COST MANAGEMENT PRACTICES IN NON-LIFE INSURANCE COMPANIES : A COMPARATIVE STUDY

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Introduction

The performance of the general insurance industry in the first three decades after nationalization has been impressive in terms of growth. But while premiums have shown strong growth, claims and operating expenses, both in absolute terms and relative to premiums, have grown faster. Claims as a proportion of premiums, have increased from 51 percent in 1972-73 to 69 percent in 1990-91 to 73 percent in 1992-93, largely due to the motor insurance business. But since the opening up of Indian insurance market, over the last five years with the effective cost control measures, the claims cost has been reduced to 54.11 percent in 2004-05 (% of claims expenses to gross direct premium). Operating expenses in 1972-73 (when the sector was nationalized), which were 30 percent of gross premium, reduced substantially due to merger efficiencies to 24 percent in 1990-91 and further to 22 percent in 2004-05. The steep increase in motor claims over the years has resulted in an underwriting profit of 8 percent in 1972-73 being converted into a loss of 4 percent and 20 percent in 1990-91 and 2004-05, respectively. Investment income has shown strong growth over the years largely driven by increasing yield due to higher interest rates. Overall, despite underwriting losses, net profits have grown from 6.3 percent in 1972-1973 to 12 percent and 13 percent in 1990-91 and 2004-05, respectively due to increasing investment income.

Internationally, many insurers lose money on products and make up with investment income. Investment income has to compensate for underwriting results which are increasingly under pressure worldwide. The non-life insurance business in India, like in most global markets, including the USA, has been incurring underwriting losses and has mostly survived on investment income. Classes like motor and liability have suffered from adverse claim experience.With increasing motor third-party losses and need for adequate provisioning, the underwriting scenario is bound to be bad for some time to come. Over the last years, since the sector was privatized, the insurance industry has witnessed a remarkable and impressive development in the sector. Increasing high claim ratio and management expenses which has been the principal causes of depleting underwriting margins of the insurance industry in recent years, still poses to be a cause of serious concern. The present study spells out the cost management practices especially claims and operating expenses of three sample companies viz. National Insurance Company Ltd., New India Assurance Company Ltd. and Tata-AIG General Insurance Company Ltd.

Objectives and Methodology

Under this backdrop, the study aims to understand cost management practices in selected companies (National Insurance Company Ltd., New India Assurance Company Ltd., and Tata-AIG General Insurance Company Ltd.). The present study will focus on the following specific objectives:

- To understand the business growth in pre and post IRDA period;
- To identify the pattern and direction of claims and operating expenses of selected companies;
- To understand the cost containment techniques being adopted by the companies;
- To examine the effectiveness of different cost controlling measures; and
- To suggest appropriate cost controlling techniques for improving underwriting performance.

The companies have been selected representing Indian general insurance industry (PSU and private). Out of 14 non-life insurance companies (including 8 private in surers), selected companies' show steady growth of business and profitability. Only the two components of expenses namely claim and operating expenses have been studied. The study covers pre and post IRDA period from 1990-91 to 2004-05 and is based on secondary data; of course primary sources are also used to gather useful information. For analyzing and presenting data descriptive statistics has been used.

Business Growth Analysis

It is clear from Table No. I that National Insurance do not project stability strategy but growth strategy by increasing their sales (GDPI). The company maintains a remarkable average growth rate since 1991 in comparison to industry average growth rate; whereas New India performance shows a below line of industry average growth rate during several years. During 2000-01, which is treated as first year of liberalization of Indian Insurance Industry, and some of the companies in the private sector like Royal Sundaram, Tata-AIG and IFFCO Tokyo had commenced business. The said year showed a negligent growth rate of 6.25% over the previous year which is mainly due to impact of rationalization of fire tariff and general economic recession. It has been observed from Table: I that although National Insurance and New India maintain the same growth of business in Pre-IRDA period but during Post-IRDA period National Insurance shows quite impressive growth.

