

Business Opportunities for Foreign Insurance Companies in China's Changing Marketplace

Facts and Figures for Potential Investors

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Executive Summary

- > Whether for nonlife or life insurance sectors, the **current market in China**, as measured by premium revenues, is small, approximately on a par with Switzerland or Taiwan. However, it is reasonable to expect the market to grow some 12 percent annually over the next decade. This would result in a market roughly half the size of the 1999 French market.
- > Currently, China's insurance market is dominated by a small number of **large local companies**, particularly legacies of PICC, the former state monopoly insurance (nonlife), China Life (life), and China Re (reinsurance). Two other firms, China Ping An and China Pacific, are major factors. In life insurance, only AIA has established a significant market share in Shanghai, the primary market for foreign competitors.
- > Currently, **foreign nonlife firms** are obtaining branch licenses, but are restricted to operations in a few cities, and to insuring foreign invested enterprises. **Foreign life companies** may form only joint ventures (with 50 percent or less foreign equity) or take equity positions of less than 25 percent in Chinese firms. They are also restricted to certain localities. So far, China has been able to retain a monopoly position in reinsurance.
- > Over the next five years, concurrent with **China's accession to the WTO**, the Chinese insurance market will be increasingly liberalized and open for foreign participants. Many more nonlife and life companies will be licensed to operate in China, and geographic and market restrictions will be largely eliminated.
- > China has adopted a protective regulatory regime, under which limits are placed on product and price competition. Strategically, the **China Insurance Regulatory Commission (CIRC)** aims to nurture the development of an insurance sector that is much stronger financially and more competitive domestically and internationally than at present. CIRC views the proper role of foreign insurance companies as that of assisting in this development.
- > At present, there is a **high degree of uniformity** in product, market, distribution, and pricing strategies among companies in the insurance sector. This is largely a result of history and the regulatory environment. In the future, scope and demand will be sufficient to differentiate strategies.
- > China's insurance market already resembles the West, with life **premiums** accounting for some 65 percent of total premiums, and nonlife for some 35 percent.
- > In the life segment, all companies have adopted an expensive **agent sales model** in major cities. This model has forced them to target the top income-earning segment of the market, which may limit growth potential. An effective model for reaching the middle-income market has not yet been developed.
- > Currently, the most popular **life insurance products** are investment-linked and dividend policies that provide policy holders with a return on their investment.

These products were introduced in China in 1999 and should continue to attract subscribers as investment and protection vehicles.

- > At present, the **life insurance sector** plays a fairly passive and minor role in the capital markets and is not permitted to invest directly in the equities market. Over time, we can expect the life insurance sector to be permitted to play a more normal role as asset manager and institutional investor.
- > Over the next few years, many new nonlife and life firms will be licensed in China. Foreign companies will find new ways to participate in the marketplace. **Alliances** – often with global scope – will offer benefits for some players.
- > Financial and industrial **group holding company structures** will create new points of entry for some foreign firms.
- > One of the **keys to success** will be to adopt a creative, pragmatic, and strategic approach to the market in the Chinese manner. Backward-looking, regulations-oriented approaches will leave companies behind the learning curve and the competition. Working together with local partners to achieve regulatory breakthroughs or to create new ventures may be the most effective course.

Market Size and Trends

The immense size and commensurate opportunity of the China market belongs to the realm of current business mythology. Chinese officials invariably try to impress outsiders with the huge potential of their marketplace. The business press, too – often citing the work of consultants or echoing Chinese government announcements – can frequently be heard proclaiming the market's great potential and the huge significance of every new deregulation measure or license issued to a new foreign participant.

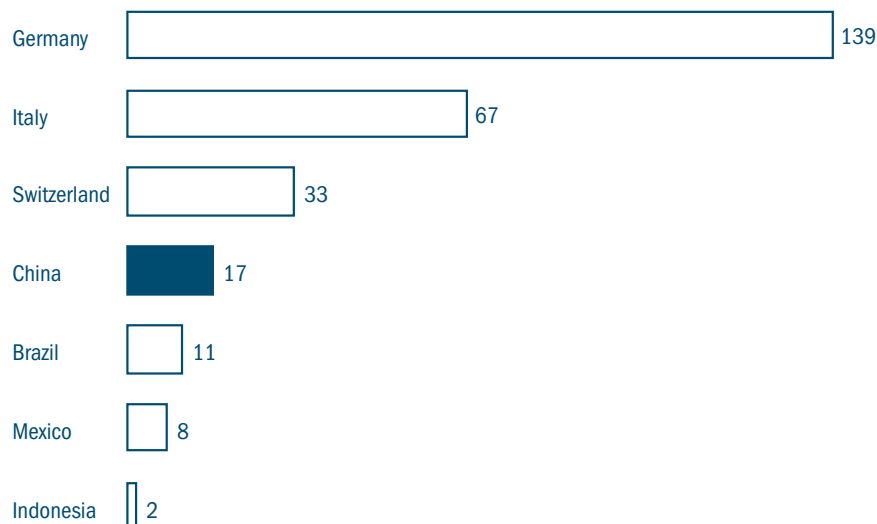
Given the mythology and media hype, it is particularly important for foreign insurance companies approaching China to firmly ground their thinking and planning in reality. The starting point should be a simple question: How big is the Chinese market, really?

For most readers, the answer is likely to be "smaller than expected." China's insurance market today is comparatively small. In 1999, total insurance premiums in the Chinese market, corresponding to US\$ 16.8 billion, placed China at a level slightly above Sweden and below Taiwan in a global ranking. In 1999, the entire Chinese market, with 1.2 billion inhabitants, produced only about half the insurance premiums of tiny Switzerland, and would have accounted for only about 13 percent of the German market or 14 percent of the French market.

Foreign insurance approaching the Chinese market should base their planning on reality

In 1999, total insurance premiums in the Chinese market amounted to US\$ 16.8 billion

Comparative Size of China's Insurance Market – Total Premiums (1999) [US\$ bn]



Source: China Insurance News

However, China's insurance market is the largest of all developing countries. It generates roughly twice the insurance market of e.g. Mexico.

Some History on the Development of China's Insurance Sector

In assessing the size of the market, it is essential to consider trends. And in considering trends in China, it is crucial to take some history into account. In the 1950s, when it introduced a Soviet-style planned economy, China shut down its insurance industry. There was no insurance in China, except for international cargo, for a period of about 30 years – more than a generation. Just as in the Dark Ages of medieval Europe, the knowledge of how to run a system was lost. The insurance sector was slowly revived beginning in 1985, when the People's Insurance Company of China (PICC, formerly known as "unibank," a department of the People's Bank of China) was established as an independent company.

With the establishment of the People's Insurance Company of China (PICC) in 1985, the Chinese insurance sector was revived

From the late 1980s through the 1990s, the Chinese insurance market grew rapidly from a small base, as measured by premiums paid, particularly in the period before 1998. As of 1989, the total of premiums paid in market was RMB 9.8 billion. By 1997, this had grown ten-fold to RMB 108.8 billion. By 2000, the figure had increased to RMB 159.6 billion.

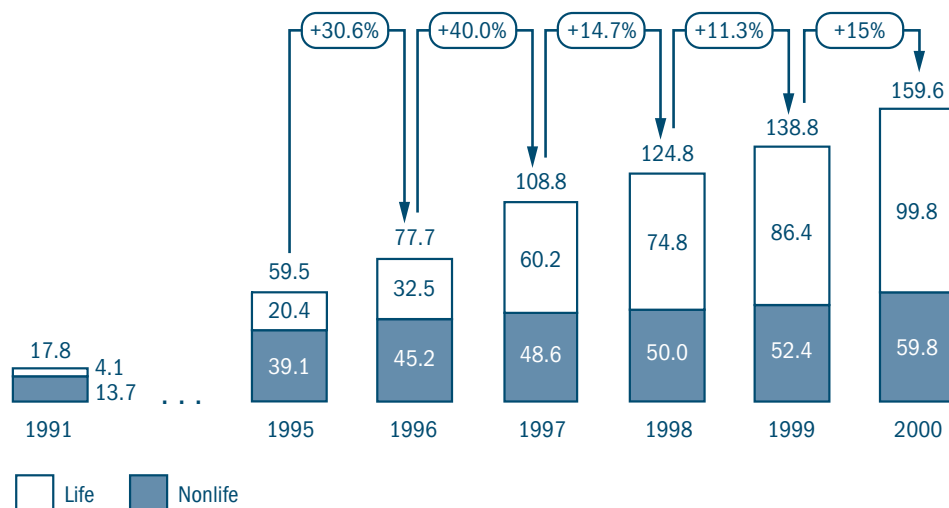
The Chinese insurance market grew from RMB 108.0 billion in 1997 to RMB 159.6 billion in 2000 (1 US\$ = 8.28 RMB (Chinese yuan) as of June 27, 2001)

From growth rates averaging more than 35 percent in the period from 1990 to 1997, overall growth in premiums slowed to around 13 percent annually in the period from 1999 to 2000. A slowdown in the Chinese economy, particularly in 1999, accompanied by record low interest rates and rising unemployment, help to explain this decline.

