

Chapter 3

China Life Insurance Business & Consumer Behavior

3.1 Introduction

The whole picture of China's life insurance business will be discussed in this chapter. In addition, we will also study the presumed patterns of consumer behavior in China and the factors influencing Shanghai's householder savings.

3.2 An Overview of China's Life Insurance Business

3.2.1 History of China Life Insurance Business

Insurance was first sold in China when two British insurance companies entered the Shanghai market in 1846. In 1875, the Merchants Shipping Bureau of the Qing Government established China's first insurance institution, the Merchants Insurance Bureau, and for the following 150 years, foreign companies monopolized the market. Then, with the founding of the People's Republic of China in 1949, China established its own government-controlled insurance company, the People's Insurance Company of China (PICC), and all foreign companies withdrew.

The PICC's own monopoly came to an end in April 1988 with the establishment of Ping An Insurance Co. Ltd. When the China Pacific Insurance Co. Ltd. was established in Shanghai in 1991, a real insurance market began to take off in a market-driven environment.

In September 1992, the American International Group's American Assurance Company (AIA) became the first foreign insurance company since 1952 to receive approval to establish a branch office in Shanghai, China. Other foreign companies

quickly followed suit, until the year 2000, there are seventeen foreign insurance companies granted permission to operate some form of insurance business in China, while 89 firms have set up representative offices waiting for permission to establish their own insurance operations in China.

3.2.2 Market Overview

(1) Market competition

The development of the insurance business in the People's Republic of China can be divided into three stages. From 1978 to March 1988, the People's Insurance Company of China (PICC) monopolized the market. Then, with the establishment of Pin An in 1988 and China Pacific in 1991, PICC's monopoly was broken and the market was characterized as a "tripartite confrontation". Since September 1992, more domestic companies, as well as foreign ones, have entered the market, and true competition has begun to take shape.

(2) Market size and potential

Although China's insurance business grew at a rapid 40 percent per year between 1982 and 1997 on average, insurance premiums in 1991 were still just 23.4 billion RMB (US\$282 million). By 1997, however, this figure had leapt to 108 billion RMB (US\$13 billion). China's insurance sector has registered 10 to 15 percent revenue growth for several consecutive years. Total income from premiums is likely to top US\$20 billion in 2001.

In major Chinese cities, the life insurance share of the total market was even higher: in Beijing, it was 70.7 percent, in Shanghai, 64.8 percent, and in Guangzhou, 60.5 percent. In the first five months of 1999, of the total 52.895 billion RMB in premiums, 31.276 billion RMB came from life insurance (up 11.07 percent from the

previous year).

3.2.3 The Chinese Market for Life Insurance

(1) Consumer Awareness and Domestic Attitudes Towards Openness

The vast majority of Chinese people still enjoy free medical care, low rent housing and retirement pensions, they still consider insurance to be unnecessary. Even when citizens (usually in big cities) recognize insurance as a necessity, they lack basic insurance knowledge.

According to a case study conducted in Shanghai, the majority of Chinese feel that the introduction of foreign insurers has advantages. They believed that the benefits of foreign participation in the market overwhelm any perceived disadvantages. A majority felt that more foreign insurers should be introduced to the market.

(2) The product scope of China's Insurance Business (Table 3-1)

Table 3-1 Life insurance companies write three distinct types of insurance based on human life contingencies²¹:

| Name | Categories (International) | | | | | | |
|----------------|--|---------------------------------|--------------------------|-----------------------------|-------------------------------|----------------------------|---------------------------|
| | Individual (Ordinary) Life Insurance | | | Group Life Insurance | | Industrial | |
| Life Insurance | Term Individual Life Insurance | Individual Whole Life Insurance | Universal Life Insurance | Variable Life Insurance | Endowment Life Insurance | Group Whole Life Insurance | Term Group Life Insurance |
| | Health Insurance (Medical Expense) | Basic Medical Expense Insurance | Major Medical Insurance | Disability Income Insurance | Medicare Supplement Insurance | Long-term Care Insurance | - |
| Life Annuities | A consumer may purchase an annual-premium, cash refund, fixed-benefit, joint-and-survivor, and deferred-benefit annuity. | | | | | | |

²¹ Author summarized from Mark S. Dorfman, *Introduction to Risk Management and Insurance*, 6th Edition, Prentice Hall International, 1998, pp369-492.

1. **Life insurance policies** provide protection against the financial problems associated with premature death. Some life insurance policies also provide a saving fund for retirement or other purposes.

Life insurance may be acquired in three ways. Many employees are covered by group life insurance, which is a frequent benefit provided to workers. Most consumers purchase their life insurance on an individual basis from life insurance agents because the social security system covered only their basic needs. Group life insurance is provided to well-defined group of people who are associated for some purpose other than purchasing life insurance. Most commonly covered by group life insurance are employee groups. Because of the benefit-formula method, consumers generally cannot rely entirely on group life insurance to meet their needs, and if a person leaves the group, that person loses coverage. Group life insurance is term coverage and does not provide a savings value. Industrial life insurance has little appeal, the benefits are small, the cost is high. Most consumers purchase individual life insurance, which is also called ordinary life insurance. It is an important part of the typical consumer's life insurance plan. Individual life insurance include five types as follow:

Term Life Insurance Policy: It promises to pay the beneficiary if the insured died within a specified period. Term insurance does not build savings or cash value as do other types of life insurance. Thus, it is often spoken of as providing " pure death protection". Most people would much rather be among those who pay term insurance premium but receive no proceeds.

Whole Life Insurance Policy: It promise to pay the beneficiary whenever death occurs. It also promise payment if the insured reaches age 100. Because claims are

certainty with whole life policies, the insurer must collect enough premiums to pay them. This is one explanation of why whole life insurance premium initially are larger than term life insurance premiums.

