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Chapter title: Foreign Direct Investment in Health Insurance Sector: A panacea to iatrogenic poverty?

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Abstract: India lacks an acceptable, accessible, equitable and affordable health care system thus requiring health financing mechanisms to bring mass population in insurance ambit. Since Foreign Direct Investment (FDI) is one of the options to provide health care through health insurance, this article explores its opportunities and challenges for mitigating iatrogenic poverty. FDI in insurance would accelerate not only the growth in capital starved industry but also help to channelize resources to the under penetrated areas and larger marginalized section of the Indian population through innovative products, healthy competition, technology infusion and new distribution channels. FDI is essential to revitalize insurance industry through appropriate product design, pricing, multi-channel strategy and operational effectiveness. Despite various benefits, the country has to take several risks while allowing higher FDI. Especially, repatriation of profits of foreign investors would adversely affect the economy and lack of conditionality of social and rural sector coverage may give rise to the neglect of large market at the bottom of the pyramid. The policy makers should balance risk and return from FDI and create a promising environment for the insurance sector to grow while balancing profitability and interests of general population.

Key words: Insurance, foreign direct investment, health, poverty, penetration

Introduction

India has 16% of the world's population, 18% of the world's mortality, 20% of the world's morbidity and healthcare expenditure is a miniscule one per cent of global expenditure (WHO, 2004). It is just 3.6% of GDP while public sector spending is 1.36 % of GDP (WHO,2009). In addition, almost 75% of total health spending in India is constituted by private expenditure of which 91.4% is out-of-pocket expenditure whereas public expenditure is 25 % of total health expenditure (WHO, 2009). Thus, high level of out of pocket expenses coupled with excessive reliance on unregulated private health services has resulted in iatrogenic poverty; high cost health care induced poverty is known as iatrogenic poverty (Messeen et al, 2003). This can be curtailed by effective health care financing which would enable mobilization of adequate financial resources to ensure timely access to health care. Some of the health financing mechanisms includes government spending, social health insurance, private health insurance and micro health insurance. Disproportionate out of pocket expenses, shrinking government budget on health, exorbitant private health insurance premium and lower penetration of micro health insurance are the challenges faced by health financing sector. To overcome these setbacks, India has to device a mechanism to expand risk pools which would increase access and utilization of needed services, and ensure better allocation and use of inputs. One of the mechanisms to expand risk pools is increasing the capital inflows to health insurance sector through foreign equity.

Indian government initiated policy reforms in insurance sector since 1991 culminating in partial foreign direct investment (FDI) up to 26% and the recent opening up of insurance sector up to 49% foreign participation. This creates a massive inflow of capital that increases production capacity of the economy and builds capabilities both at human and institutional level. FDI in insurance would augment long term funds for the development of infrastructure because of the constant premium inflows and staggered payouts. Foreign companies are eagerly waiting to explore and snatch a substantial chunk of under penetrated insurance market by tying up with local partners. Since health insurance is growing fast with enormous potential for tackling iatrogenic poverty, this paper aims to explore the role of FDI in insurance with a special emphasis on health insurance sector to understand its broader implications in combating iatrogenic poverty and achieving the ambitious goal of “Health for all” by 2020.

Journey of Insurance industry

Insurance sector has come full circle in a journey extending to nearly 200 years from pre-nationalization with large number of companies and high level of competition to nationalization in 1956 that created monopoly position for Life Insurance Company (LIC) and four general insurance companies and later liberalization policy in 1990’s. Malhotra committee recommendations led to the opening up of industry to foreign players by floating Indian companies especially joint ventures with ownership of up to 26%. In 1999, Insurance Regulatory and Development Authority (IRDA) was constituted to regulate and develop insurance industry. It restructured subsidiaries of General Insurance Company as independent companies and GIC as reinsurer. This was followed by the removal of stringent regulations governing FDI in various sectors and the insurance sector was partially opened for foreign players. In 2001, IRDA permitted third party administrators to manage health policies and in 2006, first standalone health insurance company came into being. In 2007, de-tariffication was introduced which provided flexibility to insurance companies in fixing the premium.

