

## **Chapter 4**

### **The Evolution of Shanghai's Consumer Behavior in the Life Insurance Business**

#### **4.1 Introduction**

The evolution of China's life insurance industry could be separated into 3 stages with respect to the history of the People's Republic of China. The first stage is divided into two periods: before 1949 and from 1949 to 1978. The second stage is from 1979 to 1987, and the last stage is from 1988 to present. This chapter aims to conclude the differences in each stage based on the economic and consumer behavior theories, and to show the wholistic picture of consumer behavior of life insurance in Shanghai.

This study relies upon 3 theories. The 2 theories are related to consumer behavior, which are stimulus-response model and Maslow's hierarchy of needs. Another theory is an economic theory related to bank savings behavior which is called general equilibrium model. This model explains the relationship of the savings, the investment and the interest rate.

#### **4.2 The Evolution of Shanghai's Consumer Behavior in the Life Insurance**

##### **4.2.1 Stages of life insurance in Shanghai**

##### **4.2.1.1 Life insurance industry in the underdevelopment stage: before 1978**

Shanghai is actually the birthplace of the Chinese domestic insurance industry; many businesses first appeared in Shanghai in 1846. During that time, the

insurance business was accounted to be a big source of capital in China and in the Far East. Before the People's Republic of China was established in 1949, most insurance businesses were owned by foreign companies, and they occupied the biggest share of the insurance market. Most premiums of insurance at that time were from property insurance, and the life insurance shared only a small part of the premiums. During 1846 to 1948 Shanghai was an important commercial city and port in the Far East, businessmen in Shanghai needed property insurance to protect transportation risk under the unstable political environment. For most traditional Chinese people, life insurance was a very new product concept and it was difficult for them to adopt to and buy.

Several decades from 1949, the Chinese government nominated PICC to be the sole insurance company operating in both domestic and international activities. As a result, other life insurance businesses were forced out. At that time life insurance was mostly sold by foreign companies and PICC, which is the state-owned enterprises.

During 1966-1976 (around 10 years), when the Culture Revolution of China took place, there was no institution which had any role in insurance business. The insurance industry became languished. The Chinese government provided people with support in secured jobs, pensions, housing, healthcare or even funerals, so life insurance was not in great demand for most Chinese.

The content of Maslow's hierarchy of needs is that 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. People will try to satisfy the next-most-important need.

During the time which the Chinese government provided continuing social support to their people, the people could survive although they had little household income. People felt secured with the protection of government. As a result, life insurance was beyond a necessity for most Chinese. Most of the household income was for food, water, and shelter to satisfy their physiological needs. The rest was saved in banks because of the higher interest rate of bank savings and the limited channel of personal investment. As the General equilibrium model of economic theory mentioned that the higher interest rate induces people to increase saving since the interest rate is the return to saving.

#### 4.2.1.2 The monopoly stage of life insurance industry in Shanghai: 1979-1987

From 1970s, economic growth spread rapidly in Asia Pacific, especially in the developing countries. As a leading developing country, China had started its tough economic reform since 1978, which has been steadfast implemented until the present. Since the People's Republic of China's government adopted the open door policy in 1978, China has grown strong and healthy, and has generated profound historic significance to the Chinese people's life.

During the period of economic transformation, Chinese society was influenced deeply. Among those influences, there was the problem of laid-off workers and the problem of aging people. Therefore establishing a social security system for the Chinese was one solution. The Chinese government started the experiment of social security system in Shanghai, having Social Insurance Bureau, Medical Insurance Bureau and Housing Fund Administration Center in charge of all the social

security affairs. In the later time, Shanghai drawing upon the experience of Chile, had transferred the social security system administration and control from the government to commercialized institutions. Shanghai was where China's sole open insurance market was located at that time. Shanghai has been therefore a forerunner in the development of the life insurance business. Many employees with high income demanded further protection in addition to the basic coverage from the social pension plan. They purchased additional insurance policies to assure their own future. Insurance has been more important to the Chinese after the China's economic and social reform.

In 1979 PICC became a major life insurance company, and accounted for more than 90% of the market share until other commercial insurance companies emerged in 1988. PICC's highest market share was obviously derived from group life insurance premium which has been paid by state-owned enterprises and during that time life insurance companies offered the market only the group life insurance in the market.

China started its general economic reform in 1979, the Chinese government reduced the budgets to all State-owned Enterprises. At the same time, the work-unit or the place where people work for still took the responsibility for providing old-age insurance for their employees and retirees. The difference was that the work-unit began to buy group insurance for their employees as a compensation. People in Shanghai began to recognize life insurance, but there was no change in consumer behavior because there was no individual life insurance selling in the market at that time. Most of them chose bank savings as a risk free method of investment due to the high interest rate.