It is likely that 1999, when growth was just 11.3 percent, will be seen as the nadir of the growth rate decline in the Chinese market. 2000 saw an upturn to 15 percent growth, despite continued low interest rates and economic restructuring in China.

The slow-down in growth become markedly less in 1999

Total Insurance Premiums Paid in China [RMB bn]



Source: CIRC, S.M. Harner and Company

The following factors contributed to arresting the decline in growth and to supporting an upturn in 2000:

- > Positive results of efforts on the part of insurance market leaders to reorganize and restructure themselves to become more market and customer-oriented
- > Successful new products – especially those with dividend payouts and those linked to investment performance – introduced by leading insurance firms, following approval by the Chinese regulatory authorities
- > Regulatory approval to invest a portion of insurance funds in securities markets
- > A booming domestic securities market that helped to attract funds into investment-linked insurance products and generally improve insurance company performance
- > Overall strong growth in the Chinese economy, especially in trade and infrastructure-related sectors.

Trends in Insurance Market Segments

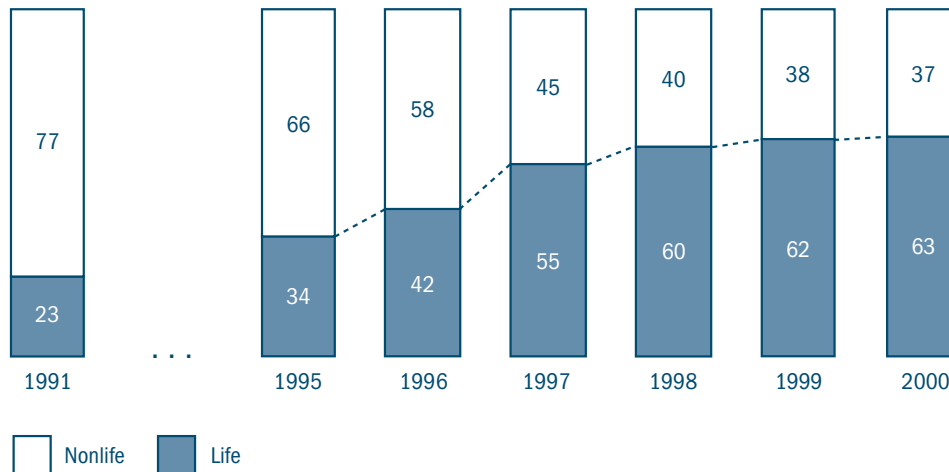
One could say that the Chinese insurance industry was born in the late 1980s, was in its infancy in the 1990s, and has entered adolescence in the 2000s. The infancy analogy seems appropriate in view of the profound structural changes that accompanied growth during the 1990s. The most important of these was the evolution of the market from one that was dominated by the corporate sector and nonlife (property and casualty) insurance, to one that is now dominated (as in developed countries) by the individual market and life insurance.

In 1991, 76.8 percent of insurance premiums generated in the market were from nonlife insurance. The life market, with a mere RMB 4 billion in premiums, made up only 23.2 percent of the market. By 2000, the positions were almost reversed, with life insurance accounting for 62.5 percent of the market, and nonlife insurance accounting for 37 percent (excluding reinsurance to avoid double counting). As mentioned above, the market proportions of life and nonlife have changed, but at the same time, both markets have grown dramatically. The most dramatic growth is clearly in life insurance, which increased roughly 25-fold from 1991 to a total value of RMB 99.8 billion in premiums paid in 2000, compared with a much slower 4.5-fold increase for nonlife insurance.

Individual and life insurance have higher market shares than corporate and nonlife insurance...

...with life insurance accounting for 62.5 percent market share in 2000

Percentage Shares of Life and Nonlife Insurance Premiums [%]



Source: CIRC

A Market in Adolescence: Outlook for Overall Development and Growth

The 1999 and 2000 data suggests that the major changes in the relative market share of life and nonlife insurance have largely come to an end. It appears that the proportion of life premiums will remain in the 60-65 percent range, and that nonlife premiums will remain at around 35-40 percent of the total.

What can we expect in terms of overall market development in the near future? In keeping with our analogy of adolescence, we expect continued growth in the quantity as well as developments in the quality of products and service providers. In terms of market "depth" and "density," China remains at the low end of those countries with a similar per capita income level.

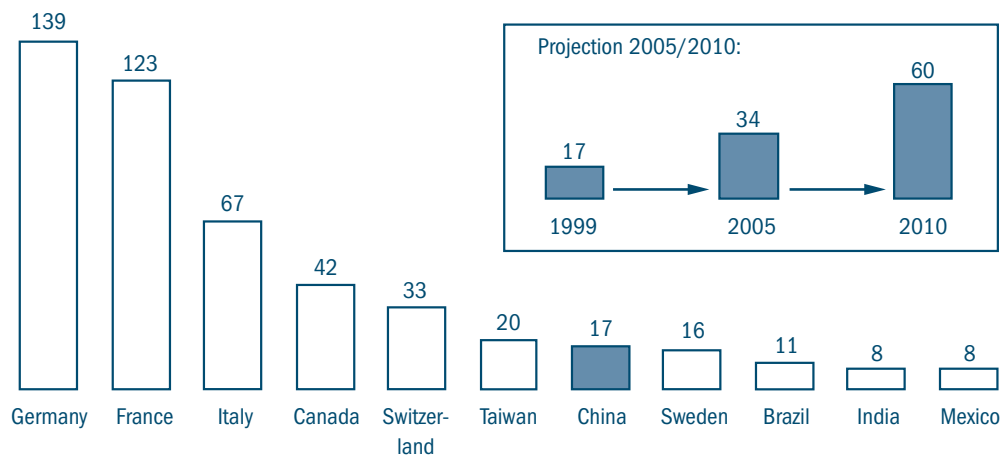
In a normal economy, it is realistic to expect insurance premium revenues to increase a few percentage points faster than GDP. In China's case, we have seen, and can continue to expect, that this growth is even quicker. For example, in 2000, as China's overall GDP increased by some 8 percent, total insurance premiums increased by 15.0 percent, or 7 percentage points faster.

Forecasts of an average growth rate of 7 percent for China's GDP for the next 5 to 10 years are in line with recent historical performance and consensus projections by economists, and a growth-above-GDP factor of 5 percentage points for the insurance sector is predicted by insurance industry estimates. Accordingly, the annual growth rate for China's insurance sector as measured by premiums will be 12 percent. At this rate, the total size of the Chinese market will increase by 76 percent to RMB 281.3 billion (US\$ 34 billion) in 2005 and 310 percent to RMB 495.7 billion (US\$ 59.9 billion) in 2010. By 2005, the Chinese market will have reached the same level of premiums as Switzerland in 1999 and by 2010 it will be roughly half the size of the market in France in 1999. Thus, while perhaps not the El Dorado suggested by some optimists, it is clear that, even based on reasonably conservative assumptions, China's insurance sector will become a significant market within the next ten years.

Market penetration in China is still low among countries with a similar per capita income

The insurance market (measured by premiums) is expected to grow by 12 percent p.a. to US\$ 34 billion in 2005 and US\$ 60 billion in 2010

Comparative Size of China's Insurance Market - Total Premiums (1999) [US\$ bn]



Source: China Insurance News, S.M. Harner and Company

Market Breakdown by Product

What are the principal product and market segments in the Chinese market today? Product statistics for all of China in 1999 are presented below.

In property and casualty insurance, virtually all premiums are earned in three categories:

- > Motor vehicle and third party insurance – 58.5 percent of the total
- > Enterprise property insurance – 21.3 percent of the total
- > Cargo transportation insurance – 6.6 percent of the total.

In the life insurance sector, premium revenues are split 32.3 percent and 67.7 percent in the group and individual insurance categories, respectively. These figures do not indicate any trends. Based on trends evident in large cities like Beijing and Shanghai, individual insurance is growing much faster than group life insurance. Thus, individual insurance may continue to increase substantially in the future.

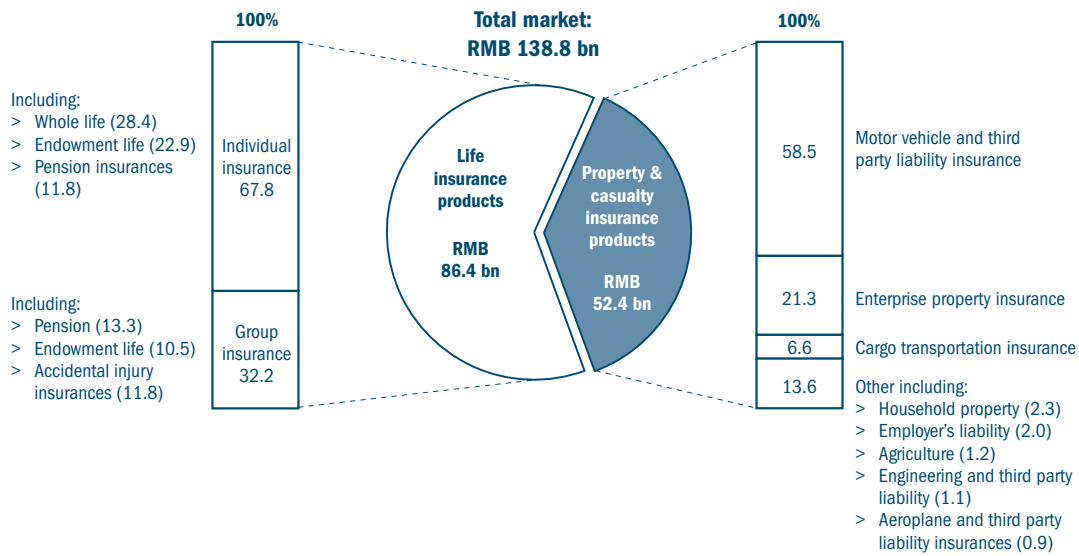
In large cities like Beijing, the market for individual life insurance is growing faster than for group life insurance

Within the group insurance category, we see that the biggest product is pension insurance. We can observe from this that enterprises in China buy pension insurance for their employees. The second largest product, with a 32.7 percent share, is endowment life insurance. A third major product is accidental injury insurance, at 20.1 percent.