Universal Life Insurance: It allows the insured to buy term insurance and invest an additional amount with the insurance company, this kind of life insurance combines flexibility in premium payments with the opportunity for increased interest earning.

Variable Life Insurance: It depends on the investment account(s) chosen, it can duplicate either universal life insurance or traditional whole life insurance. Variable life insurance allows the insured an opportunity to invest cash value in one or more separate investment accounts maintained by the insurer.

Endowment Life Insurance: It creates two rights for the insured. The first is to have the beneficiary paid if the insured dies before the policy matures or "endows." The second is for the insured to collect the endowment if he or she is alive when the policy matures. This policy type is expensive, because the insured pays a claim on all endowment policies, it includes charges in the premium for both living and dying.

2. Health insurance policies can provide payment for medical expenses or replace income lost because of disability. People purchase health insurance to provide protection against the potentially high cost of purchasing health care services and the potentially large loss of income while they are unable to work. It include five types as follow:

Basic Medical Expense: It pays for the first-dollar costs of hospitalization and associated expenses.

Major Medical Insurance: It pays for the costs of catastrophic illness.

Disability Income Insurance: It is purchased to replace income lost while people are unable to work. This coverage may be purchased separately or as a rider attached to a life insurance policy.

Medicare Supplement Policies: They are designed to fill in gaps, such as deductible amounts and participation percentages, in Medicare benefits. Neither the Medicare coverage nor the supplemental policies provide long-term care coverage.

Long-term Care Insurance: It covers nursing home bills for elderly people.

3. **Life annuities** provide a guaranteed income that annuitants cannot outlive.

Life annuities provide a steady stream of income an annuitant cannot outlive. The payment received by each annuitant comes from three sources: (1) liquidation of the principal, (2) interest, and (3) survivorship benefits. The size of each annuity benefit payment is a function of the initial premium payment, the age and sex of the annuitant, and interest earnings. Annuities are to provide regular income in retirement years. Individually purchased annuities may supplement the income provided by social security and company pension plans.

There are three types of insurance companies in China: Property insurance company, Life insurance company and reinsurance company. Life insurance companies offer both Life Insurance, Health Insurance and Pension Insurance policies.

Life insurance policies are acquired in two ways in China, Group Life Insurance and Individual Life Insurance. Many employees are covered by Group Life Insurance. Individual Life Insurance was divided to five kinds of life insurance, they are: 1) Simple Life Insurance (Similar to Term Individual Life Insurance), 2)

Individual Whole Life Insurance, 3) Endowment Life Insurance, 4) Invest-Linked Life Insurance (Similar to Variable Life Insurance), 5) Other Combination Life Insurance Policies (Similar to Universal Life Insurance).

Health Insurance Policies are acquired in three ways in China, they are : 1) Basic Medical Expense Insurance, 2) Major Medical Insurance, 3) Disability Income Insurance.

The Pension Insurance policies which are sold in China are similar to Life Annuities policies.

The product scope of China's Life Insurance could be summarized as follow: (See Table 3-2)²²

²² Author summarized from opinions of Shanghai Life Insurance Companies Managers during the depth interview, 2001.

Table 3-2 The Product Scope of Chinese Life Insurance

| Name | Categories (China) | |
|----------------------------------|--|---|
| | Individual Life Insurance | Group Life Insurance |
| Life Insurance | 1) Simple Life Insurance (Similar to Term Individual Life Insurance) 2) Individual Whole Life Insurance 3) Endowment Life Insurance 4) Invest-linked Life Insurance (Similar to Variable Life Insurance) 5) Other combination policies (Similar to Universal Life Insurance) | 1) Group Whole Life Insurance 2) Term Group Life Insurance - Group Accident Insurance - Highway Accident Insurance |
| Health Insurance | 1) Basic Medical Expense Insurance 2) Major Medical Insurance 3) Individual Disability Income Insurance | 1) Group Disability Income Insurance |
| Pension Insurance (Life Annuity) | 1) Children's Education and Marriage Insurance 2) Individual Pension Insurance | 1) Collective-enterprise Employee Retirement Insurance |

(3) Key players

China's insurance market is a complex undertaking that involves not only the China Insurance Regulatory Commission (CRIC) but also many other government agencies. Major government agencies that will be involved in the decision-making process include:

- The Ministry of Foreign Trade & Economic Cooperation (MOFTEC), which is responsible for foreign trade policy and represents China in the WTO negotiations;
 - The National People's Congress, which has the legislative power of the state;
 - The State Council, which is the executive body of the highest organ of state power and administration;
 - The Ministry of Labor and Social Security, which administers the unemployment welfare framework;
 - Ministry of Health, which carries out the health-care framework.
- In addition to the above government agencies, the other two players are: The domestic insurance companies and The state owned enterprises (SOEs), which can no longer afford to be the sole providers of health and pension insurance.

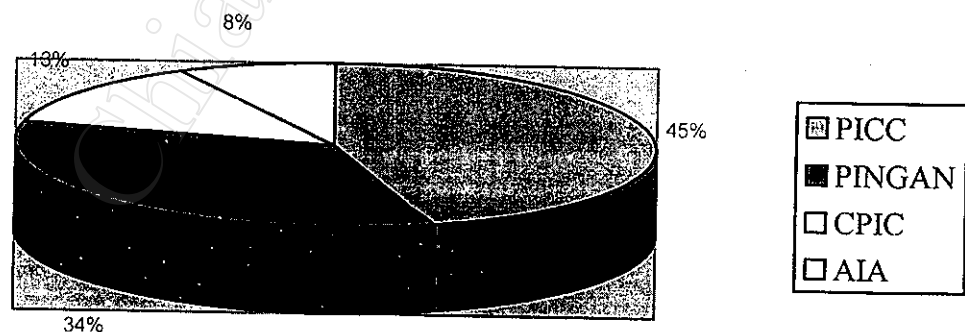
3.2.4 An overview of Shanghai's insurance market