#### 4.2.1.3 The stage of life insurance business development in Shanghai: 1988-2001

China started its social security reform in 1984. The employment system was changed to a labor contract system, which caused the pension benefits to be less secured. People needed individual life insurance policies to protect their future uncertainties. Since 1988, the development of China's life insurance industry has been a continuing progress. In April 1988, PING'AN Insurance Company Limited was established and it was the first Chinese insurer to introduce individual life insurance in China. When China Pacific Insurance Company Limited (CPIC) was founded in 1991, marketing competition in insurance industry began to take off. In 1992, AIA penetrated Shanghai's insurance industry and was the first foreign insurance company in Shanghai.

In the later years from 1984 until present, China's social reform has deepened, it influenced several areas such as employment system, health-care system and education system. During that period of time, the Shanghai's consumer behavior of life insurance purchasing has changed significantly.

During 1995 to 2001, the People's Bank of China (PBOC) reduced interest rate of bank savings many times, causing people to look for other personal investment channels. This kind of changing behavior could be explained by the general equilibrium model. The higher interest rate induces people to increase their savings, which in turn allows investment to increase. The reduced interest rate in China affected the saving behavior of Shanghainese, they transferred their savings to first investing in the stock market and real estate. However, the stock market has a

high risk and the real estate was a long-term investment. As a result, people now preferred life insurance which serves their purpose of both savings and investment which also provides the protection benefits.

Since 1978 when China started its economic reform, the high national economic growth rate influenced Shanghai people's lives. The income level of Shanghai people rose at a high rate, which affects the people's consumption and consumer behavior. According to the theory of Maslow's hierarchy of needs, the fundamental need of human beings is survival and then safety. It means that with the increase of household income, people desire to improve their living conditions and make their own lives better. As the social security reform deepened, more and more people lost the benefits and protection from their work-units, they felt their security was threatened. Therefore, Shanghai people now pay more attention to life insurance purchasing.

#### 4.2.2 The comparability of the three stages of life insurance business based on stimulus-response model

The Shanghai consumer behavior of purchasing life insurance in each stage could be explained depending on the stimulus-response model.

##### 4.2.2.1 The underdevelopment stage of Shanghai life insurance business (before 1978)

At that time, China was under a centralized planned economy, and the state-owned enterprises took care of the social security. The "Work-unit" which referred to the corporation that people worked, means everything to the employees.

The enterprises which people worked for took the full responsibilities of the employees' retirement, disability compensation, child education, and housing, including the job provision to the employee's children. These became heavy burdens for the state-owned enterprises. But under the control of the government plans, the enterprises with these functions were just like cells of economic system and must support its employees on the social security side. As a result, people had no need to purchase life insurance, and the life insurance business, in a sense, had no commercial meaning.

#### 4.2.2.2 The monopoly stage of life insurance business in Shanghai (1978-1987)

China began its economic reform in 1978, the Chinese central government has put different levels of control over industries. The insurance industry was one of the government's industry that they loosened its control on. However, during that time the insurance industry operated under regulations of the People's Bank of China (PBOC). At that time, PICC was a sole insurance company operating under PBOC, which handled both international and domestic insurance activities. The marketing strategies of PICC follows:

As for product varieties, PICC only offered group life insurance, and most premiums has been paid by state-owned enterprises.

As for pricing, PICC offered the group life insurance and charged low prices for it.

In terms of Place, the target customer of PICC were the state-owned enterprises, and accounted for more than 90% of the market share.

As for promotion, PICC did not spend a lot of money in advertising during that time because China was still under the planned economy. The central government could affect the strategies and policies of all the state-owned enterprises. People were protected by the state-owned enterprises, and they got life insurance for free from the state-owned enterprises as a kind of welfare. In other words, they did not need to buy life insurance.

In addition, there was a cultural factor that affected people's buying behavior. In a Chinese custom, most Chinese don't like to think about bad things occurring in their lives. It is called 'taboo'. Therefore, the basic benefits from Term Insurance such as accident and death benefits are not popular in buying life insurance even if they are cheaper than other kinds of life insurance benefits.