Within the individual insurance category, we find that whole life policies are the biggest sellers, at 41.9 percent of the total. This is followed by endowment life insurance at 33.8 percent, and pension insurance at 17.4 percent.

In late 1999 and 2000, all major life companies introduced investment-linked and dividend products to whole life, endowment life, and pension life products.

Life and Property & Casualty Insurance by Premiums (1999) [%]



Source: CIRC quoted in Shanghai Insurance, April 2000

Regulatory Environment

The insurance market in China is heavily regulated. The principal regulatory agency is the China Insurance Regulatory Commission (CIRC), an independent commission subordinate to the State Council. The CIRC was created in 1998 out of the regulatory apparatus of the People's Bank of China (the Central Bank), which previously had authority over insurance. Staff for the new agency came largely from PICC.

CIRC is headquartered in Beijing. It has branch offices in provincial capitals throughout China.

Understanding Chinese Regulatory Strategy – A Key First Step in Approaching the Market

At present and for the foreseeable future, the key objective of regulation is to nurture the domestic industry by restricting the operations of foreign insurance companies and ensuring that foreign insurers transfer products, technology, and capital to Chinese competitors.

China has, or is expected to, enter into agreements such as the accession agreement to the World Trade Organization (WTO), under which it pledges to take certain steps to open up its market and relax restrictions aimed at foreigners. Our view is that – notwithstanding any agreements China may sign – its policies and actions with respect to opening its insurance market and relaxing restrictions on foreign firms will be determined strictly by the pace at which the domestic industry develops and becomes competitive. In other words, foreign insurance companies will be allowed to participate and develop in the Chinese marketplace only to the extent, and at the schedule, that Chinese authorities determine their operations to be beneficial – rather than detrimental – and to contribute to the development of China's financial sector. Foreign insurance companies are expected to be supportive of China's development strategy for the insurance sector. We will discuss the question of strategy in detail below.

Regulations and Restrictions on Both Domestic and Foreign Insurers

The regulatory framework for the insurance sector was codified in the "Insurance Law of China," promulgated in 1995.

The regulations governing both domestic and foreign insurers include the capital requirements for establishing an insurance company, approval requirements for opening each new office, specific approval requirements for each product and for initiating the sale of new products in different cities, approval requirements and restrictions on the investment of company funds, and restrictions on dealing in or holding foreign currency.

For foreign insurance companies, there are additional restrictions, as follows:

> Nonlife insurance

Approval is required to establish a representative office in China. The company must maintain a representative office in China for a number of years before applying to upgrade to a branch office. Foreign insurance company branches may only be establis-

The Chinese Insurance Regulatory Commission (CIRC) has authority over the insurance market

Foreign insurance companies will be allowed to participate in the Chinese market only if they are regarded as beneficial – and not detrimental – to China's financial sector

Regulations include capital requirements, approval for each new office, and defined insurance products

Companies must maintain representative offices before applying to upgrade to a branch office

hed in designated "open" cities (currently Shanghai and Guangzhou). After the branch is established, it is only permitted to write policies for foreign invested enterprises (not for Chinese enterprises), and only within the geographic area where the office is established.

> Life insurance

Since 1995, the Chinese policy regarding life insurance has been to require foreign life insurance companies to form joint ventures with domestic companies. Since 2000, that policy has been to limit foreign equity share to 50 percent. Management control must also be shared. As with nonlife insurance, foreign life companies (JVs) may be established only in "open" cities (currently Shanghai and Shenzhen). They may write policies only for individual clients within these geographic areas. They may not write group policies or stand-alone health or pension policies.

Foreign life insurance companies are required to form joint ventures with domestic companies

> Reinsurance

Foreign firms are currently excluded from the reinsurance market within China.

Chinese Regulatory Strategy and Trends

The legal and regulatory framework for China's insurance industry is codified in the Insurance Law of China, promulgated in 1995. The Insurance Law, like other PRC laws, allows for fairly broad interpretation and flexible application. Thus, while knowledge of the Insurance Law's tenets is helpful in forming a view of China's insurance industry, it is more important to understand the fundamental strategy and objectives of China's government, and to anticipate the actions of the sole insurance industry regulatory agency, the China Insurance Regulatory Commission (CIRC).

It is essential to understand the objectives of CIRC, rather than the Chinese insurance law, which leaves room for interpretation

The Chinese government's strategy for developing its insurance industry includes the following elements:

For the nonlife sector:

- > Increase the number of domestic insurance companies in order to increase competition and reduce the dominance of PICC
- > Allow foreign companies to enter the market to share risk
- > Develop the market through introduction of new products and technologies
- > Nurture a domestic insurance industry in the medium term that can withstand competition in a global marketplace.

For the life sector:

- > Develop the life insurance sector as a key component of China's financial system and as a source of long-term capital funds
- > Maintain domestic control of the life insurance sector and life insurance investment capital
- > Increase the number of domestic insurance companies to increase competition and reduce the dominance of China Life
- > Exploit foreign life insurance companies as a source of management know-how, product technology, and capital with which to build a modernized and competitive domestic life insurance industry
- > Ensure that, in the medium term, domestic life insurance companies can compete effectively with foreign competitors.

For the reinsurance sector:

- > Strengthen the role of reinsurance in order to promote the healthy development of the entire insurance industry
- > Ensure that China Reinsurance remains a dominant and competitive element of the system
- > Exploit foreign reinsurance companies and sources of management know-how, products, and technology in order to further the first two objectives.

Consistent with these objectives, we can observe the following trends in Chinese regulatory strategy:

For nonlife insurance:

- > Gradually allowing more foreign nonlife insurance companies to establish branch operations in China
- > Licensing more domestic and joint venture nonlife insurance companies.

For life insurance:

- > Licensing more domestic insurance companies (four new Chinese life firms that were given CIRC approval in October 2000 to begin formation) and opening the sector to entrants whose previous business was not insurance (e.g. CITIC, Minmetals, Sinochem, Dazhong Group)
- > Forcing major restructuring and management changes upon China Life, including possibly splitting the firm into regional companies
- > Forcing foreign companies into joint ventures without management control in order to realize technology transfer
- > Allowing foreign companies to take minority equity positions in existing Chinese life insurance companies (already the case with Taikang Life and New China Life) as a source of capital, products, and management know-how
- > Broadening investment options for life companies' funds to include equity and debt securities markets, either through intermediaries (currently securities investment funds) or inhouse (expected)
- > Creating diversified financial group companies under holding companies in which life insurance subsidiaries (wholly domestic and Sino-foreign JVs) are component parts.

For reinsurance:

- > Allowing China Re to form JVs with foreign reinsurance firms in order to gain management and product know-how
- > Gradually increasing access to the domestic market for foreign reinsurance companies.

Life Companies Approved During 2000

Chinese companies	> Minsheng Life	Approval: Oct. 2000	
	> Dongfang Life	Oct. 2000	
	> Shengmin Life	Oct. 2000	
	> Heng An Life	Oct. 2000	
Joint ventures	> Colonial Mutual-China Life, Shanghai	Approval: Aug. 2000	Foreign ownership: 49% (Colonia)
	> UK Prudential/CITIC, Guangzhou	Oct. 2000	50% (Prudential)
	> John Hancock-Tian An, Shanghai	Oct. 2000	50% (Hancock)
	> Sun Life-Everbright, Tianjin	Preparation	50% (Sun)
	> ING-Hua Tai	Preparation	50% (ING)
	> Generali - N/A	Preparation	50% (Generali)

Source: S.M. Harner and Company

Regulatory Strategy and the WTO

It is our experience that international agreements with China rarely achieve market-opening breakthroughs or significant regulatory "concessions." Rather, they tend to be documents that codify policies that China has decided to make in her own interest, but for which the negotiation process provided the opportunity to obtain a substantial quid pro quo. Nevertheless, the agreements on accession to the WTO signed in 1999 and 2000 with the United States and the European Union, respectively, represent significant progress.