Shanghai is the birthplace of the Chinese domestic insurance business. During the 30s and 40s, some insurance companies had offices in the city; It was the insurance capital not only of China, but also of the far east. Shanghai was also the first city in China to open its insurance sector to foreign investors since China began re-

opening the business in the 1990s. The People's Bank of China granted a license to AIA in 1992, and this was followed by licenses to Japan's Tokyo Marine and Fire Insurance and to Winterthur. Total premium income of the Shanghai market has increased dramatically. Life insurance premium grew from RMB560 million in 1992 to RMB5.7 billion in 1997. PICC grew in Shanghai over the 1992-1995 period at an average annual rate of 27.3 percent, CPIC at 119.8 percent, and PING'AN at 101.7 percent. Foreign investors have been keen to enter the Shanghai market where the economic growth rate has been above 13 percent per year for five years and the per capita income has on average grown over 23 percent per year. Now Shanghai hopes to speed the development of a multi-level insurance company system to make the city the reinsurance center of China.

The market share of life insurance premium for Shanghai's major life insurance companies in 1998 were as follow: (Figure 3-1)²³

Figure 3-1 Market Share of Shanghai life insurance premium (1998)



²³ Dongshen, Chen. Life Insurance Industry and Capital Market of China. Shanghai: Economic & Science Publish House, 2000, p83.

3.3 Consumer Behavior in China

According to summarization from the results of external and internal factors for consumer behavior, we will find out what the external and internal factors special for Shanghai consumer in Chinese social & economical environment .

There are two vital factors that should not be ignored: influence of economic reform and the difference between urban and suburban in Shanghai. After 1978 when China began to implement its economic reform and open-up policies, the social background and economic structure began to change with profound significance. The surroundings for Chinese people also were adjusted following these changes. So 1978 is the best time to start the analysis of consumer behavior of people in Shanghai, I will divide it into two parts: before 1978 and after 1978. It is also obvious that the gap between urban areas and suburban areas in China is significant. By observation, it is very easy to find that Shanghai city is a modernized while the countryside lags behind. It is necessary to include this difference when we talk about consumer behavior in Shanghai.

Therefore, we will compare the China's consumer behavior before and after 1978 in first two sub-sections. At the end of this section, the consumer behavior in Shanghai are summarized based on above analysis.

3.3.1 China's Consumer Behavior before 1978

Before 1978, China was a typical socialism country with a solid central planning economic structure. The external environment was quite different with any economical model in previous research.

3.3.1.1 Comparative Research in External Factors

- Commodity in Short Supply

As we know, people in socialist countries have experienced a lack of consumer commodities.

- Administrative Allotment of Consumer Commodity

In planning the economy, administration allotment was very common. The government organized a list of commodities in short supply and implemented allotments of these commodities. The result of administration allotment is similar to commodity shortage. Replacement affection and savings affection by force appear at the same time.

- Fixed Price

Since commodity shortage and administration allotment existed, fixed price of commodity was also an important feature for planning the economy.

- Flow Restraint

There is no mature market in traditional planning economy. All kinds of flows like cash flow, merchant flow and human resource flow almost did not exist before 1978.

3.3.1.2 Comparative Research in Internal Factors

- Rational Subject

As said above, no mature market indicates that there is also no rational subject, that there is no real concept of customer existing. The consumer in Shanghai before 1978 was similar to what Keynes has described as primitive & nearsighted.

- Pursuing Maximized Utility

Because of scarcity of commodity, people in Shanghai had almost no free choice to buy any other product. No matter how they desired to arrange their demand under quota limitation, there was no chance for them to consider pursuing maximized

utility.

- No Risk Expectation & Time Preference

In traditional socialist society, employment, housing, accidental dismemberment and retirement were all the responsibilities of government. Since everything about life was planned by government, no one would think about risk. Everybody relied on the nation and it seemed everything was certain for the individual life.²⁴ It was not necessary to have risk expectation and time preference.

3.3.2 China's Consumer Behavior after 1978

After 1978, Shanghai start to open to the international market and the Chinese central government tried to implement its economy reform plan. Many changes happened in both society and economy. The final aim of reform is the transaction of economic system from traditional socialized planning economy to socialist market economy. This is a gradual process and double systems would exist for a long period before the final aim reached for the external and internal supposals of consumer in Shanghai, they were certainly influenced by these changes.

3.3.2.1 External Factors

More than twenty years of economic reform since 1978, the characters of modern market economy are more remarkable than the traditional economy. It led to the following alternations of consumer external factors:

- Free Consumption Choice

Nowadays, the domestic market in China has already changed from demand market to supply market. It is not correct to say that there is no limitation of quantity

²⁴ Householder Behavior Research Project, Consumer Choice of Householder and Growth of National Economy, Economic Research, 1988-1.

or quota when Chinese consumer purchase products and services. But there are a few restraints for them in this factor, especially in Shanghai.

- Income distribution

The income difference between each level group has enlarged²⁵, demonstration effects have been strengthened between consumer with different income levels.

- Floating prices

The fixed price of consume goods began to float according to the price system reform. In supply market, all competitors involved in the market could set its own price for its goods and the price will float up and down depending on the crossing influence of demand and supply.

- No flow barrier and budget restrain

The Chinese financial market was founded in 1988. To consumer in Shanghai, more and more new financial instruments were available to choose from. And they could invest part of their spare income in these financial instruments and cash them in when it is necessary.