Table I: Premium Growth

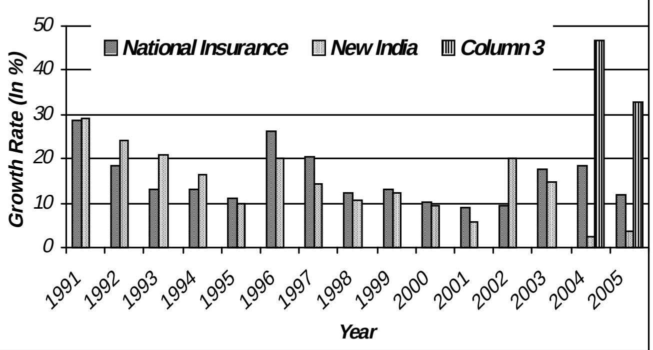
Year	National Insurance		New India		*Tata-AIG	
	Gross Premium (Rs. In Crores)	Growth (In %)	Gross Premium (Rs. In Crores)	Growth (In %)	Gross Premium (Rs. In Crores)	Growth (In %)
1990-91	568.30	28.88	925.87	29.06		
1991-92	672.46	18.33	1148.23	24.02		
1992-93	759.80	12.99	1386.79	20.78		
1993-94	859.77	13.16	1616.52	16.57		
1994-95	957.49	11.27	1776.93	09.92		
1995-96	1207.22	26.08	2132.03	19.98		
1996-97	1456.45	20.64	2433.64	14.15		
1997-98	1636.54	12.36	2688.57	10.48		
1998-99	1853.53	13.26	3017.64	12.24		
1999-00	**2042.11**	**10.17**	**3306.53**	**09.57**		
2000-01	2227.73	9.08	3493.05	05.64		
2001-02	2439.41	9.50	4198.06	20.18	81.68	
2002-03	2869.87	17.65	4812.79	14.64	240.87	194.89
2003-04	3399.97	18.47	4921.47	2.26	353.33	46.69
2004-05	3810.65	12.08	5103.16	3.69	468.83	32.69
Growth Rate:						
Pre-IRDA		**16.51**		**16.51**		**----**
Post-IRDA		**13.28**		**9.07**		**66.75**
Period Under Study		**15.50**		**13.97**		**66.75**

Source: Annual Reports of the Respective Companies

* Started operations on 22nd January, 2001

Being as the flag companies for the east and west areas, National and New India have their head offices in Kolkata and Mumbai. In every place the Regional Offices of the flag company for that area, take the lead for coordination activities. Oriental and United Insurance are designated as the flag companies for the north and southern part of India. National Insurance hold maximum market share of 34% in eastern part of the country as compared to the combined average market share of 22% for the other three public sector non-life insurers. It is interesting to note that National Insurance is also holding maximum market share in northern part of the country whereas Oriental Insurance has been designated as Flag Company of that area.

Figure: I Business Growth



Overall average market share of National Insurance since the year ending 31st March, 1991 upto 1999-2000 shows 20.38% whereas during the same period New India was treated as market leader occupying highest average market share of 31.34%. As per the audited figures furnished by the insurers for the year ending 31st March 2003, the public sector insurers accounted for 90.35% of the gross direct business underwritten within the country, with the private sector accounting for 9.65%. Among the public sector insurers, New India leads with a market share of 31.22%. The market share of National Insurance was 22.80% and the company has also improved its market position from 4th to 3rd, a significant milestone in the history of the company in the context of enhanced competition in the general insurance industry with private players already in the market and considering the fact that ever since nationalization of the industry, "National" had been occupying the 4th position in the market. Of the private insurers Tata-AIG captured 1.68% of the total market share as against for .69% in the previous year.

A review of the premium underwritten within India by the public sector insurers indicates that while the PSU insurers have increased the gross premium underwritten by them during the financial year 2000-01 to 2003-04, their market share has shown a steady decline. The market share of the public sector in terms of premium underwritten stood at 85.52 percent in the financial year 2003-04 as against 90.35 percent in the previous year. Among the public sector insurers, New India held a market share of 25.94 percent, followed by National Insurance at 21.75%. In the case of private non-life segment, it increased market share from .07 percent in 2000-01 to 14.48 percent in 2003-04 and Tata-AIG itself occupied 2.20 percent of the market share in total. The market share of National insurance within the public sector market has increased to 25 percent during 2003-04 from 22.8 percent in the previous year. This has enabled the company to become the 2nd largest insurer in the country. It is interesting to note that while National Insurance increased its market share to 25.43 per cent in 2004 from 20.32 percent in 1991, New India retained the same market share 30.23 percent during the same period. During 2004-05, the four public sector non-life insurers underwrote premium of Rs. 13972.96 crore i.e., a growth of 4.77 percent. "The eight private sector insurers underwrote premium of Rs. 3507.62 crore reporting a growth of 55.35 percent. Over the last five years, the market share of the private insurers has increased to 20.17 percent. Among the public sector insurers New India held a market share of 24.09 percent, followed by National Insurance Company Ltd. at 21.74 percent. The private insurers have broadly succeeded in stabilizing their operations and their market share ranged between 5 and .92 percent."