Political agreements with China tend to result in documents decided upon by China

U.S. and EU agreements on market access with China (WTO Accession Agreements) relating to the insurance sector were (Source: China Business Review, July-August 2000):

U.S.-China Agreement

- > China will expand the scope of activities for foreign insurers to include group, health, and pension lines of insurance, phased in over five years
- > China will eliminate all geographic limitations in three years
- > China will permit foreign property and casualty firms to insure large-scale risks nationwide immediately upon accession
- > China agrees to award licenses solely on the basis of prudential criteria, with no economic needs tests or quantitative limits on the number of licenses issued.

EU-China Agreement

- > Scope of business expanded within two years to allow: health, pension, and group in life insurance and all nonlife activities except for statutory insurance
- > Opening of Shenzhen and Foshan accelerated

> Brokers allowed to handle large-scale commercial risk and reinsurance. These agreements primarily serve as reference points for establishing a strategy or building up a business as a foreign insurer in China. In reality, the regulation environment and the scope of what is possible are constantly evolving. Thus, the key to success is to understand and to think creatively about how to fit into China's strategy for its insurance industry. We will take this approach below.

Working Capital Requirements for Insurance Company Branches and Sino-Foreign Joint Ventures

PRC regulations stipulate that, when foreign insurance companies establish branches in China to engage in insurance business, they must place a security deposit equivalent to RMB 33.2 million (approx. US\$ 4 million) with the Central Bank. In August 1998, People's Bank of China (PBOC) further ordered that the head offices of insurance company branches operating in China allocate on a cost free basis working capital to the branch in an amount no less than RMB 100 million equivalent. PBOC further ruled that the security deposit should be no less than 40 percent of the working capital. This effectively raised the minimum security deposit amount to US\$ 4.8 million.

Regarding the establishment of Sino-foreign joint venture companies in China, Shanghai regulations require minimum registered capital of US\$ 20 million (roughly equivalent to RMB 166 million). This has been overridden by the requirement in the Insurance Law that such companies have minimum capital of RMB 200 million. In most Sino-foreign JVs, the foreign party takes 50 percent of ownership and hence is required to invest the equivalent of RMB 100 million.

Foreign insurance companies setting up a business are required to make a security deposit of US\$ 4.8 million

In most Sino-foreign joint ventures, the foreign party invests RMB 100 million

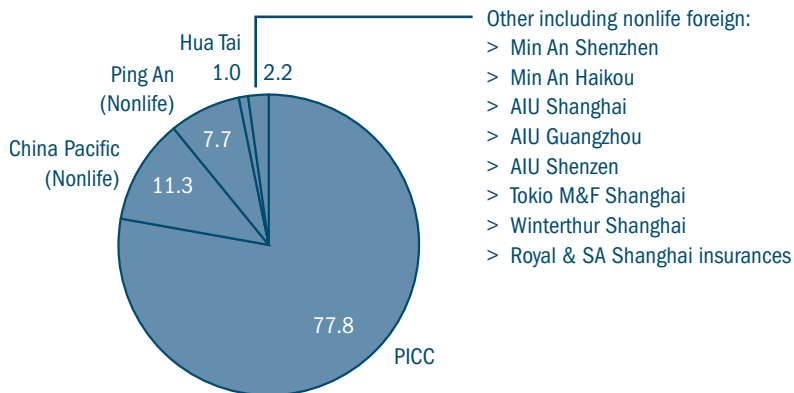
Competitive Marketplace Structure

Competitive Positions of Major Domestic and Foreign Players

The market positions of the companies currently active in China's nonlife insurance market are presented below. What is immediately apparent from this table is that three companies – PICC, China Pacific, and China Ping An – occupy virtually the entire market. In 1999 they comprised some 96% of the market. All three companies have licenses that allow them to operate nationwide. PICC still dominates the market. Underpinning PICC's dominance is its vast nationwide network of several thousand offices and staff of over 80,000. In many secondary, and, especially, tertiary towns and villages in China, PICC is the only service provider, giving it virtually a monopoly position. China Pacific's number two position is sustained by its strong base in Shanghai and Eastern China, a nationwide network of some 450 branches, and strong corporate ties owing to its origin as a department of the Bank of Communications. China Ping An had a network of 553 branches at the end of 1999, making it only the third truly nationwide service provider.

PICC, China Pacific and China Ping An comprise 96 percent of the market

China Nonlife Insurance Market Share (1999) [%]

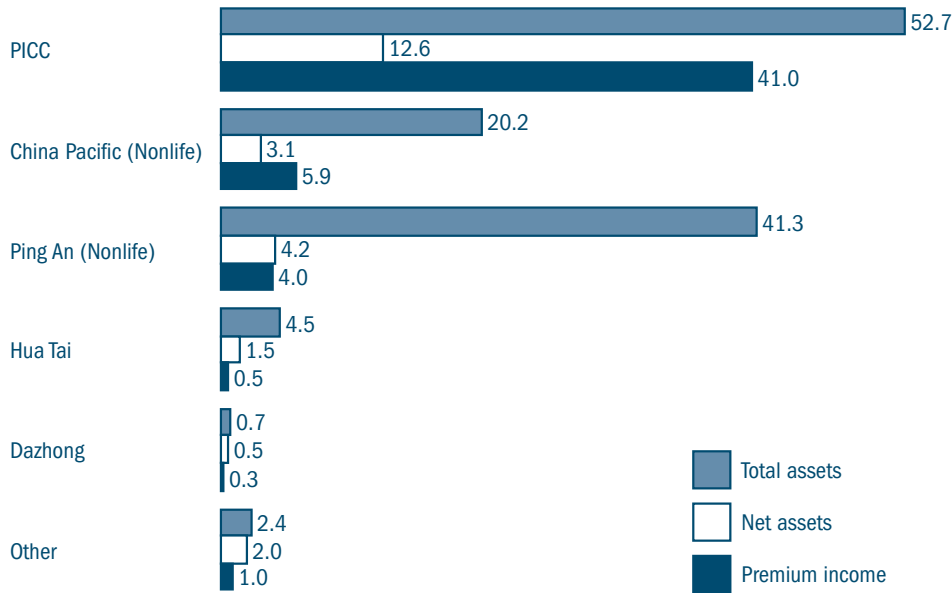


Source: CIRC and Industry

All other insurance companies outside of the "big three" have less than a handful or, in the case of all foreign companies (with the exception of AIU), only one, branch in China. Limitations on branches, along with geographical restrictions – especially against foreign firms – account for the paltry share held by other companies. Of course the poor showing of foreign firms is also due to restrictions on their market – i.e. limited to foreign invested companies only – and on the type of insurance that they may write.

Restrictions considerably limit the activities of foreign players

China Nonlife Insurance Market Ranking by Assets and Premium Income (1999)
[RBM bn]



Source: CIRC and Industry

PICC's Dominance in the State-Owned Sector

Apart from its broad market presence, the PICC's dominance is explained by its long history in the marketplace, and its "special relationship" with the vast state-owned enterprise (SOEs) sector. Senior managers of SOEs shoulder both business and political responsibilities. They are usually members of the Communist party and hold positions in government councils. By definition, they are responsible to government owners. This system of relationships and responsibilities ensures that the government-owned insurance vendor – PICC – is favored by the SOE sector. Since this sector is still the dominant buyer of property and casualty insurance, despite the growing importance of the private sector, PICC's preeminence as an insurance provider may eventually decrease.

PICC's dominance is based on its close connections with state-owned enterprises (SOEs)

It should also be noted that PICC is a "full service" provider with a complete line of products. PICC benefits from numerous technical exchanges and training relationships with foreign insurers and thus keeps up to date with product and market trends. PICC's products are as competitive as any other in the marketplace. PICC is an aggressive and competitive market player. In terms of pricing, it is a common complaint among foreign insurers that PICC is too aggressive in pricing risk, offering lower premiums than would be considered prudent by foreign insurers. This aggressive pricing has helped to bolster PICC's market position and make it competitive in the rapidly growing non-SOE market segments, particularly among foreign invested enterprises and private enterprises.

PICC is a "full-service" insurance provider with competitive products and aggressive pricing

In the nonlife sector, as in life, China Ping An is distinguished by its commercialized corporate and sales culture, by an aggressive, innovative marketing style, and by its rapid growth. China Ping An, with roots in the entrepreneurial south of China, has been most successful at nurturing relationships with China's dynamic and growing private corporate sector.

China Ping An, the third largest player in the nonlife market, is growing rapidly

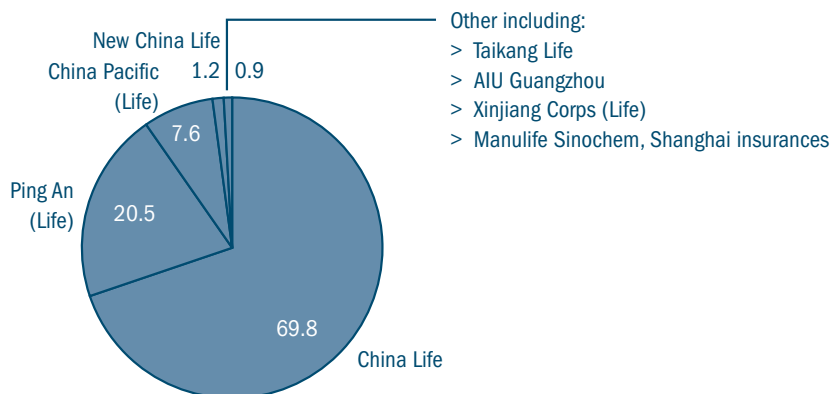
Key Life Market Statistics

Below, the market share data in the life market is shown. Once again, the most vivid impression presented by this data is the dominance of three companies – China Life, China Ping An, and China Pacific – and the insignificance of all others. Among the big three, China Life, with some 69 percent of the market in 1999, is clearly preeminent.