- Uncertainty

More risks in life are not protected by government and employers. The people would face uncertainty and think about transferring it to commercial unit, such as accident, unemployment, diseases, retirement and other welfare problems. Future life for modern people is full of uncertainty.

²⁵ Chen Zongsheng, *Income Distribution within Economic Development*, Shanghai Shanlian Public House, 1991.

3.3.2.2 Internal Factors

- Rational Subject

Because of the above changes of social & economic environment, Shanghai people began to transfer from “primitive” consumers to “forward-looking” ones. Although only some of them became real rational through 20-year reform, it is no doubt that the Shanghai consumer is getting more and more mature.

- Pursuing Maximized Utility Over Period

With the remarkable increasing of income level, financial assets increased rapidly. The budget restrains for consumer under one period enlarged through credit instruments. Consumers are preferring to pursue maximized utility over period by credit consumption.

- Risk Expectation & Time Preference

With reforms of the housing fund, the social security and the education system, people should use future risk management skills like preventing, and avoiding, and use insurance as a tool to protect themselves and their family from various uncertainties. In order to assure the efficiency of these tools, risk expectation should be well considered when choosing the foundation of proper the tools.

Inflation problem and continuously floating difference between interest rates for various financial assets caused consumption had very stronger time preference.

3.3.3 The Consumer Behavior in Shanghai

Based on the above analysis, the consumers in Shanghai hereafter:

- Shanghai consumer is between primitive and foreseeing and developing towards mature.

- As more risk expectations for Shanghai consumer appears, more sense of risk management increases.

- Time preference leads to credit consumption implement.

Since this study focus on consumer behavior in Shanghai which is the biggest business city in China, we could assume that Shanghai consumer at present are the most typical transitional consumer who has forwarding-looking characteristics with above limitation for urban people. Within the following section, we will find out whether it could be proved or not through analysis of Shanghai residents' savings behavior that influence consumption habit.

3.4 Factors influencing Shanghai Householder's Savings

Economic reform in China, which has been transforming a country from centrally planed to decentralized market economy, has also drastically changed the pattern of savings. Unlike the pre-reform period, when savings originated overwhelmingly from the central government, households and local enterprises have replaced the government as the main sources of savings. Not only has the relative share of national savings by householders increased, the absolute magnitude of household savings has risen with a higher savings rate. More striking is the fact that household savings are not kept to limited channels, such as cash and savings deposits, but have been diversified into a variety of new financial instruments. The aim of this section is to describe these changes statistically and try to explain and interpret the reasons behind the observed behavior. Also the effects of these changes on investment in fixed assets and subsequent economic development are analyzed. In section

3.4.1, a brief overview of China's savings would be presented. Section 3.4.2 offers an explanation and analysis of household savings behavior. In section 3.4.3, household savings are linked to investment in fixed assets in order to assess their contribution to economic development.

3.4.1 Household Savings and Income

It is well known that China's savings rate has been consistently maintained at a high level.²⁶ As Qian (1988) points out, China's savings rate is higher than the average rate for developed and developing countries. Except for a brief period of post-Great-Leap year in early 1960s, the rate of savings to national income has always been kept between 20 to 40 percent. This high savings rate has not only continued

²⁶ The savings rate refers to the ratio of savings to national income as defined by the Chinese Government. National income is the Net Material Product which is different from the Gross Domestic (or National) product. The latter has become available for China since mid-1980s. However, to utilize the series of data from 1978, the former definition of national income is used to express the savings rate. The savings rate calculated on the basis fact that the Chinese Savings rate is exceptionally high.

during the 1990's, but it seems to have intensified.²⁷

Prior to economic reform in 1979, savings were predominantly those originated from government budget surplus-revenues taken in taxes and enterprises profits in excess of government expenditures. Since 1979, resulting from rural and urban reforms, sources of savings have drastically shifted from the central government to enterprises and households. As shown in Figure 3-2, the share of total savings generated by the central government budget process fell from 42.8 percent in 1979 to only 20.6 percent in 1984. In contrast, the enterprise savings increased from 33.7% to 47.1% of the total savings between 1979 to 1982, reflecting the profits retention and decentralization of the tax base in favor of enterprises. This share declined to 31.0 percent in 1985 resulting from higher taxes, lower enterprise profits as costs rose due to higher material prices, wages and welfare expenditures. In the following years the share of enterprises in the total savings fluctuated between 21.7 and 30.0 percent. The share of household savings, as data shows, rose from only 23.6 percent in 1978 to 50.0 percent in 1985. By 1991 the government savings dropped to only 4.1 percent while the household savings rose to 70.5 percent of the total domestic savings (See Figure 3-2).

3.4.2 Determinants of Household's Savings behavior

Our interest is not in a debate on the econometric analysis but rather in examining how savings behavior changed as China shift from a centrally planned

²⁷ The high savings rate, or the over-emphasis on savings at the expense of consumption, is one of the items identified in 1979 to be subject to readjustment in the reform process. However, the savings rate has been higher than 30% throughout the 1980s and reached the highest rate of 38.7% in 1993. Data of national income and savings are from the *Statistical Yearbook of China*, annual issues.

economy to a socialist market economy. Prior to the economic reform, the Chinese government policy was directed towards high accumulation, low wages, full employment, and a high standard of social welfare (at least in the urban areas). Neither the government nor most Chinese scholars considered household savings as a sort of accumulation. Traditionally, an increase in monetary holding by households was viewed as monetary overhang, reflecting commodity in short supply. For this reason, bank deposits and cash were regarded as unrealized purchasing power and a potential threat to the demand of consumption. People referred to cash, for instance, as a tiger, which should always be “confined to a cage to secure the safety of community”. For many years the authorities were able, with a few exceptions, to control monetary expansion to avoid either inflation or the rapid accumulation of household savings. The low and stable savings rate of the household sector in those days, was other things being equal, the consequence of the institutional arrangement.