Since the liberalization of insurance industry in India, there has been rapid growth and intense competition in both life and non-life sectors resulting in substantial growth in customer base owing to product innovations, multichannel distribution and regulatory changes in terms of price detariffication, cap in charges and motor third party risk pooling arrangements. At present, there are 23 private life insurance companies and 21 general insurance companies including 4 stand-alone health insurance companies in India with foreign capital that varying from 18.6% to 26%. General insurance industry has grown from INR 11,446 crore in 2001-2 to INR 57964 in 2011-12 (CAGR of 17.6%). At the same time, insurance density has increased from US$ 2.4 to US$ 10 during the same period and the growth in the industry was in line with nominal GDP growth rate (0.55 to 0.75%). However, the profitability suffered due to price detariffication, entry of new companies, intense competition, higher bargaining power of intermediaries, higher claim cost, and motor third party claims.

Private life and non-life insurance companies have introduced innovative products and market them aggressively through newer distribution channels whereas public insurance companies struggle to defend their market. Almost 90% insured enrolled with the four public sector insurance companies in 2003-04 but the market share of these companies gradually declined to 65 per cent in 2006-07, 62.7 per cent in 2007-08 and 57.7 per cent in 2008-09.The market share of private insurers has increased from 62 per cent in 2006-07 to 64 per cent in 2007-08, and it has been continuously increasing and was 73.5 per cent in 2010-11 (IRDA, 2011). This implies a decline in the market share of the public sector insurers.

FDI Opportunities in Insurance Sector

Insurance industry is expected to grow from US$66.4 billion in 2013 to US$350-400 in 2020 (Insurance report, 2014) and India's insurable population would be 750 million by 2020. At present, non-life insurance penetration is 0.8% of GDP and life insurance is 4% of GDP. After liberalization, insurance density increased from US$ 11.5 in 2001 to US$ 63.3 in 2003. Life insurance increased from US$ 9.1 in 2001 to US$ 55.7 in 2010 later fell to US$ 54.31 in 2003. Non-life insurance density increased from US$ 2.4 in 2001 to US$ 9 in 2013 (IRDA,2013). There is a positive correlation between per capita GDP and total insurance penetration. When GDP of India increased from US$ 564.21 in 2000 to US$ 947.75 in 2010, insurance penetration increased from 2.32% to 5.1% in 2010. After 2010, insurance penetration stagnated even though GDP increased substantially. International monetary fund predicts projects economic growth of more than 7% in the coming years and hence insurance penetration is expected to increase accordingly. Thus, our country offers huge market to international companies in insurance industry due to favourable demography, lower penetration, increase in life expectancy, rising middle class and insurance awareness.

Considering this immense underserved market, foreign players have shown keen interest to offer competitive products by partnering with domestic companies. FDI would not only increase insurance penetration and inclusive growth but also develop insurance markets through their high level of expertise and technical knowhow in the insurance and reinsurance business. Foreign players can bring their capital and infuse into capital deficient private domestic players to utilize this opportunity by designing innovative products and compete with dominant public sector companies. To allow FDI, either the promoter has to divest his stake from 74% to 51% or increase the foreign investment by retaining promoter's stake at current level such that new ratio of equity stake is 51:49. In the former case, the objective of FDI, which is to expand insurance coverage would not happen since the capital base would remain the same. Increased capital flow as seen in the second case would enable companies to protect consumer interests against solvency and offer variety for products at different price points, at the same time domestic players would have access to state of the art technology, better underwriting skills, and wider distribution networks. There would be fierce competition resulting in price reduction, better services and healthy claims ratio. Moreover, certain insurance companies can seriously consider IPO with the help of foreign partners to raise additional funds. A consolidation may not be too far especially when there are many small players in the market.

It is estimated that around US$ 3-4 billion would flow into the sector and 70-75% of this would go to life insurance sector. INR14719 crore would be the inflow due to FDI limit hike which would be only INR7523 crore if the first case happens (Parida,T K, 2014). Non-life sector would get additional fund of INR 1374 in the first case and INR 2689 in the second scenario. Total infusion of fund to insurance industry would be INR 32709. Some of the companies such as L&T General insurance, ING Life, Sahara India Life and Shriram Life, who own 100% stake can divest to foreign players Intermediaries (brokers, web aggregators) would get better commissions and be motivated to reach untapped market.