#### 4.2.2.3 The developmental stage of life insurance business in Shanghai (1988-present)

After 1978, China began its general economic reforms, and started its social security reform officially in 1984, the "iron rice bowl" had been broken and the employment system was moving to a labor contract system. Many Chinese workers believed that their retirement income security or the pension benefits were threatened. As the reform went further, China changed the central planned economy into the socialist market economy. All those protection functions which were previously afforded by the "Work-unit" were previously transferred to social institutions. There were a series of reforms in Shanghai, such as health-care reform, education system reform and state-owned enterprises restructuring. Under these reforming situation, the customers' needs have been enhanced by strong commercial

insurance businesses. In April 1988, with the establishment of PING'AN Insurance Company Limited, the monopoly of PICC came to an end. When the China Pacific Insurance Company Limited (CPIC) was founded in 1991, a true insurance market began to take shape. In 1992, AIA became the first foreign insurance company to receive approval to establish a branch office in Shanghai. Since 1988, however, China's insurance industry has developed very quickly. The rapid growth of the insurance industry required the establishment of a legal framework. In 1985, the State Council issued Provisional Stipulations of Insurance Enterprises Administration as the sole regulation guide for the industry. In 1995, the National People's Congress promulgated a formal insurance law. In order to tighten supervision of the insurance industry, the China Insurance Regulatory Commission (CIRC) was formed on November 18, 1998 to regulate the insurance market and to promote its development. Supervision and regulation rights for the insurance business were transferred from the People's Bank of China to CIRC. Subsidiaries of PICC, including the Life Insurance Company, the Property Insurance Company and the Reinsurance Company.

In short, political and legal environment heavily influences the life insurance business and consumer behavior.

In the development stage, the primary target buyers were middle-level income people (1,500 RMB per month or above), 20-50 years old, with a high school degree or higher, works for a private enterprises or have a permanent job and possess the following psychological factors:

- a demand for a secured life.
- being family-oriented

- having life insurance can represent a modern life-style of young and highly educated people.
- wanting to have a moderate return from buying life insurance as a part of their family financial planning.
- Concerned with the continuing reduction of interest rates in bank savings.
- realizing the value of life insurance.
- having confidence in the good image of life insurance

In this stage of life insurance development, the life insurance companies used several marketing strategies to help them increase the market share.

In terms of promotion, the domestic life insurance companies do not spend a lot of money in advertising due to its well-known image and the large number of existing clients. For foreign life insurance companies, they had to advertise to create awareness through the local media more than the domestic companies. In addition, both domestic and foreign companies repay the society by offering many social welfare projects. For example, the construction of an elementary school, the donation to the Hope Project, and so on. The foreign insurers have been involved in educational activities in Shanghai such as training programs for students in the life insurance fields.

As for pricing, The domestic life insurance companies use the low cost leadership strategy to maintain the market share. For the foreign life insurers, their objectives are consistent return and low risk, so their life insurance policies are priced higher than the domestic companies.

As for product varieties, the domestic life insurance companies offered both group life insurance and individual life insurance, but the foreign life insurance companies can only offer the individual life insurance in the market under the regulations of China Insurance Regulatory Commission (CIRC) before 2001.

The main distribution method of life insurance companies is selling through an agency system, AIA was the first company that used this selling method in the Shanghai market.

After 1992, people began to recognize the necessity of life insurance in their daily lives. They looked for the life insurance information and tried to decide the life insurance products they really needed from friends, insurance agents and insurance web-sites. Life insurance policies have certain benefits or variable benefits, consumers seek to satisfy their needs such as limit medical expenses or get monetary return. The consumers make up to five purchase sub-decisions :

- Product choice: The factor which influences the insurance decision is the benefits of life insurance policies. Since the Chinese economy is continuously improving, people in Shanghai want to enhance their living environment and get more protection. Currently, there are 6 major reasons in buying life insurance. They are monetary return, disease- prevention benefits, pension return, risk-prevention benefits, their friends' recommendation and child benefits. As a result, the most popular products are Individual Whole Life Insurance, Major Medical Insurance (Health Insurance), Invest-linked Life Insurance (variable life insurance), Accident Insurance (Term Life Insurance), and Pension Annuity.

- Brand choice: The consumers in Shanghai consider the profile of insurance companies which is the most important factor for purchasing life insurance

at the beginning of this stage, because there were a few large insurance companies in the market. As a result, people will choose the insurance company which is reliable and has strong financial strength. Before the customers premeditate their life insurance purchase, they survey outstanding characters of each life insurance company, such as size, operation performance, history, reputation, etc. Although future performance of each company is also one criterion to be thought about, the current situation of a company is the main criterion to be measured. After the foreign life insurers joined the life insurance industry in Shanghai, people can compare and choose among the domestic and foreign insurance companies. Currently, people still consider this factor between their decision in purchase life insurance, but it was not the most important factor in it.