Similarly, the present household’s savings behavior is also an outcome of a changing economic structure. With the reforming role of the state in economic development, government savings have been sharply reduced over the past years. The gap between government savings and domestic investment, as a necessary consequence, was to be filled by enterprises and households, especially by the latter, which have witnessed an eye-catching growth in the disposable income. It is this sustained growth that has enabled households to accelerate savings after their daily basic needs are met.

As Table 3-16 shows, between 1990 and 1994, the nominal disposable income per capita in Shanghai increased by 171.5 percent or 34.3 percent per annum. Over the same period, the price of household consumer goods increased by 81.2

percent or 16.2 per annum. The growth rate of the real disposable income per capita, therefore, was 90.3 percent over 5 years or 18.1 percent per annum. This was 3.9 percent and 5.3 percent higher than the average industrial output and GDP growth rates per year, respectively.

It is evident that the increase in household income is attributable to a sustained rise in payrolls received by households and high profits attained from running private business and investments in securities and other financial assets.

As enterprises have gained autonomy without being subject to greater discipline in the form of hard budget constraints, the payroll income in 1992, for example, grew 14.7 percent in real terms over the previous year, with bonuses and subsidies accounting for the most of this increase. If various kinds of "in-kind" benefits were included, actual income of an ordinary worker could be 30-40 percent above the official figure.²⁸ For those who are running private business or taking a second job, it is even more difficult to tell how much they really earn.

As for investments in securities, people did not expect to make a fortune when purchase of stocks was made available to the public in 1991. But insufficient supply of listed stocks guaranteed that whoever had access to primary market would strike it shares, but only dealt in "second hand merchandise", could have their stocks doubled or redoubled in market prices. For those who had accumulated enough capital to invest in real estates, chances to be a millionaire would be even greater if they

²⁸ Some Chinese economists believe that the non-wage pay has accounted for more than half of the total pay received since 1990. The non-wage income includes bonus, consumer goods produced by the enterprises where the wage earner works, coupons, untransferrable stocks and other benefits, which are frequently and purposely omitted from the accounting books to dodge the tax.

purchased a piece of land at a low price and then made a killing on its resale.²⁹ The number of the new rich, according to a very conservative estimates, grew at an annual rate of 100 percent simply by trading in securities and real estates in the years from 1991 to 1994.

Obviously, an anticipated high return from stock and real estate markets gave a very strong stimulus to household savings. By rough estimate, nearly one third of household holdings of financial assets was in the form of stocks in 1992.

Another factor contributing to high household's savings is the ongoing social sector reforms. Officials are well aware that to improve efficiency, state-owned enterprises (SOEs) must be able to respond to market signals by adjusting the size of their operations, adding or shedding labor as necessary. For this to happen, restrictions on labor mobility must be removed by delinking worker access to housing and welfare benefits from lifetime employment in particular work units.

In general, enterprises provided lifetime housing to their employees at extremely low rents. Shanghai now embarked on the first phase of housing reform through rent increases do not yet include capital costs and taxes. Individual purchase of owner-occupied housing is therefore not expected to be high until rents reach reasonable trade-off thresholds.

Nevertheless, seeing that rents will reach market rates and the housing services will sooner or later be fully commercialized, Shanghai residents still prefer saving enough only to purchase a house or flat as early as possible. Accordingly,

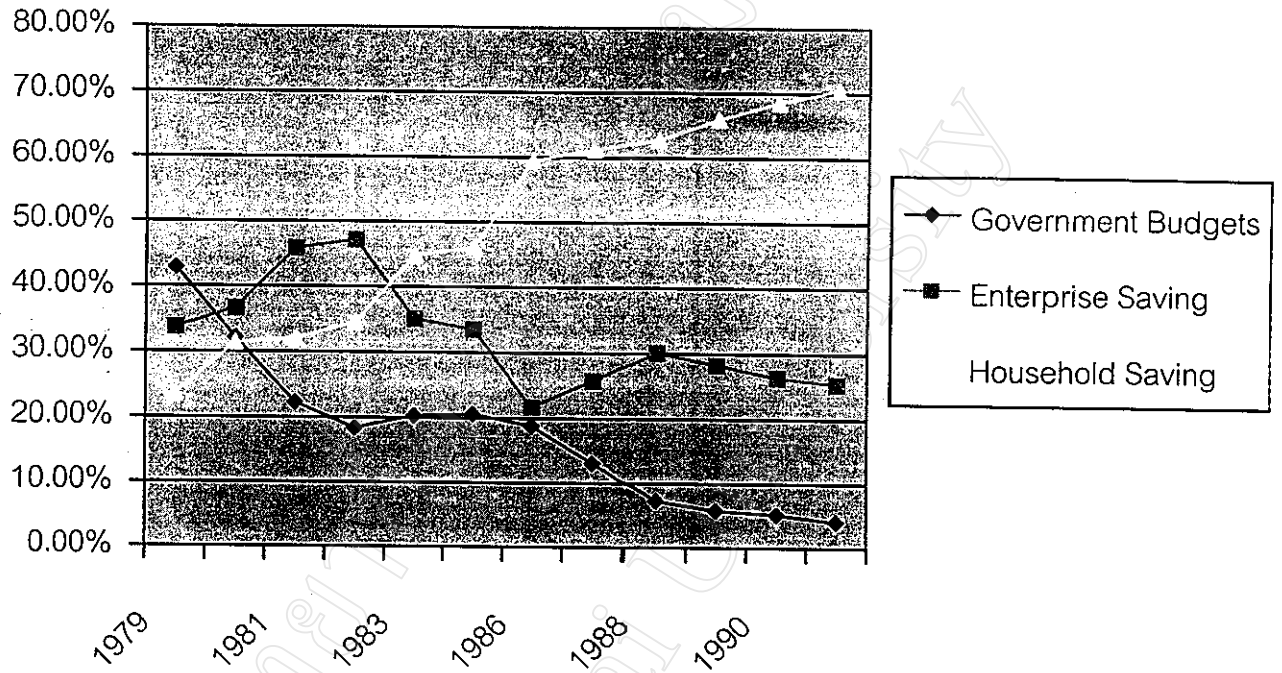
²⁹ According to Workers' Daily, from 1987 through 1992, the average price per square meter of the land sold through agreements was twenty-eight times that of public tender. Losses of state assets can be figured in tens of billion RMB