China Life was established as an independent life insurance company in 1996, when the comprehensive insurance business of PICC was split into the nonlife insurance (PICC), life insurance (China Life), and reinsurance (China Re) entities. This legacy explains China Life's vast organizational presence – 3,400 branches nationwide at the end of 1999 – and its dominant market position. This dominance is particularly pronounced in the group insurance market due to China Life's status as an SOE and its "sister company" relationship with PICC, the property and casualty insurer of choice in the Chinese corporate sector.

China Life, leader in the life market, profits from its status as state-owned company (SOE)

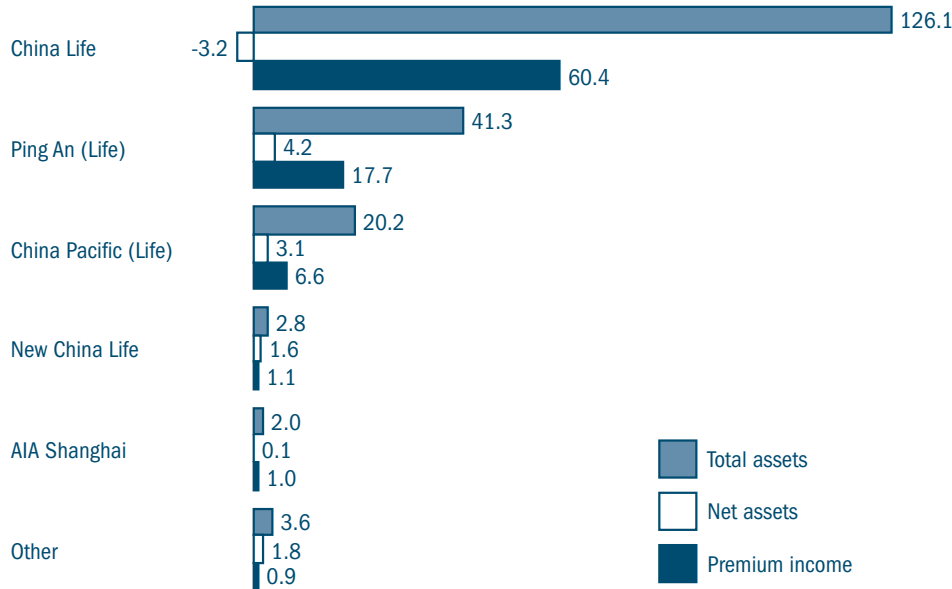
China Life Insurance Market Share (1999) [%]



Source: CIRC and Industry

In the life market, the second strongest company is China Ping An, which held a 20.5 percent share of the national market in 1999. It is followed by China Pacific, with a market share of some 8 percent. Among the other firms, only two, New China Life and AIA Shanghai, have more than a 1 percent share, and both had less than 2 percent in 1999.

China Life Insurance Market Ranking by Assets and Premium Income (1999) [RMB bn]



Source: CIRC and Industry

The Shanghai Market in 2000

The 2000 statistics for the two major life markets, Shanghai and Beijing, present a clear picture of how insurance companies in China are faring. The statistics for Shanghai, the market in which most foreign insurance firms are active, is given below. Total life premiums in Shanghai in 2000 were RMB 9.1 billion, or some 5.7 percent of the national total.

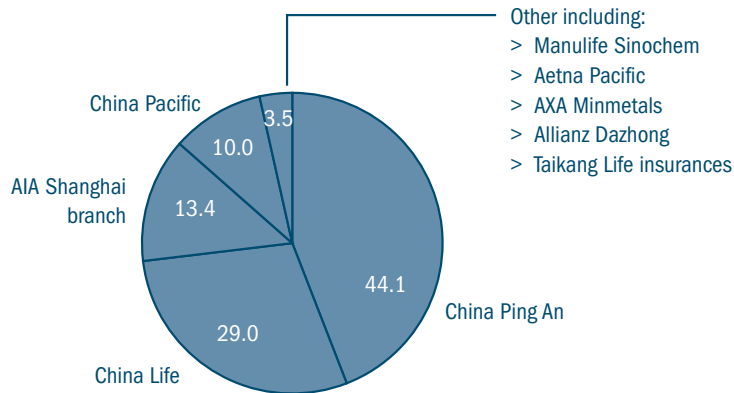
The two sets of statistics differentiate between the entire Shanghai life market – including group (where foreign companies cannot participate) and bancassurance sales – and the market for individual life sales (where foreign firms are allowed to participate). Individual life premiums totaled RMB 6.4 billion.

The data indicates that, for the market as a whole, the strongest company is China Ping An with a market share of some 44 percent. China Life is the next strongest competitor, with 29 percent of the market. Almost half of China Life's premiums came from group insurance, attesting to its historical (and still protected) strength in this market segment. AIA Shanghai Branch was third with 13.4 percent, followed by China Pacific with 9.98 percent.

In the Shanghai market, life premiums amounted to RMB 9.1 billion (2000)

China Ping An, China Life and AIA Shanghai Branch are the "big three" in the Shanghai life market

Market Shares of Shanghai Life Insurance Companies (2000) [%]¹⁾

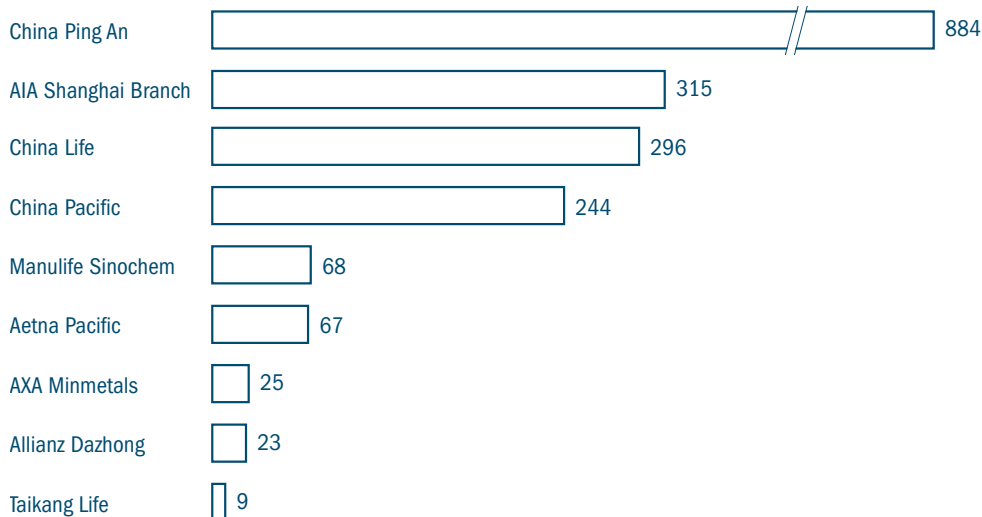


1) Including group and bancassurance

Source: Industry

To get a sense of current success and trends, we can look at new sales, which are reflected in the column for First Year Premiums. Here, we see a slightly different pattern than the above. Of the total RMB 2.04 billion in first year premiums in Shanghai, Ping An captured 49 percent, followed by AIA Shanghai Branch with 15.4 percent, China Life with 14.5 percent, and China Pacific with 11.9 percent. Foreign competitors are gaining market share in Shanghai, such as Manulife Sinochem and Aetna Pacific, each of which took about a 3 percent share.

New Sales in the Shanghai Market by First Year Premiums (2000) [RMB m]



Source: Industry

The Beijing Market in 2000

Nonlife premium revenues in the Beijing market in 2000 totaled RMB 3.232 billion, an increase of 13.2% over 1999. Nonlife premiums accounted for 34 percent of total insurance premium revenues, life premiums for 66 percent.

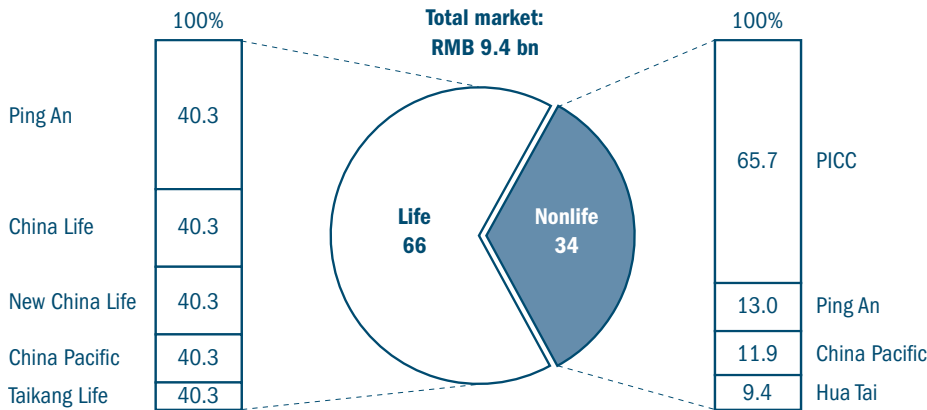
In 2000, the growing Beijing nonlife market totaled RMB 9.4 billion

The largest nonlife category of products was automobile insurance, with 70.2 percent of total revenues. Automobile premiums totaled RMB 2.27 billion, up 15 percent from 1999. It was reported that 44 percent of vehicles in the city, a total of 713,895, were covered by insurance. The average premium per vehicle was RMB 3,176.

