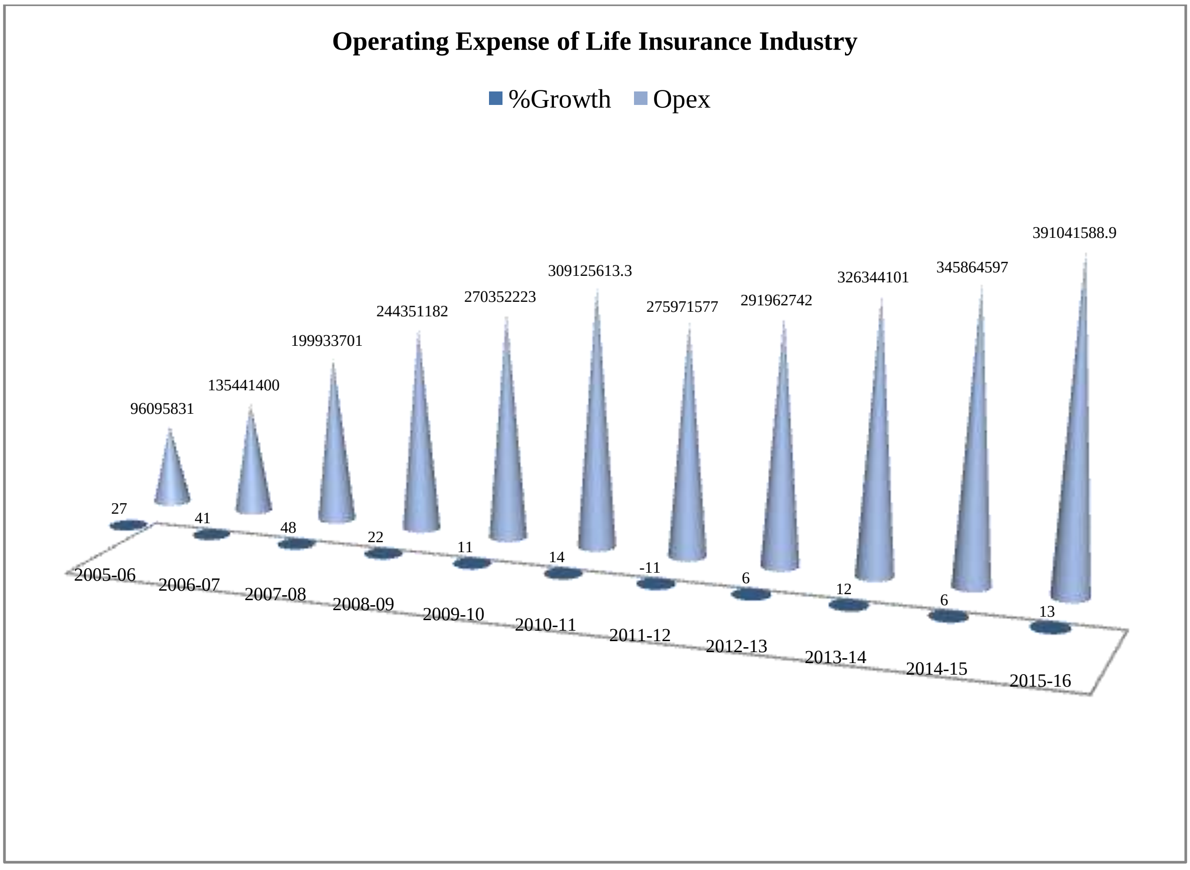
Source: IRDA Report Tableno.1

For the year 2014-15 Industry achieved 3.25 lakh crores premium of which the contribution from regular premium of which 14% contribution comes from regular premium. Collected premium for the year 2014-15 remained flat. Private Industry contribution is 26% of total premium. New business premium is 35%of total premium. Out of new business premium the regular premium is 41% and single premium is 59%. ICICI, HDFC and SBI topped the collected premium for 2014-15. In terms of renewal premium it is LIC, ICICI, and HDFC & SBI topping the list.

