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# Why foreign life insurers did not achieve their ambitions in China: Structural and operational obstacles


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# Executive summaries

**Why foreign life insurers did not achieve their ambitions in China: Structural and operational obstacles**

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China's economy has experienced rapid growth in the past 30 years. A highlight is in the growth of its insurance industry, whose premiums increased at an annual rate of around 30%. Naturally, people would think that the foreign insurance companies that entered the Chinese market during this period should have achieved impressive performances, especially given that they are competing with the domestic insurance companies that do not have the advantage of experience and technology. However, the reality is that foreign insurers, especially foreign life insurers, often found it difficult to expand their market shares in this emerging market. Many foreign life insurers experienced frequent management turnover and some even withdrew from the Chinese market. This paper aims to analyze this interesting market phenomenon from two different perspectives: (1) structural obstacles, including the regulatory environment and the influence of the recent financial crisis and (2) operational issues faced by foreign life insurers, including operational efficiency, shareholding structure and distribution channels. On the basis of these analyses, the paper offers several suggestions to market participants structured around the need for foreign life insurers operating in China to employ a customized approach. The unique regulatory environment and market characteristics, such as the importance of bancassurance, must be considered when forming business strategies for the Chinese market. These can be achieved by accumulating more local knowledge, employing more experienced Chinese managers, showing the willingness to deviate from the standard business model, and finally being patient because the regulatory environment and market conditions will not change in one day.

# Why foreign life insurers did not achieve their ambitions in China: Structural and operational obstacles

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**Abstract**
China's economy has experienced rapid growth in the last 30 years. A highlight is in the growth of its insurance industry, whose premiums increased at an annual rate of about 30%. Naturally, people would think that the foreign insurance companies who entered the Chinese market during this period should have achieved impressive performances, especially given that they are competing with the domestic insurance companies that do not have the advantage of experience and technology. However, the reality is that foreign insurers, especially foreign life insurers, often found it difficult to expand their market shares in this emerging market. Many foreign life insurers experienced frequent management turnover and some even withdrew from the Chinese market. This paper aims to analyze this interesting market phenomenon from two different perspectives: (1) structural obstacles, including the regulatory environment and the influence of the recent financial crisis and (2) operational issues faced by foreign life insurers, including operational efficiency, shareholding structure and distribution channels. Based on these analyses, we offer several suggestions to the market participants and regulators.

**Introduction**

Many economists forecast that China is on track to turn itself into the world's largest economy in a few decades. Such development needs a solid insurance industry to support the growth and provide stability. To accommodate this need, China's insurance industry has gone through dramatic changes in the last 30 years, essentially developing itself from a single-player market to the current situation where 83 domestic insurers and 47 foreign insurers[1] were operating and competing in this "promising land" in 2012. Many foreign insurers consider the Chinese market a target of their strategic expansions with the ambitions to establish another growth engine. Their ambitions are not unreasonable, given that the Chinese insurance market achieved about 30% annual premium growth in the last 30 years.

Most people, including economists, anticipate that the entry of foreign insurance companies should be beneficial. These foreign insurers generally have more experience, better technology, and well-established management teams. A study by Leverty et al. (2009), using dates between 1999 and 2004, found that productivity improvements among insurers in China was related to the entry of foreign insurers. Other studies, including Shen (2000), Sun (2003), D'Arcy and Xia (2003), Guan (2003), Xu and Li (2003), and Wang et al. (2006), also argued that foreign insurers have made a positive impact on the Chinese insurance market by bringing in advanced technology, experienced management, additional capital, new approaches of distributing insurance products, etc.

Although the overall Chinese insurance market has been improving, many foreign insurers, especially life insurers, did not achieve their initial goals in this country. This is reflected in their inability to increase market share, frequent management turnover and the fact that some foreign insurers even withdrew from the Chinese market. Although it is a rather important and interesting market phenomenon that is unique to China, we are not aware of any research that thoroughly analyzes the economic reasons behind this trend. This paper investigates the structural obstacles, including regulatory constraints and the recent financial crisis, and the operational challenges, including operational efficiency, shareholding structure and distribution channel, faced by foreign life insurers. We trust that these can at least partially explain the foreign life insurers' situation in China and will benefit both researchers and practitioners to further understand China's insurance market.

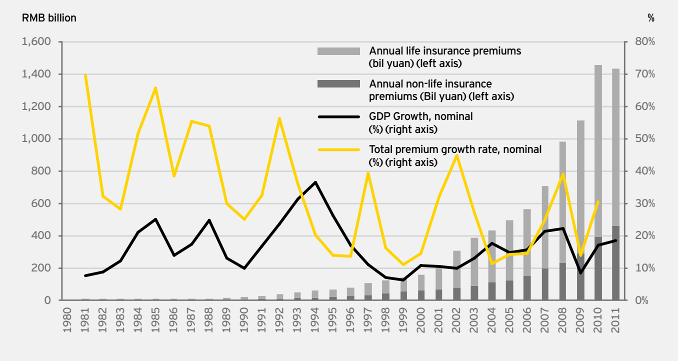


**Figure 1: China's annual insurance premiums and growth rate, 1980–2011**[2]
Source: China Insurance Yearbook (1980–98, 2012)

**Historical development and current challenges**

**Opening up of China's insurance industry**

China's insurance market has achieved impressive growth in the last three decades. Total premiums grew from RMB460m in 1980 to RMB1,434b in 2011, which implies a nominal annual growth rate of 29.63%.[3] In 2011, life insurance accounted for 67.8% of all premiums. Although China has become the sixth-largest insurance market in the world (measured by total premiums), it is still considered to be undeveloped. Its insurance density and penetration only rank 61st and 45th globally.[4]

The rapidly growing market and the great future potential have attracted the attention of many global insurance companies. However, it did take many years for China to open up its insurance market to foreign insurers. In 1980, the American International Group (AIG) created a representative office in Shanghai. However, according to the *Provisional Regulations Governing the Administration of*

1 According to CIRC, there have been 42 domestic and 26 foreign life insurers, as well as 41 domestic and 21 foreign non-life insurers in China through the end of 2012. See http://www.circ.gov.cn/web/site0/tab61/.