Nonlife market share statistics showed PICC at 65.7 percent, followed by Ping An with 13 percent, China Pacific with 11.9 percent, and Hua Tai with 9.40 percent. Market share figures for the Beijing life insurance market are given below. There are no joint ventures or wholly foreign owned companies serving this market, but the two Chinese firms with 25 percent foreign investment, Taikang and New China Life, have their head offices in the capital city. The data shows that Ping An is clearly the market leader, with 40 percent of the total. The second largest player is China Life, with a 21.2 percent market share. Surprisingly, the number three is New China Life, with 18.4 percent, followed by China Pacific with 13 percent, and Taikang with 7.4 percent.

In the Shanghai nonlife market, PICC is clearly leading - Ping An is dominating the life market with China Life and New China Life the second- and third-largest life company, respectively

Market Shares of Beijing Insurance Companies (2000) [%]



Source: Industry

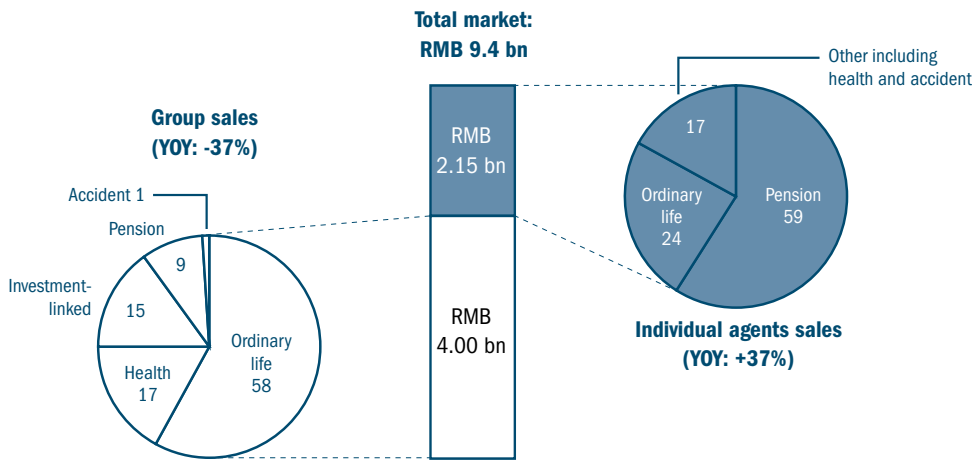
Trends in Group vs. Individual Sales

Total life premiums in Beijing for 2000 were RMB 6.2 billion (about 68 percent of the market in Shanghai). Looking at sales channels and segments, we see that premiums collected from sales to groups and through corporate agents totaled RMB 2.2 billion, or 35 percent of total premiums. Premiums collected through sales by individual agents totaled RMB 4 billion, approximately 65 percent of the total.

In the Beijing market, life products are increasingly being sold by individual agents

The dominance of the individual sales channel is a new phenomenon. In 1999, 53 percent of life sales were made through group sales, compared to 43 percent realized through individual sales. Thus, group sales was the dominant sales channel. In 2000, the market experienced a dramatic growth in life insurance sales, while group sales decreased.

Beijing Life Market Product Statistics by Sales Channel and Product Type (2000) [%]



Source: Industry

Differential Product Sales Growth Rates illustrate Market Trends

For sales through individual sales channels, the biggest-selling product was ordinary life, with RMB 2.3 billion or 57 percent of total sales. Coming in second at RMB 0.69 billion or 17 percent of sales was health insurance. This was followed closely by investment-linked and dividend policies with RMB 0.61 billion in sales, a 15 percent share. The last significant category was pension products with RMB 0.52 billion in sales, a 9 percent share.

Growth rates were highly differentiated between these products. By far the most rapid growth was in investment-linked and dividend policies, which were entirely new to the market in 2000. The fact that these products could capture over 10 percent of the market within a year's time is evidence that new products can gain quick acceptance among consumers. Growth for the largest product category, ordinary life, was fairly good at 12 percent. The sale of health-insurance products increased by a remarkable 56 percent. In contrast, sales of retirement products declined 11 percent year-on-year. The decline may be due to the shift in sales efforts by agents to new products – particularly investment-linked products – and away from typical retirement products. Also, with interest rates at around 2 percent per annum, implied yields on ordinary retirement products were not attractive.

Ordinary life, health, and investment-linked and dividend policies are the three main life products being sold by agents

Sales have increased particularly for investment-linked and dividend policies, and health-insurances products

Drastic Decline in Group Sales

For group sales, the largest product category was retirement pensions, with 59 percent of the total group product sales, or RMB 1.27 billion. The second largest product category was ordinary life which, at RMB 0.52 billion, accounted for 24 percent of total product sales. The key development in Beijing's group market was the drastic decline in sales in this segment. Sales of pension products declined by 35 percent year-on-year. Sales of ordinary life products declined by 56 percent.

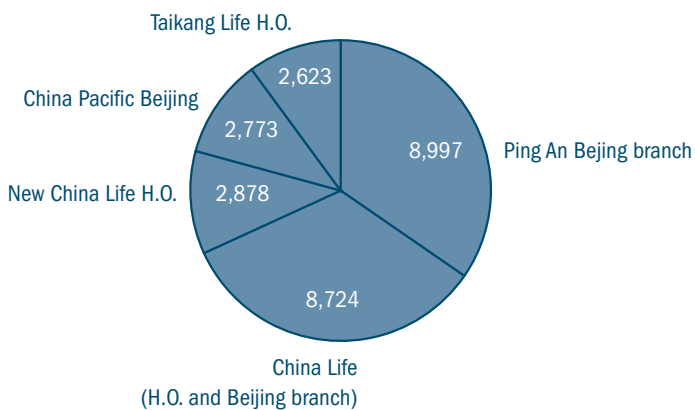
Three factors contributed to the decline:

- > This business primarily deals with Chinese state-owned enterprises (SOEs) which are restructuring and streamlining their operations. Chinese tax policy does not provide subsidies for insurance payments
- > Group products are old, standard, and lack innovative features
- > Insurance companies have had difficulty providing effective incentives for group sales staff. This has resulted in poor performance and high sales staff turnover.

The graph below presents the Beijing life market according to the number of sales agents from the insurance firms in the market. This figure shows the slightly larger number of agents at Ping An than at China Life, and the relatively small number of agents at other firms, as compared with these two leaders. Looking at sales performance, it is clear that China Life is overstaffed and unproductive compared with Ping An. Another interesting observation is that New China Life, with a sales staffing level similar to that of its peers, had significantly higher sales. This superior performance was achieved primarily in group sales, where New China Life led with 33 percent of the market.

Sales performance varies considerably between market players – New China Life is reaching higher sales with a staffing level similar to that of its peers

Sales Staffing in Beijing Market (December 2000)



Source: Industry

Key Strategy Issues

Key competitive strategy issues in the Chinese insurance market include market strategies, product strategies, organizational strategies, and regulatory strategies.

Market Strategies

There is very little market strategy differentiation among China's insurance firms, except for that which is historical legacy and mandated by regulations. History can shed light upon how PICC and China Life became leaders in nonlife and group life services, respectively, in the face of the state-owned enterprise (SOE) market. Both PICC and China Life are making every effort to expand beyond this traditional market to the non-SOE – that is, foreign invested enterprise (FIE) and collective or privately owned sectors – nonlife market, and to the individual life market.

While there is a general lack of clear differentiation, there are some exceptions. Ping An has placed greater emphasis on the non-SOE sector and on individual sales than PICC or China Life. This strategy, and a more nimble organization, has helped Ping An grow quickly in both the nonlife and life areas. New China Life appears to have recently placed greater emphasis on the group market (perhaps seeing an opportunity to win customers from China Life).

Restrictions have provided foreign firms with little opportunity to adopt distinct market strategies. Nonlife firms have been restricted to serving FIEs within Shanghai and Guangzhou. Life companies have been restricted to serving individuals in these locations and Shenzhen.

In the life market, all foreign firms are targeting the top-income earning segment of the population. People in this segment are clearly the most likely to buy insurance and to be receptive to a variety of products – life, pension, and health. This results in rather stiff competition between firms.

Product Strategies

CIRC seems to have adopted a "convoy system" approach to regulating the industry, similar to that which was implemented by Japan's Ministry of Finance with disastrous consequences. With this approach, CIRC is seeking to promote industry development by managing competition and preventing any one firm from getting too far ahead of the others. This means that approval for new products sought by one firm will only be given on a restricted basis or delayed, so that other firms will have time to catch up and introduce similar products. On the other hand, to give companies some incentive to introduce new products, CIRC purports to offer six-month "exclusive" approval to new products from any one company. Since minor packaging differences allow competitors to justify classification of a "copy cat" product as a new product, the effectiveness of this "exclusive" approval is debatable.

