Consolidation in insurance industry

July 7, 2016: Recent news on proposed HDFC Life – Max merger has triggered the waves of consolidation across the industry. Other players in the industry have become extremely cautious of the giant emerging out of this merger. As the water treads deeper, we take a look at how this consolidation wave could set forth another landmark in the Indian insurance industry.

First consolidation measure could be dated back to 1956, when LIC was created by Parliament, by merging over 245 insurance companies and provident societies. Next wave of reforms was seen in 1999, with opening up of the market to foreign insurance players, allowing their ownership up to 26% in Indian entities. With the passing of Insurance laws amendments act, 2015, the increase in FDI limit in insurance sector has moved up to 49% which clearly stated the want of a vibrant insurance sector in India. Insurance bill has opened up separate lines of businesses, encouraged capital infusion in the country.

The increase in FDI limit has encouraged greater participation of management in the operations of the holding companies. This has led to foreign management in the companies to bring in their expertise on board and creating competition for the state-run companies like LIC.

The popularity of LIC could be associated to brand value it holds in market in the form of trust benefactor and its servicing abilities. Private players in the life insurance sector, despite having innovative products, tailor-made distribution models, and huge marketing expertise are not able to come anywhere near LIC's existence.

Dominance of LIC in the Indian market presents one of the main reasons of consolidation of the insurance entities. LIC lords over the market with a share of 70.44% in premium income and 76.84% in number of policies in financial year 2015-16. Of the 23 private companies in the life insurance business, only 9 have a market share of over 1% in premium and 7 have a share of over 1% in policies.

Thus, the consolidation is being looked at to increase the market share, reduce the operating costs and also increase the distribution network of the combined entity. This would also mean combining all their strengths such as management expertise, key resource areas, and organizational strengths.

On the flip side, consolidation could also mean hurting the brand equity of the company. Potential customers will have to be engaged through a different brand name, which would involve additional operating expenses for branding, and selling and distribution.

The public vs private scenario is quite opposite in general insurance industry. Reducing business-volumes in four-public sector entities have eventually led to cumulative losses. Government is looking up to their merger, in order to reduce operational costs and administrative expenses. Main reason for losses for these companies could be attributed to competition from private sector entities. Innovative product-line and convenient modes of distribution offered by private sector entities have given tough time to the public sector insurers.

Indian insurance industry being barely in its budding phase, is significantly capital-starved. The want of capital has disturbed the business model of insurers. Profit-lines of the companies have fallen due to expenses over-shooting income gravely. Consolidation could thus, pave way for insurance companies to raise capital, by opening up avenues like IPOs as alternate sources of funding. Large consolidated players will be automatically eligible for listing after their formation.

The capital infusion, however, calls for serious attention to India-specific strategies of the multi-national partners of the insurers. As more funds get poured in, realization of long-term perspective will get more important.

However, valuation of the standalone insurers is posing as a major hurdle in the way of creation of consolidated entities. Valuing these companies is especially difficult, because no other such attempts have been carried out in the past. In case of HDFC-Max life merger, valuation of liabilities and enterprise value, and its acceptance by the foreign partners of both the companies is acting as major concern.

Increase of foreign interests in the Indian insurers, could lead to Indian insurance industry to work in tandem with the global insurance markets. To be prepared for the unexpected and to be in a position to timely respond to the challenges, insurance and reinsurance companies would now have to follow global trend.

Despite the expectation in increase in insurable population in the country, the insurance companies have not seen significant increase in business in past 5 years. Thus, consolidation of the insurance firms is seen as a way out, to create sizeable entities both in terms of profitability and also operation. The consolidation scenarios are quite opposite in life and general insurance, with public sector and private sector firms dominating both the markets, respectively. Hence, the consolidation in both the sectors would impact the companies differently.