2 New accounting standards were implemented from December 2010, in which the measurement of premium income on life and health insurance was no longer the same as before. So, the growth rate of premiums was not comparable since then.

3 The data are from the China Insurance Yearbook (1980-1998, 2012).

4 The data are from "The World Insurance" by SwissRe Sigma, 2012.03.

|  |  | Life | Non-life |
|---|---|---|---|
| Upon accession (2001) | Company ownership | No more than 50% in joint venture | Branch or joint venture consisting of no more than 51% |
|  | Geographic restrictions | Open: Shanghai, Guangzhou, Dalian, Shenzhen and Foshan | Open: Shanghai, Guangzhou, Dalian, Shenzhen and Foshan |
|  | Business restrictions | Open: individual (nongroup) life insurance to both Chinese and foreign citizens | Property coverage, related liability and credit insurance for subsidiaries of foreign companies operating in China |
| Within two years after China's accession (2003) | Company ownership | No more than 50% in joint venture | Wholly-owned subsidiaries are permitted |
|  | Geographic restrictions | 10 more opened: Beijing, Chengdu, Chongqing, Fuzhou, Suzhou, Xiamen, Ningbo, Shenyang, Wuhan and Tianjin | 10 more opened: Beijing, Chengdu, Chongqing, Fuzhou, Suzhou, Xiamen, Ningbo, Shenyang, Wuhan and Tianjin |
|  | Business restrictions |  | Non-life products open to both Chinese and foreign clients* |
| Within three years after China's accession (2004) | Company ownership | No more than 50% in joint venture | Wholly owned subsidiary is permitted |
|  | Geographic restrictions | All regional restrictions removed | All regional restrictions removed |
|  | Business restrictions | Open: health, group and retirement/annuity products to both Chinese and foreign citizens |  |

**Table 1: The removal of regulatory restrictions on foreign life and non-life insurers after the WTO accession**
Source: Governmental Provisions, tabulated by authors
*Compulsory insurance for auto third-party liability was opened to foreign non-life insurers in 2012.

*Insurance Enterprises*, foreign insurers' equity participation in the Chinese insurance industry was still completely banned. In 1992, Shanghai was selected by the Chinese Government to test the entry of foreign insurers. Soon after that, American International Assurance (AIA) received the first insurance license ever issued to any foreign insurer since 1949, but the geographic scope of its business was limited to Shanghai. In 1995, American International Underwriters (AIU) set up the first foreign P&C branch in Shanghai. Before 1998, 113 applications for insurance licenses filed by foreign insurers were declined [Leverty et al. (2009)]. Only 10 joint ventures and branches of foreign insurers obtained licenses to write insurance coverage in China. Even these 10 were strictly limited in what insurance they could write, where it could be written, what rate they could charge, and what kind of shareholding structure they could have. As a result, foreign insurers only represented less than 1% of the Chinese insurance market in 1998.

However, with the growth of China's economy, insurance demand increased as well. After China signed the WTO agreement in 2001, the Chinese Government launched an official schedule to open its insurance market to foreign players. Restrictions on locations, products, reinsurance and ownership were expected to be removed gradually. A three-year plan was created according to the WTO agreement (see Table 1).

The rest of the paper will focus solely on life insurance because: (1) life insurance and non-life insurance have fundamentally different business models and therefore cannot be mixed together, (2) the institutional restrictions on foreign non-life insurers are different and more severe and (3) foreign non-life insurers have not been able to achieve a meaningful market share in China (1.06% in 2010).

### Development of foreign life insurers in China

Before we study the development of foreign life insurers in China, we need to clarify the definition of "foreign." According to Li (2007), foreign investors mainly use two approaches to enter the Chinese insurance market, namely, participation and establishment. In the case of participation, the foreign company invests in the equity of an existing Chinese insurance company as a minority shareholder, less than 25%. When foreign insurers decide to go the establishment route, which means holding an ownership stake of in excess of 25%, they set up independent business operations through a joint venture, a wholly owned operation or a branch.

Using statistics provided by the China Insurance Regulatory Commission (CIRC, China's insurance regulation authority), Table 2 presents information about the number of foreign life insurers,

| Year | Total number of foreign life insurers | Market share of foreign life insurers, measured by total premium income | Number of wholly foreign-owned life insurers | Number of foreign joint venture life insurers | | |
|---|---|---|---|---|---|---|
| | | | | Foreign majority | 50-50 | Chinese majority |
| 1992 | 1 | - | 1 | 0 | 0 | 0 |
| 1996 | 2 | - | 1 | 1 | 0 | 0 |
| 1997 | 2 | - | 1 | 1 | 0 | 0 |
| 1998 | 4 | - | 1 | 2 | 1 | 0 |
| 1999 | 5 | - | 1 | 3 | 1 | 0 |
| 2000 | 7 | 1.57% | 1 | 3 | 2 | 1 |
| 2001 | 7 | 1.58% | 1 | 3 | 2 | 1 |
| 2002 | 12 | 1.74% | 1 | 3 | 7 | 1 |
| 2003 | 16 | 1.92% | 1 | 3 | 11 | 1 |
| 2004 | 19 | 2.64% | 1 | 3 | 14 | 1 |
| 2005 | 22 | 8.90% | 1 | 3 | 17 | 1 |
| 2006 | 23 | 5.91% | 1 | 3 | 18 | 1 |
| 2007 | 23 | 8.00% | 1 | 3 | 18 | 1 |
| 2008 | 24 | 4.92% | 1 | 3 | 19 | 1 |
| 2009 | 26 | 5.23% | 1 | 3 | 20 | 2 |
| 2010 | 26 | 5.47% | 1 | 2 | 17 | 6 |

**Table 2: Development of the total number and market share of foreign life insurers**
Source: China Insurance Yearbook 1999–2011, tabulated by the authors

their market shares and ownership categories from 1992 to 2010. Although the number of foreign life insurers increased rapidly, those who entered the Chinese market post 2001 were required to adopt a 50/50 shareholding structure with a Chinese partner.