Similar to market strategies, there is not much differentiation among insurance companies in terms of product strategies. In general, all companies have – where possible – introduced similar products.

Market leaders PICC and China Life are making efforts to expand the SOE market

Ping An is placing greater emphasis on the non-SOE sector and on individual sales – New China Life appears to be focusing on the group market

CIRC is seeking to promote industry development by managing competition – a "convoy system" which led to disastrous consequences (e.g. in Japan)

This situation is to some extent a result of the regulatory approval process described above. It may also reflect the view among the companies that their marketplace – whether corporate or individual – is currently fairly unsophisticated and uneducated about insurance products and services, but it is becoming more knowledgeable. The correct approach under these circumstances would be to offer a full range of "basic," fairly unsophisticated products, while at the same time introducing more sophisticated products.

In the nonlife area, foreign companies have been the driving force and source of innovation in the Chinese market. This apparent paradox is explained by the fact that during virtually the entire decade of the 1990s, only AIU was actually active in the market and able to exploit its huge advantage in product variety and technology over local competitors such as PICC, Ping An, and China Pacific. All but a handful of the world's other leading nonlife companies were required to "contribute" to China in order to qualify for a license. The desired contribution was, in fact, the transfer of new product technology and management skills to Chinese companies.

AIU has striven to take advantage of its position by innovating and creating new products in the nonlife as well as the life area. In 2000, AIU introduced a new credit guarantee product that allowed foreign banks to begin purchasing receivables on a non-recourse basis from multinationals.

Until 1999, the primary life products offered by all companies were ordinary life, endowment life, and pension insurance. Yields were fixed and linked to the prevailing level of bank savings rates. Since 1997, in an environment of falling interest rates – to a low in 2001 of around 2 percent per annum – life products in the savings category have been a difficult sell. All companies have responded to the difficult market situation by combining health, hospitalization, and accident coverage of various types for policies. The typical life product is a hybrid of different type of coverage including life, savings, and accident.

China's financial markets are still relatively backward, but they are developing rapidly. Increasing complexity and sophistication, and a supportive CIRC, means that opportunities to introduce new products are ever-present. In late 1999, a "new era" began when CIRC allowed Ping An to introduce an investment-linked life product on an "experimental" basis. The "experiment" was a fantastic success as consumers were delighted to have a product that offered investment features that were to some extent tied to the securities markets, instead of merely being a protection or savings vehicle. In 2000, all life companies introduced products with an investment yield feature that was either "investment-linked" or "dividend."

Investment-linked policies feature a discrete investment "account" for policy holders into which premiums (net of costs) are paid. The company invests funds from the account and provides policy holders with a periodic report of investment performance. As of March 2001, choices of investment-linked accounts are limited to three: purchase of government and certain other bonds; placement in commercial bank deposits; and indirect investment in the securities market through placement in securities investment funds. In March 2001, CIRC issued regulations allowing insurance companies to place up to 100 percent of investment-linked policy funds in any of China's three dozen or so securities investment funds.

Foreign companies qualifying for a license bring considerable product know-how and management skills into China

Yields are linked to bank saving rates – because of low interest rates, hybrid insurance products are increasingly being sold

The introduction of investment-linked policies by Ping An in 1999 was a milestone

Dividend policies provide a return to the policy holder based on the business performance of the insurance company. Policy holders are not provided with discreet investment accounts, and the derivation of the performance yield is considerably less transparent than for investment-linked products.

All local life companies and several foreign companies offer what are in essence endowment life products packaged as policies that will provide for children's education or marriage.

Pricing Strategies

The Chinese market for most products, including insurance, is highly price sensitive. Product pricing is subject to approval by CIRC. CIRC establishes pricing standards based on risk. Companies are allowed to set prices within a limited range. Generally, pricing strategy plays a minor role in overall company strategies, and there seems to be little effort to distinguish themselves in this respect.

Because of price sensitivity in the market and pricing regulation by CIRC, pricing strategies have played a minor role so far

Distribution Strategies

Distribution strategies of both Chinese insurance companies and foreign companies appear to be largely similar. They include – particularly for nonlife companies – sales staff and sales through agents.

Agents have been very successful in individual sales

Among foreign nonlife firms, AIU, Winterthur, and Royal Sun all make extensive use of agents. (During their first year of operations, Royal Sun tried to avoid using agents and to do all selling directly. This strategy was abandoned during the second year, when they began to recruit and train many agents.)

Chinese life companies combine corporate agents (such as travel agencies) and large individual agent forces with in-house sales staff for both group and individual customer sales. Individual sales have been most successful, and the leading individual life company, Ping An, has the largest individual sales force (see Beijing market statistics). All foreign companies rely heavily on individual agent sales forces.

> Foreign Relationships

Foreign nonlife companies typically obtain some business in China through referrals or contracts made outside China by these companies' head offices. This is typical of large multinational relationships that are controlled by a global service contract basis at the head office level.

Foreign nonlife companies can obtain business outside China at the head level

> Bancassurance and Brokers

All of the large Chinese life companies, as well as PICC and several of the nonlife companies, have attempted to distribute products through bank tellers, with the banks acting as agents. The performance of bancassurance has generally been disappointing. PBOC regulations currently prohibit any bank branch from acting as agent for more than one life insurance company and three nonlife companies. This restriction has complicated the use of the bancassurance channel by new foreign life entrants.

Restrictions are a major hindrance to sales through bank tellers

More foreign insurance companies are expected to seek to sell products through bank channels. AIU has been the first to establish relationships with banks, for example Guangdong Development Bank (for all Shanghai branches), Bank of Communications, Shanghai Branch, and with Bank of China, Shanghai Branch. AIG has also signed a

comprehensive cooperation agreement with Bank of China head office in Beijing. Apart from agency sales agents, banks can offer direct debit services for insurance premiums and dividend payment facilities.

There are currently three licensed insurance brokers in China. These companies appear to be experiencing difficulty explaining their role and selling their services. Insurance brokers do not present a significant distribution channel as yet. This could change in the future.

> The Internet

All domestic and foreign insurance companies have established websites. An independent website, ebao.com, functions as a kind of department store, where all insurance products are displayed by product and company. ebao.com does not allow direct commerce. After viewing information about a product, users can click a button that prompts a direct call from one of the company's sales agents.

ebao.com is a very useful way for consumers to compare product features and to learn about new products. However, it is difficult to predict whether it will be a commercial success, as it has been in business for less than a year to date.

The development of sales through websites is still unpredictable

Advantages and Disadvantages of Market Entry Alternatives for Foreign Firms

Nonlife Branches

In the nonlife sector, foreign firms are permitted to establish branches, and all foreign firms have chosen this method of market entry. Clearly, a branch provides the desired advantages of ownership and operational control. The only disadvantages are Chinese regulatory restrictions. Branches are subject to certain working capital requirements as noted above.

In the life sector, foreign firms have been and will continue for the foreseeable future to be offered two alternatives for market entry:

- > Setting up a Sino-foreign insurance joint venture with a Chinese entity, in which the foreign partner's equity share may not exceed 50 percent; or
- > Investing in a Chinese life insurance company, with the foreign equity share not greater than 25 percent. 25 percent foreign equity is the threshold above which foreign-invested enterprises are officially designated "Sino-foreign joint ventures" and become subject to various regulations and restrictions directed specifically at these types of companies.

Life Joint Ventures

Most foreign companies have chosen to establish Sino-foreign JVs, and to invest a minimum of RMB 100 million to claim 50 percent ownership.

An advantage to this mode of entry could be that the foreign partner is effectively in control of the joint venture, and therefore able to direct strategy and operations. We can expect this if the Chinese partner is a non-financial company, as is the case with the Manulife and Sinochem joint venture. This may also be the case with the JVs with Chinese financial groups, such as between Sun Life and Everbright.

The main disadvantages of the joint venture approach are the geographic and market restrictions put on Sino-foreign JVs, as compared with exclusively Chinese companies. It is expected that geographic restrictions on Sino-foreign JVs will be removed by January 1, 2003. Other restrictions are expected to be removed by 2005.

Minority Stakes in Chinese Life Insurers

This is the approach already taken by Zurich Insurance and Winterthur Insurance in their 10-15 percent investments in New China Life and Taikang Life, respectively.

The principal advantage of this approach is that the foreign company is investing in a company with a national license – thus accessing a nationwide market (at least to the extent of the investee's network). Also, the amount of the investment is likely to be substantially less than that required to finance a new joint venture company.

The principal disadvantage of this approach is that the foreign partner(s) have very little control. The degree of influence they buy with their equity probably depends on the relationship of the parties and what else the foreign partner is prepared to provide besides equity capital.

For foreign companies, regulations allow two alternatives for opening up branches

The first stage in remaining restrictions on Sino-foreign joint ventures is expected in 2003

Zurich Insurance and Winterthur Insurance hold minority shares in Chinese life insurers...

Substantial Non-Equity Contributions

Both Zurich and Winterthur are bringing substantial non-funds resources to their investments. They will provide extensive staff training; help the companies introduce and manage systems; assist the companies to develop and launching new products, including offering some of their own products.

