Preface

The history of modern insurance in China is relatively short. In 1805, the first foreign insurance firm, the Canton Insurance Society, was established by British and Indian businessmen in Guangzhou. Seventy-one years later, the first Chinese domestic insurance company was founded. The Chinese insurance market was dominated by foreign insurers until the mid-twentieth century, and the primary objective of the insurance business was to support foreign trade.

In 1949, the People's Insurance Company of China (PICC) was established, and the following ten years saw the nationalisation of the Chinese insurance industry. After reorganisation, PICC became the only insurance company in China, with 600 offices and 50,000 employees operating nationwide. Meanwhile, foreign insurers were completely excluded from China.

In 1979, the State Council approved the revival of domestic insurance operations, and the Chinese insurance industry experienced a period of rapid development in the following two decades. The PICC restored its business operations, including various types of casualty insurance, life insurance, liability insurance, credit insurance, agricultural insurance and reinsurance. It was the only authorised insurer till 1988 when China Merchant Steam Navigation formed the Ping An Insurance Company, followed by the China Pacific Insurance Company and Xinjiang Agricultural Insurance Company in 1990. Since then, domestic competitors have entered the market, challenging the monopoly power of PICC.

In March 1995, the China People’s Banking Law was implemented, establishing supervisory mechanisms for the financial sector and providing a legal basis for supervision of insurance companies. Later, in June, the Insurance Law was enacted, which contained detailed provisions governing insurance companies, insurance contracts, insurance management, insurance industry oversight, and the operations of agents and representatives. In 1996, to reduce monopoly power and to increase competition, the PICC was reorganised into three specialised subsidiaries, the People’s Insurance (Life) Company Limited, the People’s Insurance (Property) Company Limited, and the People’s Insurance (Reinsurance) Company Limited. In order to separate the regulatory and business functions of government, the control power of the People’s Bank of China over the
insurance industry was eliminated and transferred to the newly created China Insurance Regulatory Commission (CIRC) in 1998. The CIRC was empowered to formulate policy for the insurance industry, to enforce law and regulation, to supervise business practices, to protect the rights and interests of policyholders, and to establish a risk evaluation system.

Since then, the rapid growth of the Chinese insurance industry has been attracting serious attention worldwide. From 1999 to 2008, the total value of premiums increased from RMB 139 billion to RMB 978.4 billion, or by 602 per cent within ten years. Total assets increased even faster, rising from RMB 272 billion to RMB 3342 billion, or more than elevenfold in a decade. To enhance the efficiency of asset management, the China Securities Regulatory Commission (CSRC) removed the restrictions on the investment channels of Chinese insurance companies gradually, allowing them to invest directly in stock markets. By the end of 2007, the balance of ‘insurance fund usage’ had reached RMB 2.67 trillion, increasing by 37.2 per cent year on year. Investment income of the insurance institutions totalled RMB 279 billion, representing a 12.17 per cent return of the fund employed. In 2007, total profits of the insurance industry reached RMB 63.34 billion, increasing by 558.9 per cent year on year.

On 11 December 2001, China successfully ended a 15-year-long process of negotiation and joined the World Trade Organisation (WTO), signifying that China will continue to be a key player in the global economy and may face unprecedented challenge in the financial realm. By the end of 2007, China was home to 110 insurance companies including 43 foreign firms. If classified by main business activities, 42 insurers were property-liability (PL) insurance firms, 54 were life insurance firms, and six were reinsurance firms. Apart from main companies, there were ten insurance assets management companies and also 2331 professional intermediaries. The total employment of the insurance industry reached 2.57 million in 2007. Having increased by 4.4 per cent since 2002, foreign companies held 5.9 per cent of the Chinese insurance market in 2007, generating revenue of RMB 42 billion, 9.1 times higher than in 2002. In addition to welcoming foreign strategic investment, Chinese insurance companies were encouraged to ‘go out’. By the end of 2007, 42 branches and nine insurance agencies or liaison offices had been set up overseas.

In the meantime, the Chinese insurance intermediary market has expanded rapidly. In the early 2000s, the intermediary service was mainly limited to insurance consultation provided by some small firms, and its influence was insignificant to the overall market. In 2001, less than 1 per cent of premium income was contributed by insurance agencies, compared to 60–70 per cent in some developed insurance markets. Since then, these professional intermediaries have improved their business operations and
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profitability rapidly. By the end of 2007, 2331 insurance intermediaries and seven foreign ones had been approved by the CIRC, of which 254 were insurance appraisal institutions, 322 brokerages and 1755 agencies. Having increased by 29.4 per cent year on year, the premium income of the professional intermediaries was RMB 579.4 billion in 2007, representing 82 per cent of the total income. Premiums realised by insurance agencies increased by 51 per cent to RMB 19 billion, accounting for 2.7 per cent of the national income.

The structure of Chinese insurance companies had also gone through a fundamental restructuring. In order to establish a modern insurance enterprise system, all the Chinese insurance companies, except export credit insurance companies focusing on policy-oriented businesses, had been transformed into joint stock companies. In addition, the insurance industry also took the lead in overseas stock market listing. On 6 November 2003, the PICC’s Property and Causality Company Limited was listed in Hong Kong, raising HK$6.22 billion of share capital. On 17 and 18 December 2003, the China People’s Life Insurance Joint Stock Corporation Limited became the first financial institution listing in both New York and Hong Kong simultaneously, while the later Initial Public Offering (IPO) of Ping An Insurance (Group) Company inaugurated the stock listing in the form of group companies. In early 2007, both China Life Insurance Company and Ping An Insurance Company returned to the Shanghai Stock Exchange (SSE) A-share market successfully. And later, on 25 December 2007, the Pacific Insurance Group launched on the SSE, further enhancing the financing capacity of Chinese insurance companies. By the end of 2007, the combined market capitalisation of these three biggest Chinese insurance companies reached RMB 3 trillion, accounting for more than 10 per cent of the total A-share market value. It is worth noting that, in October 2007, market capitalisation of China Life Insurance had reached $257 billion, making it the tenth largest company and the biggest life insurance company in the world in terms of market value.