When foreign life insurers initially entered the Chinese market, they were confident and ambitious. A survey conducted in 2008 by a major accounting firm indicated that foreign life insurers' executives were expecting a 10% market share by 2011. However, the situation has changed in more recent years. As shown in Table 2, total market share of foreign life insurers stopped climbing in 2008 and has been hovering around 5% since then. The ownership category also indicates that several foreign life insurers changed their status from "foreign majority" or "50/50" to "Chinese majority," meaning that they gave up their controlling interests. As a result, the confidence level was reduced as well. A similar survey conducted in 2010 found that executives of foreign life insurers did not anticipate any further increases in their Chinese market share, representing a dramatic change in their ambitions from 2008.

### Challenges for foreign life insurers in China

#### Underperformance in market share

As shown in Table 2, the market share of foreign life insurers stopped its upward trend in 2008 and has remained around 5% since then. It makes sense to compare this data with other major insurance markets in the world. Figure 2 shows foreign insurers' market share in China and OECD countries. It is rather clear that foreign insurers in China (both life and non-life) have failed to gain as much market share as they did in other countries.[5] For example, foreign insurers have a 30% life market share and a 50% non-life market share in the U.K. In the U.S., foreign insurers have a 22% life market share and a 12% non-life market share. Even in other Asian countries, such as Japan and South Korea, foreign insurers could obtain 20% in the life insurance market.

Furthermore, leading insurance companies' market share performance in China is well below their global performance, as is shown in Table 3.

5 In fact, the OECD database defines foreign insurers as: insurers with foreign capital as the major shareholder, or branches of foreign insurers. So, the market share data that we used for the other OECD countries were actually underestimated compared to the CIRC standard, which suggests a larger gap between China and other OECD countries.

The marker share issue is reflected not only by foreign life insurers' historical performances in China, but also by the ongoing trend of their slow expansion in China's regional business. Table 4 contains a comparison between a number of recently established domestic life insurers and foreign life insurers in terms of how many new provincial branches were created in a year. One can easily see that foreign life insurers expanded their regional business at a much slower rate than their Chinese counterparts.

### Frequent management turnover

In addition to underperformance in terms of market share, another interesting market phenomenon is foreign life insurers' frequent management turnover in China. This is further highlighted when they are compared with their domestic competitors.[6] For example, Mingzhe Ma has led the China Pingan Insurance Group since 1994 and Dongsheng Chen has led the Taikang Insurance Company since 1996. There is no question that these fast-growing domestic life insurers benefit from their stable management teams.

On the other hand, change of senior management of the life insurers in China is not unusual. For example, a major joint venture between a foreign insurer and a Chinese corporation has changed its chief executives three times since 2007. Some observers argue that this was due to the unsatisfactory performance of the company in China, while others think that it was probably due to the differences between the domestic and foreign partners over strategies.[7] Although we cannot prove that foreign life insurers should not change senior management that frequently, it is not difficult to imagine that frequent management turnover does present challenges for the companies in carrying out strategies and achieving long-term success.

### Ownership decline

The life insurance equity transactions observed in China from 2009 to 2011 have attracted attention. These transactions are listed in Table 5. We can see that some foreign life insurers reduced their shareholding in joint ventures; some even withdrew from the Chinese market completely. These transactions provide additional evidence that foreign life insurers have been encountering difficulties in the Chinese market.

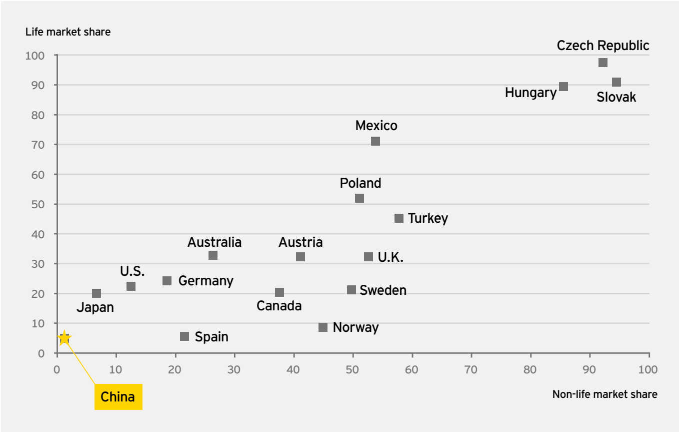


**Figure 2: Foreign insurers' market share comparisons: China and OECD countries (2008)**
Source: OECD database

| Group | Global market share (2004) | Market share in China (2004) | Market share in China (2010) |
|---|---|---|---|
| AIG | 3.60% | 1.49% | 0.78% |
| Metropolitan Life | 3.20% | 0.01% | 0.23% |
| AXA | 3.20% | 0.05% | 0.10% |
| Allianz | 3.00% | 0.06% | 0.15% |
| ING | 2.50% | 0.04% | 0.12% |
| Generali | 2.50% | 0.10% | 0.58% |
| Aegon | 2.30% | 0.02% | 0.16% |
| Aviva | 2.00% | 0.03% | 0.47% |
| Manulife | 1.70% | 0.19% | 0.18% |

**Table 3: Major catastrophe reinsurance pricing approaches**
Source: CIRC website and Sigma 2006, Swiss Re

## Structural obstacles

### Regulatory environment

Entry barriers and regulatory restrictions have been widely blamed for causing difficulties for foreign insurers in China. However, few credible analyses with solid data exist to support this argument. In this study, we employ the International Association of Insurance Supervisors (IAIS) database to investigate the impact of insurance regulation.

