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Cheap isn't the way to go

The approach used for other products—selecting on the basis of price—may be flawed when it comes to buying an insurance product

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I had an interesting conversation with a friend of mine quite some time back, who is into investing in companies. This conversation was about the insurance sector specifically. We were debating on why an insurance company should make underwriting profit, if it has a business model which serves the company well, builds a good brand and reputation, which survives over hundreds of years.

His view was that burning cash is good and he gave an example of ride-sharing/cab companies that were initially burning cash, by which they destroyed the competition such that they were the only ones standing. After this, they upped the price of their offering, higher than what it was and that is how they were able to make money. This is what the game is he said, that you burn cash, build an ecosystem, drive out competition and then make money, & that is why it made sense to burn cash. And I thought that is good for an industry if let's say, by doing so you become a winner that takes it all. Then I was thinking for the insurance industry, and specifically speaking of General Insurance, no market in the world has a winner takes it all scenario that has played out. There is typically a wide spread amongst players in terms of market share, positioning, and other factors. Its typically a multidimensional, multifaceted market!

I was thinking that will burning cash, lead to a winner takes it all environment, and the more I thought about it, especially looking at our industry I observed something very significant. A few large organisations that were market leaders a few years ago are now struggling to cope because of their inability to operate with underwriting profits! As a result, they were losing market share as well, and struggling with their solvency margins, in fact in a few scenarios even below the level prescribed by the regulator. Some of the new players that entered the market about 10 years ago, also attempted to burn cash and lower prices in a bid to acquire customers. Now, these organisations have either been sold out or are on the verge of being sold out! I thought to myself why was this the case.

Let's say as a customer is buying a car, and the two cars being compared are similar products, and if one is cheaper than the other, the customer is getting a better deal and would not think about the fact that which company is burning cash etc. before deciding to buy the inexpensive offering. Even a mobile phone for that matter. If someone gives the same mobile on XYZ site at a cheaper price, the customer would be more than happy to opt for it rather than buy it from another site/seller. But why does it not make good sense for the customer to buy cheaper insurance then? Insurance is however very different from products and services we otherwise consume, in the insurance business the product is not available when you are paying the premium, because the product is Claims! So fundamentally when you are paying the premium, the comparison on price does not make a lot of sense and ideally it should not be the only criteria for selecting an insurer. If you look at a cheaper product, then that is exactly what you will get a "cheap" product. When the claim happens, you will realise that if you have gone for one of the companies that are burning cash and wooing you with a low price, will more often than not have a below par claim settlement ratio, lower speed of claim settlement; they reject more claims and, as a result, have higher grievances from their customers. This can be clearly seen as this data is published by the regulator. There is a direct correlation in the way an organisation looks at risk-based pricing and their capability to service their customers in the times of their need, i.e., claims, the moment of truth for the product when it comes to insurance. It is hence clear that the approach used for other products when it comes to selecting on the basis of price, may be flawed or not the best approach when it comes to buying an insurance product.

Customers must realise that organizations without sufficient cash flows and adequate solvency often cut corners, especially on claims. To state a few examples, I am sure you must have read lately that some insurers have said that they will not be paying claims for cocktail drugs or not be paying claims for non-network hospitals, etc. We see all this coming in the market over time! In Insurance there is no winner takes it all and no comparison based on premium when you are buying it because the product is actually used when you claim. It would be better to base decisions on the basis of ease of claim settlement, solvency, and grievance ratio rather than only price. That is why burning cash in insurance, based on the data thus far does not seem like a viable proposition based on nature of products and past experience of balance sheets of the Indian industry seems to be a good option! I have yet to see this anywhere across the world as well. If I see some of the recent IPO in India, and just because the answer on winner takes it all was not clear, we saw how fast the stock prices plummeted for some of these highly-rated IPOs which were there.

A good underwriting philosophy, high customer centricity, a lot of innovation on products, ease for customers, and building distribution till the last mile is the best approach that insurers can adopt for a long-term, sustainable business. We are in the business of trust, we are in the business of relationships and most importantly we are in the business of Care! If we do not care for ourselves, we cannot be expected to do good for others!

(The author is MD & CEO Bajaj Allianz General Insurance. Views are personal and not necessarily that of Financial Express)