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Insurance in China
Bucking Global Trends



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EXECUTIVE SUMMARY

The global financial crisis has created a window of opportunity for China's insurance companies to grow and strengthen. By so doing, they will increase barriers to entry for newer participants.

STRONG FUNDAMENTALS

Like financial institutions worldwide, Chinese insurance companies have suffered because of the global financial crisis. With China's own stock markets plunging in 2008, all of its leading insurers have booked major write-downs. China Life, for example, wrote down US\$1.3 billion (RMB8.7 billion) in the third quarter of 2008, while People's Insurance Company of China (PICC) and China Pacific Insurance Company (CPIC) probably suffered similar losses.

Few Chinese insurance companies have made major overseas purchases, so most were only indirectly affected by the troubles that have affected Europe and America. The one firm to have suffered badly is Ping An, which last year wrote off RMB15.7 billion on its purchase of a 5 percent stake in Europe's Fortis.

Despite their losses, all the major insurance companies report that their operations and overall financial structures remain healthy. Indeed, due to past reforms and continuous improvements, China's leading insurance companies now have much more solid balance sheets than most institutions in other insurance markets around the globe.

The industry is conservatively optimistic for 2009. Insurance companies will undoubtedly be more careful in their investments, and while the high earnings of recent years may not return in the foreseeable future, most major players will remain profitable.

WINDOW OF OPPORTUNITY

The insurance industry's global downturn presents various opportunities for Chinese insurance companies. With some major international insurance companies withdrawing or become less aggressive in China, domestic companies have a window of opportunity to improve their operating skills and professionalism and take a larger share of the global market.

Those Chinese companies with overseas aspirations are advised to prepare themselves to move rapidly if unique overseas franchises become available. They should note, however, that although valuations of overseas banks and insurers have dropped dramatically, a low price is not in itself sufficient reason to buy: A rapid recovery in valuations is unlikely, and such companies may become even cheaper.

INCREASED REGULATION, BETTER RISK MANAGEMENT

As a result of the financial crisis, China's insurance companies and regulators, in particular the China Insurance Regulatory Commission (CIRC), are realigning their operating models and regulations to manage risks more carefully.

The regulation of investment channels for insurance companies, liberalized in 2006 to encourage purchases of domestic and foreign stocks, property, and other financial instruments, may be tightened. The domino effect of the global financial crisis is also making companies more wary of investing overseas, and causing them to spend more efforts to ensure that any investments made are shielded from related risk exposure.

The subprime crisis in the U.S. may lead China's credit rating institutions, still at an early stage of development, to apply more stringent and professional standards. The industry is likely to become more conservative in its evaluations of both customer risk and institutions' payback ratios.

STRONGER, MORE PROFESSIONAL

The growth rate of the Chinese insurance industry may slow compared with previous years, but it will still far exceed that of most developed markets prior to the crisis, and China will remain an attractive market for the foreseeable future.

As they lower their growth expectations, companies will pay more attention to improving operational fundamentals and risk/return profiles, for both underwriting and investment. Companies will focus on increasing professional standards, improving shareholder value, and better managing their assets and liabilities.

Given that China's GDP growth rate is predicted to fall from double digits to high single digits, many insurers will need to optimize their business models and make their internal operations more efficient. The leading companies are looking for ways to reduce after-service costs, particularly for claims processing in general insurance.

One consequence of the financial crisis could be a more rapid shakeout of weaker Chinese companies, which would leave stronger players even more ready to compete internationally.

AGENTS WILL REMAIN THE MAJOR DISTRIBUTION CHANNEL

All China first-tier insurers operate large agent forces. These continue to improve their effectiveness and efficiency, and will continue to be the major source of income and profits for many years, even as other sales channels emerge. Insurers continue to struggle with a high agent churn rate, which is pushing down profitability.

The market is reaching a saturation point in China's leading three metropolitan centers—Beijing, Guangzhou, and Shanghai. Elsewhere, there remains significant room for further growth. Leading second-tier cities such as Hangzhou and Tianjin are likely to be major targets for the leading players, and a significant presence is also being built in third-tier locations—the more than 270 cities with a population of more than 1 million people.

CORPORATE SALES

Customer segmentation and targeting will be the key to selling to the corporate sector. Success will require working with distribution partners such as agents, brokers, and other channels, aligning interests and sharing resources. It will also be important to stay abreast of industry developments, such as the emergence of high-end brokers and agents who are identifying and filling the gaps between customer needs of different segments.

Newcomers to the market have the potential to claim market share from the large incumbents that have been slow to upgrade their product offerings or relationship management techniques to meet latent customer needs.

For foreign insurers one obvious attractive segment is large foreign companies—Booz & Company has identified more than 100 multinational companies with China revenues of more than US\$1.5 billion in 2008. Another group of potential buyers of high-end corporate life or annuity products are the more than 1 million professionals working in China.

For all such customers, it is increasingly important to provide tailored solutions rather than standard products. For corporate customers, it will be vital to understand the needs of everyone involved in a purchase—from their human resources and finance departments to the staff who will be insured. Insurers must also demonstrate their delivery capability by, for example, opening up access to hospitals when providing hybrid life/health insurance products.

INVESTMENT MANAGEMENT IS AN AREA OF WEAKNESS

Chinese insurers need to acquire the core capabilities to become skilled managers across the range of asset classes currently permitted by investment regulations. This will likely require a mix of external acquisition of talent and capabilities, and accelerated internal development. Some insurers may eventually choose to outsource at least some part of asset management to a third party.

Investment competence takes time to build, but as competition in underwriting becomes ever more intense and risk pricing more finely graded, it is also a key differentiator. Developing an appropriate asset allocation model and formulating an investment philosophy are essential foundations for long-term success. However, these are typically underdeveloped capabilities within insurance businesses. Recruitment, integration, and retention of talent, especially for the core team, will be a key task for all companies.

ACT LOCALLY

China's size, complexity, and regional differences mean that any simple extrapolation from a province-level market to a national one will likely falter in execution. In most cases, regional—sometimes even city-level—expertise will drive profitability, and building strong regional leadership will be critical to success. At the national level, brand and PR strategy will remain important, providing the umbrella coverage necessary for distinctive regional and local positioning.

EVER TOUGHER TO ENTER

The cost of entering China's insurance market is already high. A successful nationwide rollout establishing a presence in 270-plus cities requires more than US\$1 billion in capital investment.

In terms of strategy, new entrants will have to set out a clear path to building a distinctive position, whether by customer segment, channel, or product. They need to identify key regions where they can start building a credible organization and distribution presence.

Newcomers also face organizational challenges to attract, develop, and retain staff in all functions, to build distribution, and—for foreign companies—to work with a local partner where required to by regulations.

Delaying entry—concentrating instead on putting one's domestic house in order—may be riskier still. China's insurance incumbents are strengthening their management capabilities, building scale, and supplementing their already strong regional positions with nationwide branding, relationship management, and investment skills. As they do so, the price to enter what will be the world's largest insurance market will only rise further.

About the Authors

Andrew Caine is a partner and the head of financial services for Booz & Company in Greater China, and the director of Booz China Strategy Foresight Institute. He has over 20 years of management consulting experience in Asia and Europe, and has been working in Asia since 1997. He advises local and multinational financial institutions on all aspects of strategy, organization, and capability building in China, Korea, and the rest of Asia.

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