Using IAIS' Insurance Laws Database, we compiled in Table 6 a comparison of licensing, scope of business, shareholding restriction, and the average market share of foreign life insurers in a number

6 See news reports, such as http://insurance.zgjrw.com/News/2011414/Insurance/358619383400.shtml.
7 See the report from China Insurance News: http://news.hexun.com/2013-02-28/151559728.html.

| | Till 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|---|---|
| **Domestic life insurers*** | | | | | | | | |
| Union Life (2005)** | 6 | 5 | 5 | 8 | 3 | | | |
| Jiahe Life (2005) | 0 | 6 | 4 | 5 | 1 | | | |
| PICC Life (2005) | 1 | 4 | 16 | 9 | 1 | 2 | | |
| Nissay-Greatwall Life (2005) | 4 | 2 | 0 | 2 | 1 | 1 | | |
| **Foreign life insurers***** | | | | | | | | |
| Cathay Life (2004) | 1 | 2 | 1 | 3 | 1 | 1 | | |
| Aegon-CNOOC (2003) | 3 | 1 | 1 | 3 | 1 | 1 | 1 | |
| Heng An Standard Life (2003) | 2 | 2 | 2 | 3 | 1 | | | |
| Skandia Life (2004) | 2 | | 1 | 2 | | 1 | 1 | 1 |
| Changsheng Life (2003) | 0 | | | | | | 1 | |
| CIGNA & CMC Life (2003) | 3 | 1 | 1 | 1 | | 2 | 1 | |
| Sino-French Life (2005) | 0 | | | | | | | |
| Samsung Air China Life (2005) | 0 | | | | 1 | 1 | 1 | 1 |
| Sino-US MetLife (2004) | 2 | | 1 | 1 | | 1 | | 1 |
| Great Eastern Life (2006) | 0 | | | 1 | 1 | | 1 | 1 |

**Table 4: Provincial branches establishment of some domestic and 50-50 foreign life insurers**[8]
*Data of domestic life insurers are from the China Insurance Yearbook 2006–11.
**Number in parentheses is the foundation year of the company.
***Data for foreign life insurers are from the CIRC website, published by the International Department for Authorization Announcement.

| Current company name | Year of foundation | Equity transaction descriptions | Time of transactions |
|---|---|---|---|
| Sun Life Everbright Life Insurance Co., Ltd. | 2002 | The company was founded in 2002, with two major shareholders, the China Everbright Group and Canada Sun Life Financial, each holding 50% of the total shares. The China Everbright Group injected more capital in 2009, reducing the share of Sun Life Financial Services to 20%, and turned the company into a domestic one. | 2009.07 |
| Tian An Life Insurance Co., Ltd. | 2001 | The company was founded in 2001, with two major shareholders, Manulife Group and the China Tianan Group, each holding 50% of the total shares. Manulife Financial withdrew all its capital in 2009, leaving the Tianan Group holding all the shares, and the company turned into a domestic one. | 2009.09 |
| ICBC-AXA Life Insurance Co., Ltd. | 1999 | The company was founded in 1999, and the AXA Group held 51% of the shares initially. In 2010, the Industrial and Commercial Bank of China made a deal with the AXA Group and the Minmetals Group by purchasing 60% of the company's shares, leaving 27.5% for the AXA Group and 12.5% for the Minmetals Group. | 2010.10 |
| BoCommLife Insurance Co., Ltd. | 2000 | The company was founded in 2000, with two major shareholders, China Life and the Commonwealth Bank of Australia, holding 51% and 49% of the shares, respectively. In 2010, the China Bank Of Communications purchased all the shares from China Life and injected more capital to hold 62.5% of the company's shares, leaving the Commonwealth Bank of Australia with 37.5%. | 2010.01 |
| ING-BOB Life Insurance Co., Ltd. | 2002 | The company was founded in 2002, with two major shareholders, the Beijing Capital Co. and the ING Group, each holding 50% of the shares. In 2010, the Bank of Beijing purchased all the shares from the Beijing Capital Co., and changed the name of the company from ING Capital Life Insurance to the ING-BOB Life Insurance Co. | 2010.04 |
| Founder Meiji Yasuda Life Insurance Co., Ltd. | 2002 | The company was founded in 2002, with two major shareholders, the Haier Group and New York Life Insurance, each holding 50% of the total shares. In 2010, New York Life Insurance withdrew from the company, leaving the Haier Group as the major shareholder. After another equity transaction in 2012, the company is now called Founder Meiji Yasuda Life Insurance. | 2010.12 |
| CCB Life Insurance Co., Ltd. | 1998 | The company was founded in 1998, with two major shareholders, the China Pacific Insurance Group and the ING Group, each holding 50% of the shares. In 2010, the China Construction Bank (CCB) acquired the 50% shares from ING group, turning the company into a domestic insurer. In 2011, the CCB, as well as other strategic partners (such as China Life Taiwan and China Jianyin Investment Co.), took over the other 50% shares from the China Pacific Insurance Group, while CCB became the majority shareholder. | 2011.03 |

**Table 5: Some equity transactions of foreign insurers in China over 2009–11**
Source: company website and public information