Zurich and Winterthur hope to be able to increase their equity positions in New China Life and Taikang to over 50 percent at some point. If they are able to do this, their minority shareholding approach may prove to be a smart competitive strategy.

...which they plan to eventually increase

Prospects for Market Development through 2005

The Chinese market for insurance should change significantly during the next five years and grow substantially larger, as indicated above. More importantly, the accessibility of the market for foreign companies will improve dramatically.

As suggested above, China's regulatory philosophy is that foreign firms should play a supportive role in the development of China's financial system and marketplace. This means that we need to understand and predict the major trends in China's domestic marketplace, particularly among the key domestic companies in order to predict what opportunities will be open to foreign firms.

Predicting the major trends in the Chinese marketplace is the basis for predicting business opportunities for foreign firms

Restructuring and Strategic Initiatives by Domestic Companies

During the five years through 2005 we can expect the following changes for domestic insurance companies and in the regulatory environment:

- > The possible division of China Life (and perhaps PICC) into independent regional companies
- > The listing of Ping An's life and nonlife companies, creating a major rival for China Life and PICC as well as the listing of China Pacific
- > Establishment of numerous new life and nonlife companies. In October 2000, it was reported that CIRC had approved the establishment of four new domestic insurance companies, which will be to be set up as shareholder corporations of domestic sponsors. The companies involved are Minsheng Life Insurance Shareholding Company, Dongfang Life Insurance Company, Shengming Life Insurance Company, and Heng An Life Insurance Company. All of these would be expected to seek foreign partners in 50-50 JVs, or to accept minority foreign investment
- > Establishment of in-house asset management departments within Chinese life companies with CIRC approval
- > Further integration of financial service groups, wherein insurance can be sold by bank and securities agents
- > Further opening of the securities market for the investment of insurance funds, especially life company funds
- > Increasing opportunities for the introduction of variable insurance products and annuities
- > Possible change in tax laws to provide tax incentives for private pension insurance
- > Initial approval and opportunity for life companies to provide asset management services for corporations and government institutions, including public retirement funds.

Key Changes Impacting Foreign Companies

The following are major changes in the environment for foreign insurance firms that we can expect to occur through 2005.

For nonlife companies:

- > Geographic restrictions will be removed in two stages: for twelve major cities (including Beijing, Chengdu, Dalian, Suzhou, Wuhan, and Tianjin) by 2002; for all other cities by 2003. However, we can expect that CIRC approvals will be requi-

red before operations can begin. This will slow down and prevent foreign companies from descending en masse upon any one location

- > By 2004, foreign companies will be allowed to provide insurance for the full range of nonlife services to both foreign and domestic clients. However, only those insurance companies with licenses will have access to this market.

For life companies:

- > Geographic restrictions will be lifted within the same timeframe and under the same conditions as for nonlife companies. We would expect the same restrictive approach for the issue of licensing in each location
- > Foreign insurers will be permitted to offer health insurance by 2004 and offer group and pension/annuities insurance to foreigners and Chinese by 2005
- > Many more potential insurance JV partners will emerge, and form insurance JVs. As noted above, in October 2000, four new domestic life companies were approved by CIRC. Lacking capital and know-how, all are potential partners for foreign firms
- > Capital requirements will be increased for those foreign companies seeking to establish significant in house asset management capabilities
- > Capital restrictions will keep the development of a domestic asset management industry mainly in the hands of large Chinese institutions.

Reinsurance:

- > China will license a small number of branches to provide reinsurance services for life and nonlife insurance
- > China will encourage and license a small number of Sino-foreign joint venture companies in the reinsurance field. China Re will be one joint venture partner
- > Notwithstanding the above, the 20 percent reinsurance quota for China Re is expected to remain in place.

Potential Strategies for Market Development and Profitability for Foreign Companies

In light of all of the aforementioned facts, the question is: how can and should a foreign company position itself to take advantages of the Chinese market in the future?

The answer to this question depends on the one hand upon the specific strategies of the company. On the other hand, there must also be a realistic evaluation of the alternatives available. What are these alternatives?

Alternatives for Product Focus

In the nonlife sector, there seems to be considerable scope for launching new products. The issue for foreign companies is whether to pursue a comprehensive product strategy, or one more focused on market niches, or both. The current market leader, AIU, is considered to be pursuing both, but later market entrants may find it prudent to focus on niches. In the life area, the same choice must be made. In years to come there will most likely be considerably more scope – perhaps necessary for competition – for a "niche" product approach.

Pension and health-related products will be a major area of new opportunity and competition in the future. In general, we would expect niche approaches to be the most effective way to take advantage of these opportunities.

Alternatives for Market Focus

In the nonlife sector, the market has been severely restricted for foreign companies. In future, the market will be virtually unrestricted, offering a broad range of alternative strategies. In the life sector, foreign firms have routinely targeted the high income earning sector of the population. Competitive pressure and opportunities for rapid growth are strong arguments in favor of efforts to develop the middle and, even, low-income sectors. Such development will require a change in distribution strategy.

Alternatives for Distribution

The individual agent method of distributing life insurance has been reasonably successful for market leaders, but its high cost inevitably restricts it to the top earnings bracket. In other words, companies whose distribution has been based on individual agents, have been forced to pursue a narrowly targeted market segment: top income earners.

The company or companies that find a cheap and effective distribution model in China – and are thereby able to adopt a more broad-based market strategy – could reap substantial benefits. It is uncertain whether bancassurance in its current form in China is such a model. Most likely, a successful model will be one that is developed locally and that has "Chinese characteristics."

Alternative Entity Structures or Approaches

In the nonlife sector, we see opportunities for expanding in China through alliances and even the full acquisition of Chinese companies. Foreign companies with a long-term strategic perspective are advised to begin positioning themselves to take advantage of these opportunities.

AIU, current market leader among foreign nonlife players, is offering comprehensive products and focusing on niches at the same time

Developing the life sector for the middle and low income population appears to be a feasible option

Finding an inexpensive and effective distribution model will reap considerable benefits

Mergers with Chinese companies will be preceded by alliances

The trend toward financial and large corporate groups that are organized under holding companies will create openings for alliances and new insurance entities within these groups. It is very likely that China will permit the effective merger of life and nonlife insurance firms in due course. Such mergers will be preceded by alliances.

A good example of such an alliance is that of AIU and Ping An insurance. In February 2001, the two companies signed an agreement to mutually introduce customers and cooperate in other ways. AIG is likely to be an investor in Ping An nonlife equity issues abroad.

As mentioned above, in the life sector the two entity structures currently available to foreign companies are 50-50 joint ventures and a maximum 25 percent investment in Chinese insurance companies. In the future, we expect to see alternative structures made possible. For example, the foreign share limit in Chinese insurance companies is likely to be raised to 50 percent.

Alliances and licensing-type arrangements could prove to be valuable alternatives in a more competitive and crowded marketplace. Chinese insurers will increasingly strive to develop internationally, especially in Hong Kong and Southeast Asia. Alliances that comprise activities both within and outside of China may be particularly attractive to Chinese parties, and therefore yield greater advantages for the foreign firm within China.

Key to Success: Taking a Creative and Strategic Approach

We believe that the most successful companies in China will be those that adopt a creative and forward-looking strategic approach. Companies should avoid imposing a priori models or constraints on their thinking about how to develop business in China. Also, they should avoid taking a backward-looking, regulations-oriented approach.

The reality in China is that circumstances continue to change dramatically, even within a few years time. Chinese regulators are accustomed to pragmatically adapting to change by interpreting regulations broadly, or even disregarding regulations that are clearly inappropriate under current circumstances when considering actual cases and requests from market participants.

The pragmatic approach of regulators presents the greatest opportunities for companies who decide on specific goals, a reasonable strategy to achieve them, and work with the regulators for necessary approval. This has been the approach of AIG in China. Of course, if regulatory decisions are made pragmatically and not necessarily "by the book," it means that political influence can play a decisive role. This suggests that successful companies must also learn how to become more politically effective in China. Often, the best (or only) way a foreign firm can exert effective political influence is if they create an alliance of interests with a politically strong local partner. In this respect, China is no different from many other countries. This suggests that alliances with local interests will be a key factor in the future development of the Chinese market for many foreign firms.

Successful foreign companies must learn how to become more politically effective in China

The Author



Stephen M. Harner is an authority on financial services in China and Japan, having been a practitioner and scholar in the field over the past 25 years. In the 1980s and 1990s, he held management positions in commercial, investment and private banking with Citibank and Merrill Lynch in Japan and Taiwan. He established Deutsche Bank's office in Shanghai in 1995 and served as its Chief Representative for four years. He is author of two highly acclaimed books, "Japan's Financial Revolution and How American Firms are Profiting" and "China's New Political Economy – Revised Edition", as well as many articles appearing in leading publications. Currently, Harner is working with Roland Berger Strategy Consultants as a Senior Advisor for financial institutions in our offices in Shanghai and Beijing and teaching financial management courses in two of the best universities in China. He is also author of the Roland Berger Study "Business Opportunities for Foreign Financial Companies in China's Changing Marketplace".