- Dealer choice: Most people purchase their life insurance from agents and banks which have mutual agreement with the life insurance companies. Some customers purchase life insurance via internet, brokers and other branches of life insurance companies.

- Purchase amount: Most people are interested in purchasing a set of life insurance for themselves. For example, a customer may purchase Individual Whole Life Insurance plus other kinds of Term Life Insurance policies. Most of the time the person who needs insurance the most is the one who is the major income generator of the family. The family will suffer financially when this important person has an accident. As a result, purchasing life insurance for the parents is the most efficient method to completely take care their children. However, there are some customers who are still interested in only child benefits because the child is the center

of the family under the Chinese population policy (A couple-child family is typical for Chinese).

- Purchase timing: Customers purchase life insurance when they need stable securities, especially those people who work for private enterprises having high income but uncertain securities in their lives. Due to the fact that the People's Bank of China has reduced the interest rate many times, the consumers prefer to buy life insurance rather than save their money in banks. Because people end up paying more medical expenses after the reform of the health-care system in Shanghai, they desire life insurance to substitute those medical expenses. Besides, they also buy life insurance when they are laid off from some state-owned enterprises which has now begun their organizational restructuring.

- Payment-method: customers pay their insurance premiums by cash, by installment and by credit card. Most customers pay cash to the agents of life insurance company. Some customers pay their installments through the banks which have an agreement with the life insurance companies. Some pay through post offices. Although China's banking systems need some improvement, the Direct Debit Account (DDA) auto-bank transfer payment was used by some Shanghai people. There are not many customers paying via credit cards because the money transfer systems between banks and life insurance companies are still under development.

After the consumers go through the decision process, the last stage is the postpurchase stage. The likely performance of the product/service reflects the postpurchase behavior of the consumers, showing the consumer satisfaction or dissatisfaction. 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 hard to ensure customer satisfaction at all levels of the buying process.

While life insurance is an intangible product, the service quality becomes an important factor which influences the customers' postpurchase behavior. Both domestic and foreign insurance companies should pay more attention to improve their services. The competition is so intense that the premium levels for similar products among various competitors show little differences. Hence, the key success factor is the quality and the kind of customer services. A better service is perceived under several conditions. First is the quality of the life insurance agents. The agency system is quite successful in Shanghai life insurance market. The agents have good understanding of the products, and can give the professional advice to their customers before they decide to purchase life insurance. They can also help the customers understand the values of the products. The agents are also a bridge between the company and their customers. Then can transfer the customers' comments to the life insurance company. Second is the advance service system. Most of the large life insurance companies have their own nationwide service network which can offer 24 hours customer services, and have the service department dealing with important requests. Last is the information technological facility. Currently, the life insurance companies use both the agent system and e-commerce as major marketing channels in selling in this competitive market. Internet attracts the young life insurance customers' attention. And the information system helps the companies have a better understanding in customers' needs and wants and in return find effective ways to satisfy their customers.

Shanghai life insurance market is now approaching its maturity stage. Shortly after the WTO accord, WTO membership will also promote China's link to the world economy, which in turn will help create more stable environment for China's economic development, thereby helping China realize the strategic goal of sustained, rapid and health development of the nation economy. Therefore, WTO membership will have a deepen impact to Shanghai, and the life insurance market will have more opportunities while there is strong competition between domestic life insurance companies and foreign life insurance companies. It will be certain that the growth of life insurance industry in Shanghai will be greater than 7% growth rate of GDP of China.

In the future, the strong competition among foreign companies and with domestic companies will force all insurance companies to think more carefully of survival and growth strategies. Small companies may need to merge with other small company to be a big company to competed in the insurance market, or focus on several specific segments such as medicare supplement insurance, offer special and full time service to their customers. Big companies may want to build their own brand, service identity, or use joint venture strategies to find partners in expanding business. But the key success factor in doing life insurance business is offering high quality service to satisfy customers' needs and wants.

#### 4.3 Summary

This chapter summarized the evolution of consumer behavior in purchasing life insurance in Shanghai. The data was gathered to support the analysis in this chapter. Secondary, accompanied with the depth interviews of 4 life insurance

companies and 1 related government agency in Shanghai, the analysis is based on the general equilibrium model, Maslow's hierarchy of needs and the model of buyer behavior which is called Stimulus-Response model. In addition, the trend of life insurance business also presented in this chapter.

In the next chapter, the implications, the applications and the limitations as well as future study are presented.

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