Incurred Claims and Operating Expenses:

Combined ratio indicates percentage of claims paid and operating expenses to gross premium. It has been observed that claims expenses and operating expenses ratio of National Insurance all time higher than New India and Tata-AIG (Figure II and III). Table II projects the combined ratio of three companies since 1991 and it is clear that National Insurance has the highest incurred claims and expenses, except for the Financial year 2003-04; whereas the combined ratio of New India is higher than the National Insurance and Tata-AIG.

Figure : II Status of Expenses of Managment

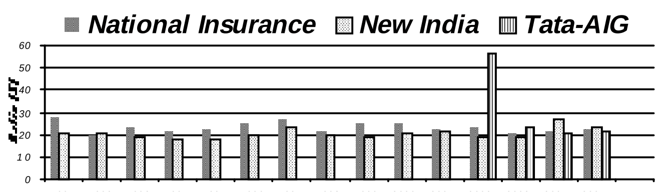


Table : II Combined Ratio

Year	National Insurance		New India		*Tata-AIG	
	Claims + Expenses	Ratio	Claims + Expenses	Ratio*	Claims + Expenses	Ratio
1	2	3	4	5	6	7
1990-91	444.08	78.14	723.21	78.11		
1991-92	507.66	75.49	890.58	77.56		
1992-93	600.42	79.02	1018.2	73.42		
1993-94	608.12	77.71	1120.12	69.29		
1994-95	919.93	96.05	1519.23	85.53		
1995-96	931.93	77.20	1547.01	72.56		
1996-97	1247.25	85.64	1822.93	77.91		
1997-98	1336.81	81.69	1914.25	71.20		
1998-99	1610.49	86.89	2138.05	70.85		
1999-00	1806.15	88.45	2580.92	78.06		
2000-01	1951.89	87.62	3017.70	71.88		
2001-02	2287.12	93.76	3329.67	79.31	55.99	68.55
2002-03	2221.85	77.42	3594.28	74.68	116.51	48.37
2003-04	2842.91	83.62	4054.14	85.87	157.33	44.33
2004-05	3122.90	81.95	4093.96	80.22	227.72	48.57
Mean Ratio:						
Pre-IRDA	**82.63**		**68.44**			-------
Post-IRDA	**84.87**		**78.39**			**52.45**
Average	**83.38**		**76.43**			**52.45**
*Combined Ratio = Claims Paid + Expenses × 100/ Gross Premium						

Source: Annual Reports of the Respective Companies

* Started operations on 22nd January, 2001

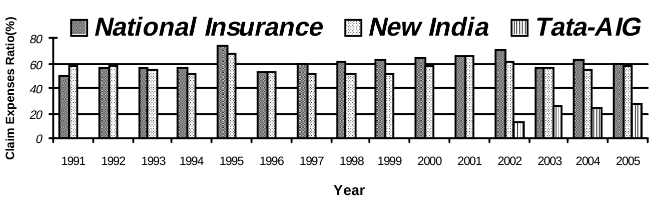
Regarding expenses of Non-life insurers, Section 40C of the Insurance Act, 1938 lays down the limits for management expenses in general insurance business. The expenses of management are required to be within the prescribed limits under Rule 17E of the Insurance Rules, 1939. While the Insurance Regulatory and Development Authority has been stressing the need for insurers to conform to the prescribed limits, during 2003-04, these limits were breached. In respect of public sector insurers, management expenses exhibited a sharp increase on account of Special Voluntary Retirement Scheme (SVRS) introduced to bring down the staff strength and to streamline the management structures. It is envisaged that by trimming the size, expenses towards employee remuneration and benefits will come down. "These expenses presently constitute 80 percent of the total operating expenses and 20 percent of the gross premium underwritten, as against 73 and 15 percent, respectively in the previous year." The revamping of the organizations may facilitate the process of lowering operational expenses. The New India recorded highest combined ratio because of the hefty increase in the management expenses contributed by the SRVS payment of Rs.716 crores. If the effect of the extraordinary item is removed, the combined ratio shows a decline of 18.04 percent, whereas it was 4.42 percent in the case of National Insurance.