8 All the companies were founded around 2005, so the establishment of new branches in the same year is comparable.

| | License of doing business | | | Maximum shareholding for foreign investors | | Limits before notification of intended participation in an insurance company | | |
|---|---|---|---|---|---|---|---|---|
| | Foreign companies through a branch | Foreign companies by way of cross border business | Are foreign insurers entitled to underwrite all risks? | For a single investor | For total participation | Domestic shareholders/ investors | Foreign shareholders/ investors | **Average market share of foreign life insurers (2006-08)** |
| **Slovak Republic** | √ | × | √ | 100% | 100% | 20% | 20% | 90.75 |
| **Czech Republic** | √ | × | √ | 100% | 100% | 20% | 20% | 90.6 |
| **Mexico** | √ | × | √ | 100% | 100% | 5% | 5% | 70.09 |
| **Luxembourg** | √ | √ | √ | 99% | 100% | 10% | 10% | 62.56 |
| **Poland** | √ | × | √ | 100% | 100% | 10% | 10% | 57.95 |
| **Turkey** | √ | × | √ | 99% | 100% | 10% | 10% | 34.81 |
| **Italy** | √ | √ | √ | 100% | 100% | 5% | 5% | 32.43 |
| **Australia** | √ | √ | √ | 100% | 100% | 15% | 15% | 31.84 |
| **Netherlands** | √ | √ | √ | 100% | 100% | 5% | 5% | 26.74 |
| **U.S.** | √ | √ | √ | 100% | 100% | 10% | 10% | 25.24 |
| **Sweden** | √ | √ | √ | 100% | 100% | 10% | 10% | 24.19 |
| **Japan** | √ | × | √ | 100% | 100% | 5% | 5% | 23.56 |
| **Austria** | √ | × | √ | 100% | 100% | 10% | 10% | 23.11 |
| **Germany** | √ | √ | √ | 100% | 100% | 10% | 10% | 22.98 |
| **Korea** | √ | × | √ | 100% | 100% | 10% | 10% | 20.83 |
| **Canada** | √ | × | √ | 100% | 100% | 10% | 10% | 19.3 |
| **Denmark** | √ | × | √ | 100% | 100% | 20% | 20% | 16.85 |
| **Switzerland** | √ | × | √ | 100% | 100% | 10% | 10% | 13.4 |
| **Spain** | √ | × | √ | 100% | 100% | 10% | 10% | 8.82 |
| **China** | √ | × | √ | 50% | 50% | 5% | 5% | 6.28 |

**Table 6: Comparisons of the supervision environment for foreign life insurers**
Source: IAIS Insurance Law Database, tabulated by the authors

of countries. We can see that the major difference in the regulatory environment of China, as compared to OECD countries, is that it has a shareholding cap of 50%. This resulted in the "50/50" shareholding structure that has been adopted by many foreign life insurers in China, which has further led to other operational issues, such as high management turnover and low efficiency.

In addition to the direct impact on the shareholding structure, the regulatory environment in China also has an indirect impact on the foreign insurers. Using reinsurance as an example, the Chinese market experienced a "statutory reinsurance period"[9] (from 1985 to 2006), a "priority reinsurance period"[10] (from 2006 to 2009) and finally entered the "free competition period" (since 2009). However, even in the free competition period, China Re, the traditional market dominant owned by the Chinese Government, has an obvious advantage in client relationship, customer resources, and operational data. Although we admit that it is not possible to quantify these indirect impacts, they do exist and deserve market participants' attention.

### Financial crisis

The recent financial crisis significantly shrunk the global equity market, and therefore created additional constraints for insurers to develop in the emerging markets. Many foreign markets faced capital constraints and were even bailed out by their governments. As a result, some were forced to revise their global strategies and move resources from emerging markets back to their core markets.

9 In this period, 20% of the non-life insurance premiums had to be ceded to reinsurers, which mainly referred to China Re.
10 In this period, 50% of the reinsurance business needed to be ceded with priority given to at least two domestic reinsurers. China Re, of course, received most of the business.

As Figure 3 indicates, the equity capital of life insurance companies declined by more than 25% in 2008. Apart from asset loss, two aspects of the life insurance business were also hit by the financial crisis — variable annuities and securities lending. Variable annuities businesses with equity market guarantees suffered from the falling equity markets when regulators asked these insurers to post reserves against the rising market value of their guarantees.

Securities lending businesses caused illiquidity problems for the insurers since they invested the collateral in high-risk assets before the crisis. Since these assets could not be sold easily during the financial crisis, some life insurance companies had difficulty meeting the liquidity requirement.

Given the pressure from the financial crisis, it was not unreasonable for foreign life insurers to reduce their shareholding in China. After all, these companies failed to deliver satisfactory results in the Chinese market. When they desperately needed cash to boost liquidity, selling the shares in China became a natural option.

**Operational challenges**

The structural obstacles, such as the regulatory environment and financial crisis, are external factors that impacted the development of foreign life insurers in China. In addition, there are internal issues that can also explain the current challenges faced by foreign life insurers. These internal issues include operational efficiency, shareholding limitation, and distribution channel.

**Operational efficiency: the DEA model**

The nature of the life insurance business determines that it is difficult to generate immediate returns from initial investments. In other words, it is common to expect no profits at the early stages of development. However, management decision is driven by shareholders' interest and investors' need to see how their investment is performing. Consequently, efficiency analysis that essentially measures the output-input ratio becomes an important topic. Logically, if the business operation is not efficient, then investors would want to withdraw their investment.

Chen et al. (2007) investigated the efficiency performance of domestic and foreign life insurers in China. They found that,

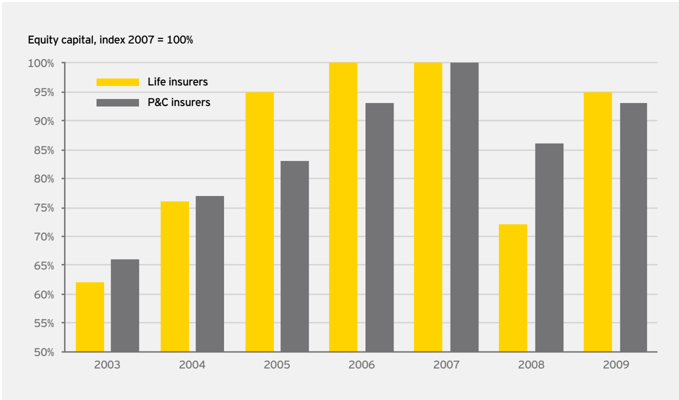


**Figure 3: Equity capital for life and P&C insurers, 2003-09**
Source: Swiss Re Economic Research & Consulting

in contrast to the common view, domestic insurers possess advantages in terms of both pure technical efficiency and scale efficiency. This suggests that maintaining growth is an important strategy for foreign life insurers that wish to compete in the Chinese market.