housing accumulation funds have been set up with couples through their employers. Five percent of the couple's salary is put into a fund under their name.³⁰ The health care reform, another main step to relieve the SOEs from the heavy burden, began in 1990 with experiments in risk pooling for catastrophic illnesses and co-payment system. The medical services are no longer fully provided by the SOEs. Instead, employees have to pay a certain portion of the medical bills.

The labor reform, given its potential for creating social instability, is firmly back on the agenda since March 1993. The key to the labor reform is the labor contract system, under which any worker can be fired. Both the health care and labor reforms have been contributing to a strong incentive to save as a precautionary measure. Meanwhile, a multi-level pension insurance system is rapidly taking shape. Employees are gradually developing the awareness for the necessity to rely on their own incomes to provide personal security.

³⁰ Money from the fund can only be used to buy housing or pay rent and maintenance. Officials announced that 20 percent of housing to be built should be affordable to the family of average income.

Figure 3-2 Trend of Chinese Saving Resources



Source: Xie Ping (1993)

It is observed that the rise in the percentage of household savings to total domestic savings came with a rise in the savings rate over increased disposable income.³¹ Table 3-16 reveals that on the average, urban households in Shanghai saved approximately 12.1 percent of their disposable income in 1992, compared to 1.3 percent in 1980, and 5.5 percent in 1990. As of 1994 this rate hit as high as 16.2 percent.

³¹ The average propensity to consume decreased from 0.872 in 1979 to 0.535 in 1990. During the same period the marginal propensity to consumer decreased from 0.771 to 0.160. See China's GNP, the People's University Press, 1991

Table 3-16 Income and consumption: A Survey of 500 Urban Household's in
Shanghai

| | 1980 | 1990 | 1991 | 1992 | 1993 | 1994 |
|--|------|------|------|------|------|------|
| Persons per household | 4.06 | 3.25 | 3.18 | 3.11 | 3.03 | 3.07 |
| Employees per household | 2.41 | 1.98 | 1.91 | 1.84 | 1.77 | 1.69 |
| Persons supported by each employee | 0.69 | 0.64 | 0.66 | 0.69 | 0.71 | 0.82 |
| Disposable Income Per Capita (in RMB) | 560 | 2050 | 2334 | 2842 | 4057 | 5566 |
| Consumption per Capita (in RMB) | 553 | 1936 | 2167 | 2509 | 3530 | 4669 |
| Saving rate (%) | 1.3 | 5.5 | 7.2 | 12.1 | 12.9 | 16.2 |

Notes: Savings rate = 1- Consumption/ Disposable Income

Source: Shanghai Statistics Yearbook, 1993-1995

Finally, traditional family ideas about saving, the virtue of thrift, provision for children's education and the financial of marriages are also the factors which have strong impacts on household savings.

The increase in the household savings rate in the mid-1980s can be partially

attributed to repressed inflation and forced saving, that is, the household savings was forced because of a monetary overhang and a shortage of commodity. The higher savings rate in recent years, however, is consistent with the theory of voluntary saving.

With the growth in household saving, new financial instruments have been made available through successive institutional changes. This has permitted savings diversification.

When funds involving social welfare reform were available that is when households started to diversify their savings for risk consideration rather than for higher return only.

3.4.3 Influence of Savings Behavior

The flow of savings has a significant influence on production, investment and consumption in Shanghai and China. Prior to 1978, without foreign direct investment and foreign loan, the central government obtained the needed savings through extracting surpluses wherever possible and allocating them according to the priority set by the government plan. Notably the dominant share of savings was devoted to heavy industry. Household savings, mostly in the forms of cash and saving deposits, resulted from forced savings and were viewed as a threat to economic stability.

Post-1978 reform era has witnessed gradual changes. The savings rate remains high but most of the savings are no longer those of the central government but are those of enterprises and households. By the early 1990s, the share of household savings became dominant, or more than 70 percent, in the total national savings. In Shanghai, sample survey data reveal that households are savings at a

higher rate of their increasing income. More importantly, households can diversify their saving among alternative instruments for higher returns and risk considerations. In contrast to previous savings which came about involuntarily or forced, today's activities appear to reflect voluntary behavior. The revival of the traditional view of savings as a virtue is also evident.

To sum up, the significance of a diversified and accelerated household savings might be viewed from the following four perspectives:

First, with a declining role the government plays in making economic decisions, household savings affect immensely the course of economic development. As Shanghai data demonstrate that by holding various kind of financial assets, households are financing the bulk of investments in fixed assets including technical updating and transformation investment, nonproductive capital construction investment, and other investment mainly in non-state-owned sector. These savings are channeled to previously neglected areas such as housing, services and local infrastructure rather than concentrating on the heavy industry.

Secondly, the sustained increase in household savings not only fills the gap between the reduced government savings and the required investment, but also enables the government to implement social sector reform and reforms in other areas by a gradual approach, which is often cited as a leading example of successful economic liberalization in soviet-type central planning economies(Perkin, 1992; Mckinnon,1994).