For some of the new insurers 2003-04 was the fourth year of operations. Given that the insurers are in the process of establishing their operations, the expenses of management as a percent of premium underwritten are high. "The major expense of these insurers comprise employee remuneration (22.72 percent); legal and professional charges (12.78 percent); technical charges (11.15 percent); business promotion charges (8.79 percent); rent rate & taxes (8.66 percent); and depreciation (5.92 percent)." But among the eight private non-life insurers operating in India, Tata-AIG reported lowest combined ratio of 46.77 percent (Table II). In the year 2001-02, National Insurance recorded highest combined ratio of 93.76 percent since 1991, this was mainly due to heavy net incurred claims at 95% and added with the outgo on management expenses. As noted earlier the Insurance Act, 1938 provides for a cap on the aggregate expenses of management on business operations in India. As per the provisions of Section 40C of the Insurance Act, the permissible limit of expenses, after due adjustment, was Rs. 462.95 crores, in relation to the volume of business written in India by the company in the year 2001-02. As against the allowable limit as aforesaid, the actual expenses incurred on business operations in India, after due adjustment, amounted to Rs.557.02 crores. Tata-AIG recorded the combined ratio of 71.37 percent, since it was the first year of operation incurred heavy expenses in comparison to other years and gradually the same has been decreasing (Table II).

During pre-IRDA period, National Insurance registered highest combined ratio in the financial year 1994-95, this was mainly due to high incurred claims as management expenses grew by Rs. 28.76 crores which represents 22.54 percent of gross premium. Similarly, 85.53 percent of combined ratio reported by New India, which was not due to expenses of management as it was only 18.25 percent of the gross premium, but incurred claims occupied the significant portion. The moderate combined ratio of National insurance and New India i.e., 85.64 and 77.91 percent shows heavy operating expenses in the financial year 1996-97. Although Net Incurred claim ratio of the company was 73.92 percent, expenses of management for the year have been Rs. 389.01 crores against Rs. 389.01 crores in the previous year. "The substantial increase was mainly because of a portion of Rs. 39.92 crores on account of introduction of pension scheme for employees as determined by actuarial valuation." Similarly, the management expenses ratio of New India (Management Expenses to Gross premium) has increased to 30.98 percent from 25.82 percent of 1995-96 (Figure: II). This was mainly on account of payment to pension fund and provisioning for leave encashment.

Thus it is clear that all of years since 1991, both the companies have been complying provisions of Section 40C of the Insurance Act, 1938 regarding the permissible limit of expenses, only exception being the years 1996-97, 1998-99, 1999-2000, and 2003-04. The rising trend of management expenses is mainly due to introduction of pension scheme, salary revision, arrears of salary and SVRS. The high combination ratio does not always mean rising expenses of management but may be due to heavy incurred claims ratio. By and large the combined ratio of National Insurance is higher than of New India and needs to adopt cost control measures.

Figure III Status of Claim Expenses



Cost Control Measures

The recent extraordinary spurt in the motor losses due to ever increasing road vehicle accidents has set serious thinking on the part of the technocrats of the insurance industry and the government bodies. . About not less than 7 to 10 vehicular accidents occur in a day on an average in each city and /or district jurisdiction. Road accidents generally occur due to rash and/or negligent driving and/or bad roads. Motor T.P claims, the principal cause of depleting underwriting margins of the insurance industry in recent years, still poses to be a cause of serious concern. The major outgo continues to be on Motor T.P claims. As it is, the existing regulatory stipulations do not allow the insurers to suitably load the Motor T.P premium. Therefore, it has to curve the way out and the solution, lies in speedy and amicable settlement of T.P. claims through various forums, on a negotiated settlement basis with due safeguards. The objective is to save on interest cost and legal overheads apart from the anticipated reduction in the quantum of claim amount itself. Considering the huge financial implications, National Insurance has committed managerial resources of high order in tackling this challenge. Comparatively, New India adopted strategic cost control measures in several years and as a result its average combined ratio has declined to 76.43% (Table: II); whereas it is 83.38% in the case of National Insurance. The following loss control measures were initiated/ implemented by New India with a view to reduce/ minimize the incurred claims in Motor Own damage (OD) and Third party (TP) Damage/Loss:

1. Micro management of offices with high claims ratio through verification of settled folders, systems, and analysis of incurred claims undertaken with encouraging results.
2. August month of every year has been declaring a "Claims Clearance Month" when Third Party Damage Claims were also encouraged to be settled through Lok Adalat and Conciliation Committee in order to minimize compensation and interest outgo.
3. Detailed guidelines were issued to operating offices for improving underwriting standards and better claims management both in Own Damage and Third Party Damage.
4. Regional Offices have a manager dealing exclusively with Motor Third Party Damage Claims.
5. Operating Offices are encouraged to settle Third Party Damage Claims through alternate forums such as Lok Adalat and Conciliation Committees.
6. A workshop on legal Claims has been conducted, which was attended by officers handling Legal department at Regional Offices, where various measures for effective management of Third Party Damage Claims were discussed.

Similarly, National Insurance have organized various forums such as MACT, Lok Adalat, Jald Rahat Yojana (JRY) effectively for expeditious settlement of Motor Claims. Various measures have also been adopted for effective monitoring of MACT claims at the level of Regional/Divisional Offices and for reduction of pending claims. On the other hand Private insurers Tata AIG General Insurance Company has enhanced its claim settlement image by setting industry standards in claim settlement ratios of 99 percent. This has been made possible by innovations such as:

- E-claims notification for corporate clients;
- Auto restore garages (ARG) for cashless claim settlement with a written warranty;
- PDA (Personal Digital Assistant) enabled claims assessment and reporting for speedy settlement of claims.

Suggestions and Concluding Remarks

At the stage of entry into the market, the insurance companies may not be ready with totally new products and services. Naturally, initial competition will be more in the form of prices charged, as all companies, public and private, fight for gaining or retaining a share in the market already developed. The companies must, therefore, adopt appropriate cost control measures. Cost leadership implies tight control systems, minimization of overhead costs, and pursuit of economies of scale. The two important areas where cost can be reduced or controlled would be administration and claims. Controlling administration and establishment costs is the most difficult and yet an essential task that any organization must undertake. These costs can be kept within limits by exercising care in the initial recruitment and subsequent deployment of staff as also the emoluments made to them. In the case of public sector, which is known to be overstaffed, cost can be brought down by down-sizing, accompanied by better utilization of the workforce-both extremely difficult in the public sector mould-but there are no options for doing so.

Cost reduction cannot be attempted solely by the traditional 'across the board' cost-cutting methods. Efforts have to be made on several fronts simultaneously. Thus, on the operational side, it would pay if non-value added activities are curtailed to avoid waste of effort and excess cost in the business. Re-engineering to simplify workflows and automating manual tasks are the other two cost reduction strategies that need to be pursued. Claims cost can be controlled through two methods: claims minimization and fraud control. In the first category, the aim would be to minimize the number of claims lodged with the insurer, of course, not by declining to accept them, but by persuading the customer to take adequate precautionary measures. Claims minimization can also occur if the importance of risk management is impressed on the customer. In the long run, with the adoption of proper preventive measures, the number of claims and their amounts can be reasonably controlled, which is really in the interest of the insurer because it reduces its liability in claims should such an occasion arise.

It is really difficult to eliminate fraud; but modern technology can help in detecting and minimizing the risk of fraud to some extent. This will become possible by building up a database for monitoring and checking possible frauds. Most claims follow a certain pattern and technology can be used for identifying those that deviate from the pattern and decide they are fraudulently made. From a statistical angle, high volumes in this business assume importance, since they help spread risks wider, allowing a lowering of rates and rising of profits. With a wider base, the probabilities become more predictable, and with system-wide risks balanced out, there is a possibility of improving profits. Thus, increasing the volume of business is an important measure of bringing down per unit costs. There are also certain constraints which limit the ability of public sector insurance companies to cut down certain costs. On the one hand, they are expected to run on commercial lines and simultaneously they are expected to implement several socially oriented schemes, which bring down any surplus generated.

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