Several studies attempted to understand the relationship between FDI and life insurance penetration and they found that countries with higher FDI in finance sector tend to have higher life insurance penetration. However, when other financial development variables (bond market capitalization, public bond market capitalization, deposit money, bank credit to private sector, M2/GDP) were included in the model, the effect of FDI on insurance penetration was less. Hence, FDI alone may not achieve deeper penetration of the market. Managerial decisions to enter the market are influenced by knowledge of foreign markets (Schroath and Korth 1989), prohibitive non-tariff barriers (Zimmerman 1999), insurance premium, national income of host country, bilateral trade, labour and capital costs (Moshirian 1999), large foreign markets (Elango 2003), market structure and trade barriers (Ma and Pope 2003). Outreville (2008) focused on determinants of large insurance companies entry to developing world's market and he found that size of market, human capital, good governance, cultural distance, regulatory barriers and market competitiveness influences the host country choice. Thus, attracting foreign investments require huge insurance demand, entry barriers, less market concentration and higher return on investment. India has substantial unmet insurance demand, lower entry barriers that can reduce market concentration and provide high return on investment.

The benefits of FDI in insurance studied by Ahuja (2004) did suggest that foreign partners would bring in professional approach, underwrite more risks and promote intense competition. Hennerberger and Ziegler (2006) examined the employment effects of FDI and showed that positive effects were evident only for the services that required physical proximity involving high mobility costs. In general, benefit of attracting foreign investors would be the expertise in underwriting, claims handling, loss adjusting and proven marketing strategies giving rise to deeper penetration of market, higher per capita insurance premium and economic development through capital market investments.

India provides abundant opportunities for insurance companies that target mass population and design products that meets social security objective especially due to strong economic fundamentals, higher than expected growth in per capita income, better risk awareness, tax incentives introduced by the recent budget for health insurance, and increasing non-communicable diseases coupled with expensive private health services. Opening up of the sector to 49% FDI would change the way businesses view competition, both price and channel payout-based, which may lower the profits in the short run for new entrants. However, if these players focus on niche markets and adopt international best practices, profitability would improve in the medium term. Public sector players would face severe competition from large private players having large talent pool, huge investment in information technology services, efficient operating models, multi-channel aggressive distribution and service and innovative marketing capabilities. Mid-sized private companies would be forced to adopt inorganic approach to growth through joint ventures, acquisitions and mergers to leverage synergies and tackle competitive pressure.

Role of FDI in Health Insurance

Health insurance provides coverage against unexpected events that would lead to financial loss and works on the principle of risk pooling. It compensates for economic loss of insured resulting from illness such as medical charges and income loss. Since mid-80s when health insurance got the recognition as a separate industry, it became an important mechanism to pool risks faced by the people. In addition, socio-economic changes such as increased awareness, higher literacy rates and brand development by insurance companies contributed to the growth of the industry. TPAs (Third Party Administrators) have revolutionized the administration of policies, settlement of claims, servicing of policyholders, technical support and customer services. In 1987, private health insurance (PHI) in India took birth with Mediclaim policy.

Micro health insurance (MHI) is a type of micro insurance that finances health care expenses through the principle of risk pooling. MHI is different from the private health insurance, i) individuals cannot choose a coverage level at a given price (usually low premium), ii) premium is based on community rating and iii) group contract distributed through nodal agency such as non-government organisation (NGO) or micro finance institution (MFI) (Preker et al. 2002). These schemes target low-income households living in the same district or the members of micro-finance groups. These tailor-made products cannot offer generous benefit package due to the resource constraints owing to low income of the target population. MHI schemes intend to provide financial protection to poor families and safeguard them from falling into indebtedness or impoverishment. MHI brings down the burden of health care expenditure on poor, improves the health status, increases utilization of services and reduces the financial barriers to access health care while balancing the local requirements and affordability (Preker et al. 2002). The limitation of small pool due to modest size of membership, inadequate benefit packages, lack of external subsidies, non-financial barriers to access health care, limited management capacity and lack of awareness inhibit the successful working of such schemes (Ranson 2003). With FDI, private companies can design suitable products and select efficient distribution channels to tap MHI segment.