Insurance Industry registered double digit growth till 2009-2010 and took a dip/remained flat in the overall premium collection till 2012-13. This can be attributed to various regulatory guidelines on products and expense ratio and also the global meltdown.
IRDAI and SEBI turf led to stringent guidelines which in turn reduced the commission outgo thus leading to advisor attrition. All those companies having higher exposure towards ULIP plans registered de-growth post the guidelines in September 2010. Life Insurance Industry registered a growth of 15% with a collected premium of 3.66 lakh crores for 2015-16.

II) Operating Expenses

Operating expense is the other decisive factor determining the efficacy of Insurance Company. Writing new business also amounts to unjustifiedsurge in operating expenses but the same gets eased out through renewal collections during later years. Companies will incur hefty expenses in the form of underwriting, policy printing, Commission and other allied expenses. Since Life insurance is a protracted contract the same gets annulled with the flow of renewals during the policy period. Hence having a substantial renewal base will conclusively aim them recompense the cost aspect. Insurance companies are directed by 17(D) which outlines the expense ratio. Employee cost remains the significant contributor followed by commission outgo and other associated costs in the overall costing. Companies are making conscious effort to bring down the cost by focusing on efficiency parameters and optimum utilization of resources. Also organizations are apprehensive about infusing higher capital and sincerely pondering upon the ROI on the deployed capital. Also in order to lessen cost organizations are getting into variable model distribution channels than fixed one... Employee model is a fixed cost and hence companies have incorporated numerous measures to build up the productivity of agents by continual engagement and also new distribution models which primarily focus on variable costing. We have witnessed string of regulations in product design to bring in more openness to the all-inclusive cost structure. With September 2010 regulations we have standardization on charge structure as regulator introduced the concept of Gross yield and net yield. However the same is not pertinent to Non Linked funds which will adhere to the concept of overall expense ratio.