This paper analyzes efficiency from a different perspective. Our primary interest lies in companies' decisions to leave the Chinese market. We, therefore, think that premium income and profits are appropriate output indicators. Compared to realized benefits, additions to reserves and invested assets used by Chen et al. (2007), the current approach fits the context of business decision-making.

### Methodology and data

We use the Data Envelopment Analysis (DEA) model developed by Banker et al. (1984) to test the operational efficiency of life insurers in China. The model is based upon the goal programming below:[11]

$$\underset{\underline{S}^-,\underline{S}^+,0}{\mathrm{Min}}\left\{\theta - \varepsilon\left(\underline{e}^T\underline{S}^- + \underline{e}^T\underline{S}^+\right)\right\}$$

$$\text{s.t. } \sum_{j=1}^{n}\lambda_i \underline{x}_i + \underline{S}^- = \theta\, \underline{x}_{j0}$$

$$\sum_{j=1}^{n}\lambda_i \underline{y}_i - \underline{S}^+ = \underline{y}_{j0}$$

$$\lambda_j \geq 0,\ j = 1, \ldots\ldots, n$$

$$\underline{S}^+ \geq \underline{0},\ \text{and } \underline{S}^- \geq \underline{0}$$

11 For more references and details about DEA and the model, please refer to Chen, Powers and Qiu (2009).

| | | 2010 | 2009 | 2008 | 2007 | 2006 | 2005 | 2004 | 2003 | 2002 | 2001 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Number of companies** | | 51 | 49 | 45 | 45 | 38 | 34 | 27 | 25 | 17 | 15 |
| **Number of domestic companies** | | 27 | 24 | 21 | 21 | 15 | 12 | 19 | 8 | 6 | 6 |
| **Number of foreign companies** | | 24 | 25 | 24 | 24 | 23 | 22 | 8 | 17 | 11 | 9 |
| **Number of employees (X1)** | Mean | 6,944 | 6,025 | 7,623 | 6,568 | 5,961 | 6,104 | 6,256 | 5,684 | 8,078 | 6,648 |
| | Median | 675 | 1,056 | 1,151 | 750 | 621 | 438 | 290 | 236 | 954 | 890 |
| | Maximum | 103,868 | 105,111 | 102,777 | 96,786 | 77,318 | 75,728 | 75,437 | 72,900 | 65,232 | 51,880 |
| | Minimum | 11 | 62 | 33 | 47 | 39 | 75 | 42 | 63 | 54 | 56 |
| **Equity (X2), in milion RMB** | Mean | 2,517 | 6,297 | 3,791 | 1,251 | 833 | 2,579 | 3,203 | 3,174 | 1,173 | 1,318 |
| | Median | 765 | 590 | 362 | 306 | 245 | 222 | 219 | 379 | 294 | 182 |
| | Maximum | 33,654 | 212,776 | 135,881 | 17,189 | 9,957 | 62,951 | 57,499 | 62,436 | 13,269 | 7,941 |
| | Minimum | 5 | 17 | 12 | 2 | 6 | 56 | 12 | 23 | 122 | 16 |
| **Expenses (X3), in million RMB** | Mean | 2,893 | 2,480 | 794 | 1740 | 734 | 1,116 | 961 | 581 | 1,780 | 1,579 |
| | Median | 177 | 363 | 333 | 257 | 212 | 149 | 97 | 70 | 192 | 116 |
| | Maximum | 48,173 | 42,174 | 8,447 | 32,379 | 6,153 | 23,315 | 8,269 | 7,148 | 21,199 | 16,779 |
| | Minimum | 4 | 4 | 6 | 1 | 2 | 7 | 5 | 2 | 4 | 15 |
| **Premium Income (Y1), in million RMB** | Mean | 10,026 | 6,672 | 12,166 | 5,537 | 9,682 | 3,831 | 8,861 | 5,694 | 13,169 | 10,465 |
| | Median | 666 | 615 | 1,495 | 363 | 505 | 236 | 188 | 146 | 240 | 60 |
| | Maximum | 95,587 | 71,876 | 294,939 | 78,237 | 183,843 | 58,849 | 149,983 | 58,959 | 128,781 | 81,313 |
| | Minimum | 0 | 1 | 14 | 0 | 3 | 1 | 4 | 0 | 4 | 0 |
| **Profit (Y2), in million RMB** | Mean | 1,002 | 1,050 | 71 | 940 | 338 | 150 | 103 | 251 | -1,606 | -52 |
| | Median | -16 | -21 | -173 | -34 | -56 | -38 | -51 | -14 | -32 | -16 |
| | Maximum | 33,811 | 33,036 | 10,205 | 28,297 | 9,601 | 5,456 | 2,919 | 5,857 | 1,825 | 1,761 |
| | Minimum | -450 | -473 | -3,025 | -376 | -346 | -565 | -424 | -205 | -30,649 | -3,107 |

**Table 7: Summary statistics of input and output variables**

In our study, number of employees (X1), equity (X2), and expenses (X3) are used as input indicators; premium income (Y1) and profit (Y2) are used as output indicators. Inputs are in general agreement with insurance efficiency research and the selection of output indicators is based on the discussion above. Our dataset includes company-level data from 2001 to 2010, obtained from the China Insurance Yearbook. Summary statistics of input and output indicators are provided in Table 7.