Health insurance is the fastest growing segment of the non-life industry in the country today, but it still remains vastly underdeveloped. It is almost one fifth of the total non-life insurance market and is the second biggest component of the total non-life premium in the country (Mayur,2009). In the Indian non-life market share by value, health insurance premium was 22% in 2013 (IRDA, 2013). Health insurance industry was worth INR5125 crores in 2008 that grew with a CAGR of 30.05% in the last 5 years that has increased market penetration. It is worth INR60497 crores in

2015. Private sector insurers infused INR1114 crore and standalone companies provided INR 430 crore (IRDA 2013). In 2001-02, 7.5 million policies were sold that increased to 10.3 million in 2003-04. The total number of insurance holders was reported to be 5.17 million in 2006-07, 8.64 million in 2007-08 and 10.66 million in 2008-09. In the years 2002–2011, health insurance premiums increased five-fold from INR6.75 billion to INR114.79 billion. In 2006-07, the industry registered a premium of INR 32.08 billion, in 2007-08 INR 51.25 billion and in 2008-09 INR 66.25 billion. The premium collection in 2009-10 was INR 83.05 billion and in 2010-11 INR 114.79 billion and INR 157.1 billion in 2012-13 (growth of 16.57%) (IRDA, 2013). The claims paid decreased to 78% in 2011-12 from 99% in 2010-11. In 2011-12, premium per policy has declined by 6% due to 33% reduction in number of claims and 26% decrease in claim paid per policy.

The share of public sector companies in premium collection was 61% in 2011-12 who still dominate the market, while private players contributed 28% and the rest by standalone companies. ICICI Lombard had one third of market share, followed by Star Health (23%), HDFC Ergo (9%), and Royal Sundaram (6%). Standalone companies had higher market share than general insurance companies with health portfolio. The claims ratio was 20-15% higher for public sector companies, due to the effect of subsidizing the health insurance premium to corporates in lieu of premium received on fire and marine business. Public sector companies had a claims ratio of 79% whereas private companies had only 103.2% overall average of 96.43% (IRDA 2013).

Despite impressive growth, the penetration of private voluntary health insurance is extremely poor despite the existence of a huge market and is a highly cost-inefficient mechanism owing to significant administrative costs, lack of regulation and control on provider behaviour, unaffordable premiums and high claim ratios, exclusion of many diseases from the coverage, and co-variate risks (NCMH,2005). At the same time, there is latent demand for health insurance in India due to very high level of out of pocket expenses caused by medical inflation, increasing life style diseases and lower penetration of health insurance. Hence, we cannot deny huge the potential of the Indian Insurance industry and its role in achieving the ambitious goal of India, “Health for all” by 2020. The risk coverage of these companies is very low (less than 5 % of population); hence there lies a huge unexplored insurance market in India. Capitalization of this opportunity needs additional funds which can be augmented through FDI. This would also increase the stake of foreign partner allowing them to enjoy a bigger share of the pie and promotes active participation in the management of the company. With FDI, domestic players can offer affordable policies and lower administrative costs, streamline provider contracts and ensure speedy claim management because of the foreign partner's expertise, capital, technology, better customer service mechanism and experience in the matured developed countries' markets. FDI would facilitate partnerships with health service providers and insurance companies and build a seamless value chain to meet health care needs of poor people by providing affordable insurance policies. Prospective customers can expect innovative products such as wellness management and managed health care.