Thirdly, the autonomous decision of households on the amount and structure of their individual savings enables business of various sizes and different ownership to compete for the scarce resource available through the market. This is of

particular significance for non-state-owned sectors to expand under the multi-ownership system and play a far-reaching role in economic and social development.

Finally, with millions of households encouraged to diversify their savings into various financial instruments, the government is now competing for capital in a non-inflationary manner. And with its reduced role in financing SOEs, the government is less likely to print new money to balance its budget deficit. A large portion of funds raised by the government from capital market has gone to support price reform, subsidize loss-making SOEs and finance poor regions. These expenditures may be necessary to achieve full employment and equitable income distribution that prevailed for thirty years prior to 1979 but they will become costly if the SOE's fail to reform.

This case study of Shanghai suggests that economic reform is achieving major strides in basic institutional changes conducive to decentralized market economy. What remains to be seen is to what extent the market forces can bring about efficient examples, on the issue of negative real rates of interest which have been observed in recent years because of high inflation rates exceeding nominal interest rates on bank loans. To avoid inefficient investment, the real loan rate must be kept positive by relaxing financial constraints and pursuing successful anti-inflation measures. China's economic reform has further to go, although basic ingredients for growth are being successfully put into place.

3.5 Theories related to consumer behavior

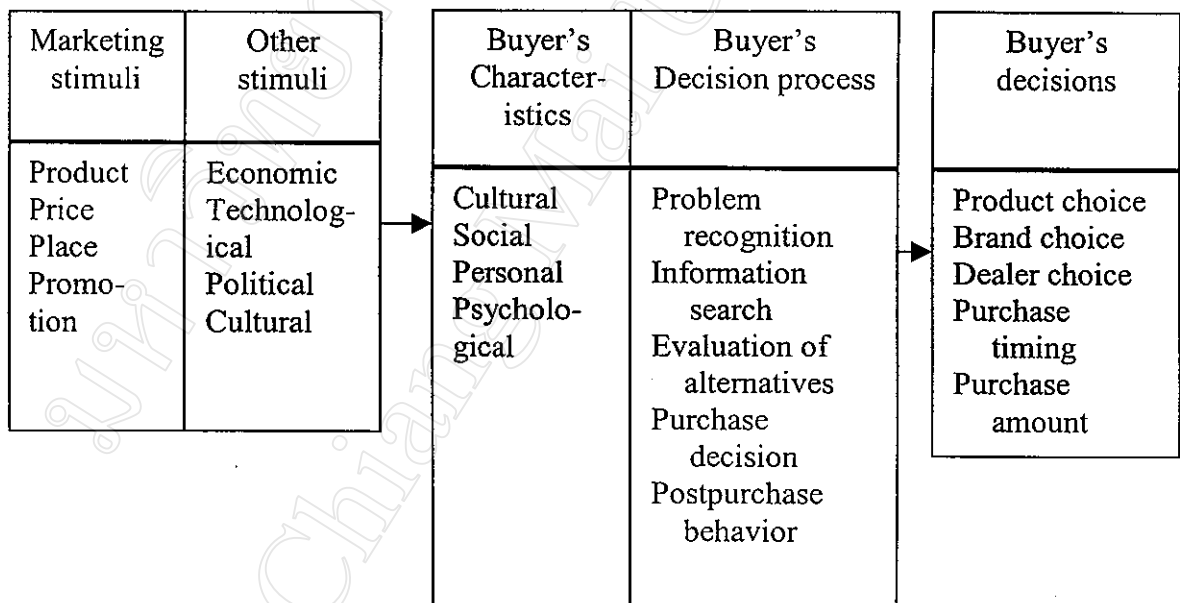
3.5.1 Stimulus-response model³²

Marketing and environmental stimuli enter the buyer's consciousness. The buyer's characteristics and decision process lead to certain purchase decisions. A consumer's buying behavior is influenced by cultural, social, personal, and psychological factors. Culture, subculture, and social class are particularly important in buying behavior. In addition to cultural factors, a consumer's behavior is influenced by such social factors as reference groups, family, and social roles and statuses. A buyer's decisions are also influenced by personal characteristics. These include the buyer's age and stage in the life cycle, occupation, economic circumstances, lifestyle, and personality and self-concept. A person's buying choices are influenced by four major psychological factors: motivation, perception, learning, beliefs and attitudes. Research into all these factors can provide clues as to how to reach and serve consumers more effectively. The typical buying process of consumers passes through five stages: problem recognition, information search, evaluation of alternatives, purchase decision, and post purchase behavior. The buying process starts when the buyer recognizes a problem or need. The need can be triggered by internal or external stimuli. At the information search level people become more receptive to information about the product. The consumer evaluation process consists of three basic concepts: First, the consumer is trying to satisfy a need. Second, the consumer is looking for certain benefits from the product solution. Third, the consumer sees each

³² Kotler, Philip. *Marketing Management*. 10th ed. Prentice Hall International, 2000, p161.

product as a bundle of attributes with varying abilities of delivering the benefits sought to satisfy this need. In executing a purchase intention, the consumer may make up to five purchase sub-decisions: product choice, brand choice, dealer choice, purchase timing, and purchasing amount decision. Postpurchase behavior of the consumer, showing the consumer satisfaction or dissatisfaction. The product's likely performance reflect satisfied customers will continue to purchase; dissatisfied customers will stop purchasing the product and are likely to spread the words among their friends. For this reason, companies must work to ensure customer satisfaction at all levels of the buying process. (see Figure 3-3)

Figure 3-3 Model of Buyer Behavior (Stimulus - Response model)