## Analysis results

The power of the DEA model is reflected in its ability to distinguish pure technical efficiency from scale efficiency. Mathematically,

Technical efficiency = pure technical efficiency × scale efficiency

Technical efficiency measures a firm's overall efficiency performance, pure technical efficiency captures the efficiency of resource allocation and internal management, while scale efficiency reflects the degree to which the firm is operating at an optimal level. Average efficiency scores from domestic and foreign life insurers in China are presented in Table 8.

| | **Technical efficiency** | | **Pure technical efficiency** | | **Scale efficiency** | |
|---|---|---|---|---|---|---|
| | Domestic | Foreign | Domestic | Foreign | Domestic | Foreign |
| 2001 | 0.66 | 0.42 | 0.76 | 0.82 | 0.71 | 0.52 |
| 2002 | 0.84 | 0.30 | 0.99 | 0.89 | 0.84 | 0.33 |
| 2003 | 0.79 | 0.27 | 0.87 | 0.78 | 0.88 | 0.36 |
| 2004 | 0.89 | 0.37 | 0.91 | 0.75 | 0.98 | 0.48 |
| 2005 | 0.47 | 0.17 | 0.69 | 0.70 | 0.60 | 0.23 |
| 2006 | 0.58 | 0.35 | 0.79 | 0.74 | 0.72 | 0.48 |
| 2007 | 0.41 | 0.42 | 0.68 | 0.63 | 0.56 | 0.70 |
| 2008 | 0.59 | 0.50 | 0.77 | 0.66 | 0.80 | 0.75 |
| 2009 | 0.54 | 0.33 | 0.67 | 0.53 | 0.79 | 0.60 |
| 2010 | 0.54 | 0.45 | 0.65 | 0.66 | 0.80 | 0.64 |

**Table 8: Average of efficiency results (domestic and foreign)**

We observe that foreign life insurers in China exhibit lower efficiency than their domestic competitors. This is especially true for scale efficiency. Even for pure technical efficiency where foreign players should have the competitive advantage, domestic life insurers' performance is slightly better.

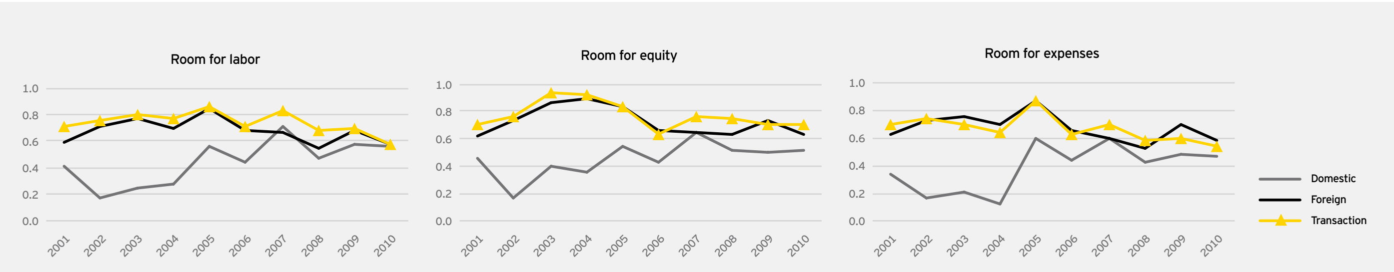


**Figure 4: Improvement in inputs for domestic, foreign and those with transactions**

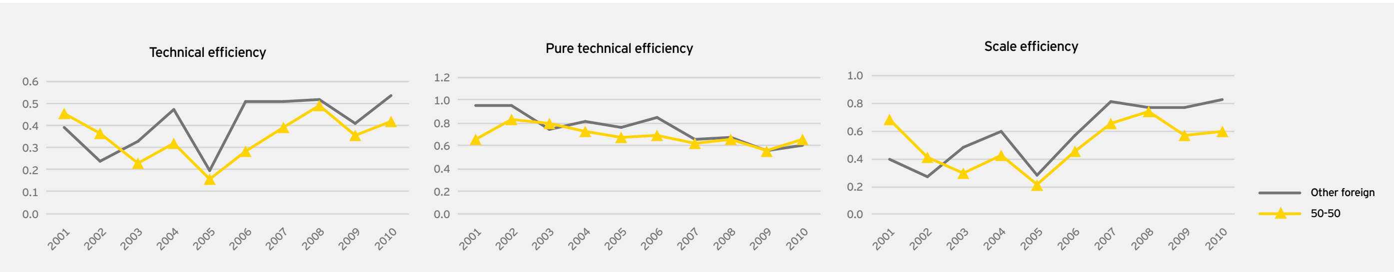


**Figure 5: Efficiency differences between 50-50 foreign life insurers and others**

Interestingly, foreign life insurers appeared to perform better in 2007, with technical efficiency higher than domestic companies. However, this momentum failed to continue in 2008. In the following discussion, we found that underdevelopment of the distribution channel was the major cause of this issue.

Low efficiency performance provides an incentive for foreign life insurers to reduce their shareholding in China and even leave the Chinese market. Those foreign life insurers with such equity transactions spent more labor, equity capital and operating expenses but failed to generate sufficient premium and profit for their shareholders. After the equity transactions, we see that efficiency performance of these companies improved (Figure 4).

### Shareholding limitation

Due to the regulatory restrictions on foreign shareholding, many foreign life insurers adopted a 50/50 shareholding structure when they entered the Chinese market, meaning that the foreign and domestic shareholders each hold 50% of the total shares. In this section, we utilize the efficiency analysis results to investigate whether the 50/50 shareholding structure has a negative influence on foreign life insurers.