Although uncertainties and challenges galore the insurance industry, strong fundamentals would drive growth in the coming years. The bargaining power of hospitals has declined because of active involvement of health insurance companies, third party administrators and concentration of volumes with some players. Insurance companies have taken several initiatives like standardization of treatment protocols, negotiation of benefit package especially cost of treatment, tighter scrutiny of claim processing and system to detect and control fraudulent behaviours. Union Budget has increased the 80C investment and health insurance premium cap which would help insurers to get new business. Various initiatives were taken to develop health insurance industry such as Guidelines for standardization in health insurance, 2013; portability of health policies; guidelines on repudiation of health claims; and IRDA (Health Insurance) Regulations 2013. To be successful, companies should conserve capital and deploy the resources efficiently by innovative operational models that would give sustainable competitive edge.

In MHI market, currently there is a limited competition since the evidence base on the positive impact is yet to be studied. Besides, the insurance companies are sceptical of covering risks, at the same time MFIs hesitate to diversify into non-core activities like insurance. Barriers to entry into MHI market are high which reduces the threat of new competitors. At the same time, its commitment to the welfare of the underprivileged people makes the exit from the market difficult. There is limited competitive pressure in the product market as the schemes aimed at the poor in the informal sector are rare. A few government programmes that target the poor are Yeshasvini, UHS and RSBY. In Yeshasvini programme, only surgical hospitalization is covered and it acts as standalone insurance programme, not embedded in any development programme. Most of MHIs have little competition in the insurance market. Hence, there are plenty of growth opportunities in MHI sector that needs to be explored and captured. This would not only increase revenue for companies but also mitigate iatrogenic poverty of the larger population.

Challenges of FDI in Insurance Sector

There have been significant changes in insurance industry in the recent years that has attracted foreign capital. Asian continent accounts for 35% growth, India being the major source of growth. Discontinuous technological changes are creating complex operational models blurring the divide between online and offline business. The consumers are increasingly using digital world to make purchase decisions thwarting marketing efforts of companies to retain them. Newer consumers expect a solution oriented approach and not a claim linked transactional approach. Indian health insurance industry caters to several of category of target market of which rural market is the most underdeveloped. Insurance companies have to target customers who have low level of awareness, insurance-averse cultural and religious beliefs, misconceptions, perception of insufficient benefits, and low level of trust in insurers. Insurance premium is seen as a means of tax evasion and savings. A large section of rural population does not have bank accounts. They have various misconceptions about insurance and substitute joint family for life insurance. The affordability of premium is low because of little income, for most of them insurance are a luxury. Even the policies are inflexible and standardized that fail to meet local needs and requirements. The lack of information about getting the claim and associated uncertainty mars mass coverage of health insurance.

From the distribution point of view, covering hinterland population spread across 6 lakh villages is challenging and requires sufficient incentives and training of agents which would increase operations cost. Existing tariff structure is heavily regulated limiting the penetration of market. Reinsurance market is monopolized by GIC restricting the risk coverage of domestic companies. Insurance companies shy away from mass coverage due to high transaction costs and low ticket size, lack of proper documents to honour the claim, financial exclusion, inadequate actuarial data for risk assessment, weak rural healthcare infrastructure, and lower renewal rates. Thus, penetrating this market requires a huge capital of INR60000 crores (IRDA) that is possible only through foreign partners.

Despite impressive growth of private companies, public sectors continue to dominate the market. Critics of FDI assure the adequate availability of funds in the domestic capital markets. Moreover, it is claimed that companies without foreign capital made profits while most of the companies with foreign capital incurred losses in the last 5 years. Another fallacy is that foreign partners bring expertise, technology and professionalism to Indian market. Their poor predictability of economic events has been proved during the recent global financial crisis that witnessed collapse of established players such as AIG, Lehman Brothers and Goldman Sachs. Many of the European insurance companies are short of capital because of risky investments and speculative activities. Even the reputation of some of foreign partners is questionable. The domestic insurance industry would be exposed to dubious and risky behaviour of foreign players.