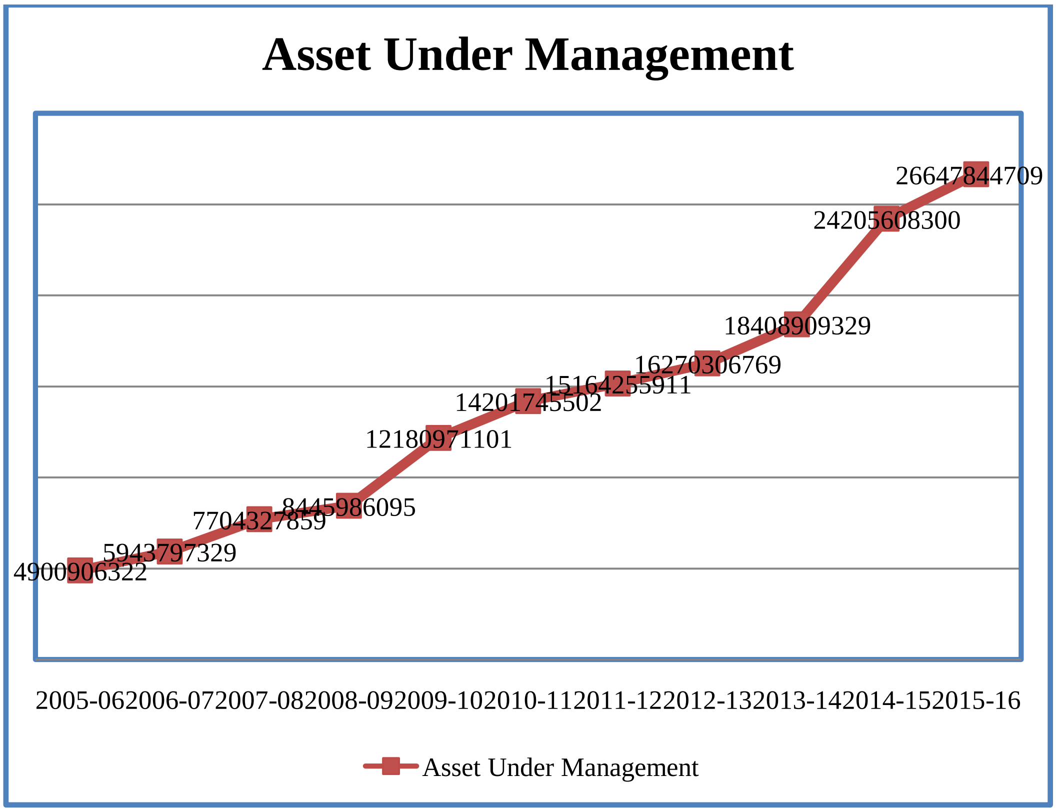
Source: IRDA Report Tableno.2

Life Insurance Industry till 2008 was focusing on growth in premium. Hence we witness companies expanding their distribution and investing heavily in setting up new branches. This resulted in higher operating expense. Between 2008-10 we had seen a dip in new business premium which in turn led to decline in operating expense. Also with change in ULIP regulation restricting the charge structure and communication from the regulator about expense ratio prompted insurance companies to focus more on bottom line than top line. We could witness insurance companies consolidating Post 2010 and they started driving efficiency. Companies are investing heavily in Digital platform and also analytics which is increasing employee productivity. Hence we see a dip in overall operating expense ratio.

III) Asset Under Management

Incremental Asset under Management reveals the growing confidence of customer on the organization. Augmented AUM is a welcome measure for insurance companies as it will earn fees through Fund Management Charges... Regulator kept a cap on AUM charges fund-wise to ensure transparency and uniformity. Also management of fund lies with the insurance company as the same cannot be sourced. This is to ensure safety and security of funds deployed and also to have focused attention on the asset base from the organization. Investment income generated from premium deployment is the other major source of inflow for insurance companies. Insurance companies distribute investment surplus with the policy holders if the product is a participating plan and retain the surplus if it is non-participating one. Hence the major inflow for shareholders would be investment surplus post bonus distribution and the fund management charges with the companies are allowed to charge.

Investment Income remains the major source of revenue for Insurance Companies in addition to premium income. Also Insurance Companies are allowed to charge fee for managing assets. Because of volumes insurance companies are in a better position to generate superior returns which in turn will help them distribute higher bonus and higher dividend. Also the fee which is charged for managing assets would be straight through profit for shareholders. Companies strive to have higher AUM for the said reasons and hence the need to consider AUM as the imperative one for profit analysis.



Source: Irda Report Tableno.3

AUM for the Industry had grown by more than 8% during last year. It crossed 26 lakh crores for the Industry of which LIC has an AUM of 21 lakh crores. AUM has been steadily growing since inception and this can be attributed to higher savings ratio in the financial space and also growing confidence on Life Insurance Policies.

III. CONCLUSION

Initially Indian Life Insurance Companies were completely focused on business expansion and driving revenue targets which is top line. However with the regulatory interventions and expectations from shareholders, insurance companies started emphasizing on bottom line. Also with the latest regulation on expense management from IRDAI focus completely shifted to profitability. Vintage companies with huge renewal base are surviving because of collectibles. Challenge lies for new companies which do not have renewal base but also need to write new business premium. Also we are not seeing much investment in distribution from insurance companies in India. With the advent of FDI industry expected huge pump in of capital and some amount getting into distribution. But we have not seen much progress in this case. Companies with banc assurance tie up continue to generate good revenue with low cost. But the fact remains that we do not have many insurance companies which have banc assurance tie up. IRDAI proposed open architecture wherein banks will have tie up with multiple insurance companies. And as of now it is only given as an option for insurance companies to decide whether to have tied structure or follow open architecture. This model is very well opposed by all insurance companies promoted by banks. Hence there is no much progress made on this open architecture. LIC is the only exception which has one of the lowest Opex to Total Premium ratio in spite of it completely depending on agency model.

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