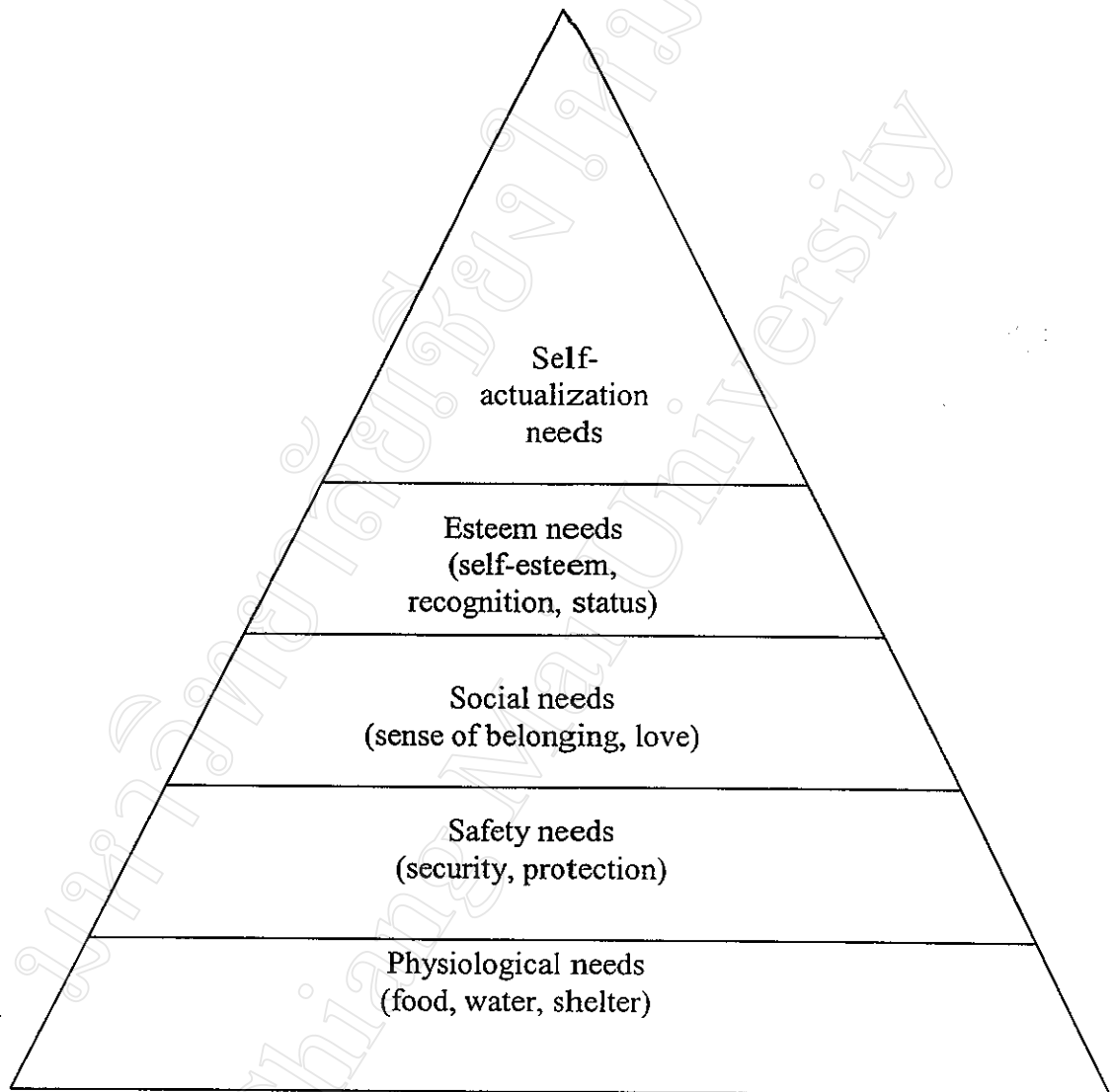
3.5.2 Maslow's theory³³

This theory helps marketers understand how various products fit into the plan, goals, and lives of consumers. The content of the theory sought to explain why people are driven by particular needs at particular times. Human needs are arranged in a hierarchy, from the most pressing to the least pressing. In their order of importance, they are physiological needs, safety needs, social needs, esteem needs, and self-actualization needs (Figure 3-4). Normally, people will try to satisfy the next-most-important need.

Maslow's theory specified 5 categories of human needs starting from the most pressing to the least pressing states, however people may need the next pressing state without being satisfied in the fore-pressing state. A person whose is esteem is satisfied may redemand the safety. In addition, the same product may satisfy several levels of needs. Popcorn, for example, is a low-calorie snack (physiological needs), but it is also a good food for informal social occasions.

³³ Ibid., p172.

Figure 3-4 Maslow's hierarchy of needs



3.6 Summary

This chapter presented an overview of China's life insurance business. It includes the history, market size and its potential, market competition, product scope, and key players of China's insurance business. It described China's insurance business' position and environment in both an international, and domestic marketplace, and introduced the life insurance business in Shanghai.

Then the consumer behavior in China was presented. It included China's consumer behavior before 1978 and after 1978. Later this chapter focused on insurance purchasing behavior of Shanghai residents and attitudes towards savings which is the main source of purchasing power. It further discussed factors influencing Shanghai householder's savings, and how it influenced the savings behavior in Shanghai as well as presenting the various new money transaction tools which came along with the new market.

With respect to the savings behavior in Shanghai, an anticipated high return from stock and real estate markets gave a very strong stimulus to household savings. Shanghai residents still prefer saving enough money to buy a first house or a flat ; secondly is the health care reform. Thirdly, is the restructuring of state-owned enterprises. Finally, traditional family ideas about savings is for their children's education and financing of marriage.

In chapter 4, we will summarize the evolution of consumer behavior in purchasing life insurance in China with the literature review of economies, social, social security system, savings behavior and in-depth interviews of life insurance companies in Shanghai. The analysis is based on economic theory and consumer behavior theories.