Insurance industry is expected to channelize savings to productive nation building activities. Private foreign partnered companies are more interested in mopping profits than nation building. FDI may not always improve product offering as projected by the proponents of foreign capital. Most of the products of foreign insurers are investment oriented with high risk that would benefit stock market and fail as a social security measure because of myopic view of managers who sold more ULIPs than endowment policies and the funds were channelized to stock market rather than infrastructure and social sectors. After liberalization, Birla Sun Life sold 95% and ICICI Prudential sold 80% of ULIPs in 2003-04. Life Insurance Company has invested heavily in infrastructure, housing and social sector activities to the tune of INR 40000 crore in 2003. There is apprehension among small domestic players that they may lose their market share to foreign subsidiary that have access to low cost capital. The resistance to FDI comes from the argument that foreign capital would de-stabilize Indian financial markets and make foreign partners largest shareholders especially when multiple Indian partners with minor share exist.

Insurance companies in developed countries look for newer markets due to saturated domestic markets and are attracted by high growth underpenetrated markets like India. At the same time they face various challenges such as complex market dynamics, lack of extensive distribution channels, intense competition, lack of trained staff especially in actuarial science, lack of database on risk occurrence, pressure on profits due to falling premiums, greater emphasis on short term profits from capital markets, inadequate capital, and higher reliance on traditional distribution channels, lack of trained professionals and non-availability of insurers' data (most of them are not listed on stock exchanges).

Future Strategies: The Way Forward

The opening of insurance market is beneficial for both Indian and foreign companies. It will not only promote growth and deeper penetration but also capitalize huge opportunity while creating employment opportunities. The industry would transform to a mature market with best practice, better products and wider customer choice and satisfaction. At the same time it poses certain challenges that can be judiciously dealt by following certain measures.

Building customer engagement to capture growth opportunities, modernization and upgrading technical capabilities, adopting global best practices and operating models to improve efficiency, strengthening human capital and building infrastructure for fraud detection, claims management and consumer protection and distribution reforms are needed to face these challenges. There is a need for regulatory changes that promotes infrastructure and social sector development and prevents capital flight and ensures transparent and predictable policies. In addition, it is advisable to adopt micro market strategies to tap high potential and profitable markets. This requires in-depth research and analysis of data, such as policy issuance data, demography, infrastructure, occupation, buying behaviour of consumers etc. Based on the data, hotspots can be identified and targeted to sell the insurance product. Predictive analytics can be employed to understand latent and untapped requirements and needs of potential consumers. Risk management practices especially related to operational risks are to be strengthened. To outsmart competition and reach growth targets, companies have to tweak the distribution network with balanced mix of channel partners and rationalize claim processes.

MHI market can be tapped through strategic partnership with micro finance institutions or local community networks. While doing so, awareness and knowledge of insurance products should be created and misconceptions regarding health insurance should be removed. The vast market at the bottom of the pyramid is loyal to the company; hence retaining customers would not require extra efforts. Yet, attracting the potential consumers and selling a policy is a daunting task that can be tackled effectively through coordinated efforts of the company and other local organizations that work at the grass root level. The possibilities of joint ventures should be explored so that resources can be shared and channelized to face the challenges through new products, proper prices, speedy claim management, common IT framework to transfer data seamlessly, bargain with providers for better benefit package and control cost as well as moral hazard, and accreditation.

Conclusion

Indian health insurance market has immense potential for growth owing to low penetration, favourable demographics, recent budget initiatives and increasing awareness and income among the uninsured population. However, private insurance companies could not exploit these opportunities for the lack of huge capital and best practices that would reduce transaction cost and improve efficiency. Recent FDI increase opens up the huge untapped market for these players who can grow exponentially and support Government's objective of "insurance inclusion".

Nevertheless, the effect of FDI in insurance on infrastructure development is limited, much lesser is the coverage of poor. Even with the foreign capital, these companies may not develop products that meet the requirements of Indian masses. On the contrary, it's prudent to realize that it may expose Indian economy to global economic problems and make it vulnerable when foreign players with unsound balance sheets enter the industry. There is a danger of flight of capital from India and the consequent adverse effect on the policy holders. To confront these challenges, policy makers have to create an enabling environment for the insurance sector to grow while balancing profitability and risk. FDI would be essential to revitalize the capital starved insurance industry and to promote healthy competition through appropriate product design, pricing, multi-channel strategy and operational effectiveness. This will go a long way to make health insurance industry in India to be vibrant and dynamic healthy industry.

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