However, development of the Chinese insurance market is still quite imbalanced in different regions. In 2007, insurance premiums in 16 eastern and coastal provinces were RMB 434 billion, representing 62 per cent of the total premium income. It clearly indicates that the development of the insurance business is ultimately determined by the local economic level. This explains why foreign insurance companies concentrate on developing business in coastal areas rather than expanding towards the inland provinces. The unfavourable geographical environment together with the low economic level result in low saving rates, low risk awareness and finally low demand for insurance in western China.
Moreover, if compared with the insurance income of other developed nations, the Chinese insurance market is still much underdeveloped. In 2006, Chinese insurance market volume was less than half of that of Italy and, if we consider the population, the situation is even worse. The per capita insurance expenditure in China was about $75, while the figure for some industrialised nations was more than $3500. The US and UK have less than 7 per cent of the global population; however, these two alone account for 42 per cent of world insurance. Other emerging markets generated only around 10 per cent of world insurance premiums with over 85 per cent of the world population. In 2007, China’s insurance premiums increased by 25 per cent over 2006, accounting for 2.8 per cent of the country’s GDP.

After China fully opens its insurance market, the domestic insurance companies will face increased pressure imposed by experienced foreign insurers. In 2006, foreign insurance companies achieved a premium income of RMB 2.6 billion, accounting for 4.6 per cent of the market. However, in some big cities like Beijing, Shanghai and Shenzhen, their market share has reached 21.2 per cent, 19.1 per cent and 11.9 per cent respectively. It has been predicted that, by 2010, the market share of foreign insurance companies could reach 10 per cent. To survive and to profit, Chinese insurance companies need to maintain their competitive strength and learn from their foreign competitors. Therefore it calls for the necessity of studying the efficiency of Chinese insurance companies.

Efficiency refers to a firm’s ability to maximise output (such as premiums and investment income) for a given set of inputs (such as labour and capital), or to minimise the use of inputs given a set of outputs. It has always been a key concern for insurance companies to be competitive in the market. Measuring performance and efficiency can bring about a behavioural response in the organisation and this in turn can lead to changes in performance. Benchmarks can be identified by efficiency measurements and, by emulating the best practice in the industry, insurance firms can be better prepared to face the change in the environment. Examination and exploration of efficiency issues also help policymakers regulate the insurance market more effectively.

This book is the first study in the English literature to address the efficiency issues of the Chinese insurance industry. We try to identify which insurance companies are the benchmarks in the Chinese insurance industry as measured by technical efficiency. Where do the efficiency gaps come from? What factors are influencing the technical efficiency of insurers? And what strategies and policies can be applied to improve efficiency? The benchmarks identified in this study can be different from those obtained with other ranking techniques but it will clearly indicate areas in which an
inefficient insurer can emulate a benchmark in order to improve its own performance.

In our study, we first adopt the non-parametric approach, DEA, to measure efficiency. This method was first developed by Charnes, Cooper and Rhodes in 1978 based on linear programming. It is particularly useful in identifying the reference set for inefficient observations for further improvement, and it imposes less restriction on input and output variables. However, DEA technique cannot statistically identify relationships between input and output variables and other factors that may affect firm efficiency. Therefore, a correlation analysis between DEA and SFA results is applied to check the robustness of the DEA results as well.

We use a panel dataset consisting of 22 insurance companies over 1999–2004 and adopt a unique approach to define DEA output variables. One model chooses total income as output while the other uses the sum of claim payments, additions to reserves and incurred benefits (RSRB) as output. The separation of these two outputs avoids conflicting results, as some insurers may prefer lower RSRB if they manage the same income. The tested average efficiency scores are 0.743 and 0.575 for property-liability (PL) insurers and life insurers respectively. In the PL insurance sector, PICC and Hongkong Mingan achieve full efficiency consistently over six years, while in the life insurance sector Xinghua and AIA outperform other insurers continuously.

Domestic insurers are found to enjoy scale advantages over foreign and joint venture insurers. With wider network distribution and a longer operation history, domestic insurers are able to generate more premium income and provide more risk sharing and bearing services to the public. However, these advantages will be weakened after the removal of geographic and operational restrictions on foreign or joint venture insurers. Facing tough competition, domestic insurers need to strengthen their performances in areas like investment income generation and asset–liability management.

The results of SFA show that ownership structure does not affect the efficiency level of Chinese insurance companies. State-owned insurers have been transformed into modern enterprises with well-established corporate systems. Compared with capital resources, labour is a more important input in the insurance output production process. However, the educational background of employees does not influence efficiency significantly. A truly influential factor is the size of the firm. Both DEA and SFA models indicate that half of insurers need to expand their scale in order to improve technical efficiency.

Apart from the managerial implications, this book also contributes to the methodology of efficiency studies on insurance companies. It is the first
attempt to examine insurance efficiency, with two efficiency measures and two output models which separate insurers’ income generation activities from risk sharing and risk bearing activities. The approach itself enhances the robustness of empirical results.

Large-scale reforms in the Chinese insurance industry have just begun. Efficiency issues will attract more attention as the reforms deepen. This book is the first piece of study on this critical topic. Although the DEA results have provided useful implications on efficiency improvement, the impact of price changes has not been considered in the technical efficiency analysis. When price information becomes available, cost efficiency and profit efficiency analysis can be conducted to give more information about the efficiency status of insurers in China.