From Figure 5, we can see that there are significant efficiency differences between those foreign life insurers with a 50/50 shareholding structure and other foreign life insurers, especially in scale efficiency. This concurs with market observers' criticism that the 50/50 shareholding structure held back the scale development of the companies. According to Fang (2011), under such a structure, the chairman of the board, financial managers and human resources managers are usually appointed by the domestic partner. The foreign partner usually names the chief executive and other management team. This illustrates how the 50/50 shareholding creates potential conflict among the management team and possibly results in low efficiency.

### Distribution channel

Bancassurance is a very important distribution channel in the Chinese insurance market. According to CIRC, bancassurance accounts for 30% of the premium income (all product lines). Driven by the synergy effect, banks naturally want to serve as strategic partners and shareholders of insurance companies. However, they were not able to do so until the regulation was changed in 2008 allowing banks to hold insurance shares.

After that, banks played an increasingly important role in the insurance equity transactions and mainly served as acquirers.

Table 9 lists the proportion of premium income attributable to bank and postal insurance for each of the foreign life insurers from 2008 to 2010. Insurers that experienced equity transactions are highlighted. Prior to the equity transactions, they generally had poor performance in China and needed bancassurance to boost their business volumes. At the same time, China's domestic banks were looking for insurance partners. This at least partially explains why the equity transactions occurred and the fact that bancassurance of these companies grew rapidly, post transactions.

| Name of the company | Proportion of premium income from bank and postal channels | | |
|---|---|---|---|
| | 2008 | 2009 | 2010 |
| ING-BOB Life | - | - | 65.23% |
| Changsheng Life | - | - | 66.29% |
| Shin Kong & HNA Life | - | 55.85% | 78.24% |
| Tian An Life | - | 81.72% | 83.87% |
| HSBC Life | - | - | 84.09% |
| King Dragon Life | - | 72.76% | 88.91% |
| BoComm Life | - | - | 91.41% |
| CCB Life | - | 0.96% | 4.19% |
| Manulife-Sinochem Life | 0.00% | 0.03% | 0.08% |
| Heng An Standard Life | 3.97% | 62.24% | 18.12% |
| Founder Life | 6.61% | 4.12% | 0.38% |
| AIA Life | 13.53% | 14.44% | 11.31% |
| ICBC-AXA Life | 31.81% | 31.31% | 28.98% |
| Prudential Life | 41.55% | 32.68% | 46.37% |
| Skandia Life | 55.96% | 74.45% | 66.71% |
| Sun Life Everbright Life | 57.54% | 72.85% | 84.39% |
| Aviva-COFCO Life | 57.99% | 59.87% | 58.21% |
| Sino-US MetLife | 58.20% | 36.14% | 18.64% |
| Generali China Life | 63.27% | 62.56% | 37.44% |
| Cathay Life | 66.53% | 55.01% | 29.65% |
| CIGNA & CMC Life | 70.07% | 9.54% | 64.53% |
| Samsung Air China Life | 70.49% | 74.90% | 32.46% |
| Great Eastern Life | 71.18% | 67.16% | 86.31% |
| Aegon-CNOOC | 76.21% | 49.26% | 33.47% |
| Allianz Life | 76.22% | 71.06% | 57.03% |
| Huatai Life | 87.63% | 90.57% | 91.95% |
| Sino-French Life | 100.00% | 100.00% | 100.00% |

**Table 9: Bank and postal insurance distribution percentages for foreign life insurers in China**
Source: China Insurance Yearbook, 2009-11

**Conclusions**
The importance of the Chinese insurance market is determined by China's economic growth. This market deserves the attention of any ambitious insurance company. In fact, many foreign insurers entered the Chinese market with the goal of establishing their strategic positions in this emerging market and possibly secure another growth engine. However, although it has been widely acknowledged that those foreign insurers have had a positive impact on the Chinese market, the foreign insurers themselves, especially the life insurers, are having difficulties expanding their market share in China. Their competitive advantages in experience, technology and management were not fully realized. Some foreign life insurers have experienced frequent management turnover and some even withdrew from the Chinese market recently. It is important to thoroughly understand this unique market phenomenon and the reasons behind it. Market participants and regulators should adjust their strategies accordingly.

This paper utilizes both quantitative and qualitative analysis to investigate the challenges faced by foreign life insurers. We identify the regulatory environment and the financial crisis as the structural obstacles that impact foreign life insurers' performance externally. Regarding operational challenges, we employ DEA to compare the efficiencies of domestic and foreign life insurers and find that latter are not as efficient as their domestic competitors, especially in terms of scale efficiency. Insurers that reduced their equity shares in recent years exhibit particularly poor efficiency performance. In addition to efficiency, we further study the 50/50 shareholding limitation and distribution channel issues that also negatively impact the performance of foreign life insurers in China.

On the basis of these analyses, it is not surprising to see that foreign life insurers in the Chinese market have become more conservative and lowered their expectations about their future growth potentials. Some prefer to serve as minority shareholders instead of operating the daily business in China. Some have shifted their focus and resources from China to other countries.

In order to improve the current situation, Chinese regulators need to look at the long-term benefit that free market competition can bring to Chinese customers. A more relaxed regulatory environment will promote competition, and therefore provide incentive for both domestic and foreign insurers to improve their businesses. For example, gradually relaxing the shareholding limitation, streamlining the license approval process and encouraging product innovation are good things to consider. Regulators should also play a role in removing the current obstacles and ensure fair market conditions.

Foreign life insurers operating in China need to employ a customized approach. The unique regulatory environment and market characteristics, such as the importance of bancassurance, must be considered when forming business strategies for the Chinese market. These can be achieved by accumulating more local knowledge, employing more experienced Chinese managers and showing the willingness to deviate from the standard business model. Additionally, the fact that foreign insurers have more experience and better technology does not mean that they have nothing to learn from their domestic competitors. Realistically speaking, foreign insurers need to improve their business volume first in order to realize competitive advantage. Finally, foreign insurers should be patient because regulatory environment and market condition will not change in one day. They should remember that it took AIG many years to establish its current position in China.

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