
**Management of Change in the Financial Services Industry
Implications of Liberalisation**

Keynote Address

By

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As the financial services industry in Tanzania begins its journey along the path of competition and openness, there are challenging times ahead for all of us. With the imminence of the next millenium almost upon us, it is important for us, as practitioners, to consider the implications of this new structure under which our insurance industry will operate. My address today will focus on those management issues facing the insurance industry of Tanzania, now and in the future.

1. INTRODUCTION

The manifestation of international trade liberalisation in goods and services crystallises over forty (40) years of intense and complex negotiations between and among many countries, both developed and developing. Trade in services, however, only arrived at the negotiating table between the years 1982 to 1986. The primary objectives were to dismantle what was perceived to be pernicious and regressive barriers to trade and either to eliminate or diminish the stringent regime of protectionist trade policies.

On the 1st of July 1995 Tanzania acceded to membership of the World Trade Organisation (WTO) which itself was established on the 1st of January 1995 to oversee the numerous multilateral trade agreements entered into by its members. Tanzania has already embarked on a programme of liberalising its market in goods and services.

One of the major concerns for Tanzania and countries like it is whether it can take advantage of the undoubted opportunities that will arise out of this new prototype for trade. Whilst developed countries may have the necessary resources in terms of know-how and abundant technologies, the developing countries are not so luxuriantly disposed. Added to this dilemma is the fact that although many developing countries have made or are in the process of making the transition to the new order, there is no set model upon which a country can pattern itself. It is evident that each country will have its own characteristics and must respond accordingly. Of course there may be similarities between countries in economies, demographic changes and political persuasions. However in the final analysis it is only those aspects upon which liberalisation has had a beneficial effect which can be adopted. By and large it could be said that in the context of freedom in trade, each country's destiny lies in that country's ability to exploit the resources at its disposal, in making what could be a serpentine journey into largely unknown territory.

This paper deals with the Management of Change as it applies to liberalisation of the financial services sector of Tanzania. However, it should be noted that the financial services sector includes banking and insurance. This forum and most participants in this conference belong to the insurance sub-sector, and it is this sub-sector to which the rest of this paper will be devoted.

2. BENEFITS OF INSURANCE

In an effort to deal effectively with the theme, it is necessary to provide a brief overview of the importance of insurance to a country's economy.

Risk transfer through insurance reduces adverse financial consequences for policyholders (and very often third parties too) of those losses that do occur.

The sense of security is heightened. Business type insurances contribute to the efficiency, development and competitiveness of the industrial and commercial sectors of a country's economy. The substitution of insurance for highly liquid contingency reserves reduces the cost of risk for all firms and the risk financing disadvantages of small firms. Enterprises with insurance have more security and may be willing to be involved in more hazardous activities such as innovations in processes and products. The loss prevention services of insurance contribute to safety in production and products. The spreading of risks internationally can help to stabilise a country's balance of payments. Claims paid in foreign currencies can be used to finance imports of materials and goods needed to reconstruct buildings and plant after a major disaster and in the case of losses that give rise to liabilities overseas (such as air crashes), to cover the cost of compensation payable in foreign currencies.

In addition to providing financial protection against the premature risk of death, life insurance has developed in many countries into an important form of long term savings. Consequently, life insurers are embroiled in the financial services revolution competing with banks and other institutions for savings and loans and in some countries developing into or being acquired by financial conglomerates.

Access to insurance contributes to the welfare of risk averse individuals and organisations in all countries, and generates other macroeconomic benefits. Most insurance services can be supplied domestically. Without international trade however, insurance markets would not be able to supply all of the insurance demanded for very large individual and catastrophic risks.

Insurance is the chaperon of trade. It stimulates market efficiency. All knowledgeable commentators have recognised and accepted the fact that the insurance industry can play an important role in the development of the financial services sector of a country's economy.

3. ABOUT THE TOPIC

The theme of this address is the Management of Change in a liberalised financial services environment. It can best be considered at three distinct levels, namely, governmental, industry and company levels.

4. MANAGEMENT OF CHANGE AT THE GOVERNMENTAL LEVEL

Governments the world over have had more than a passing interest in insurance. UNCTAD at one time favoured protectionism for domestic insurance industries. The reasons cited were as follows:

- Because of the unpredictable and fiduciary nature of insurance, legislation was meant to protect consumers
- Avoidance of destructive competition that might lead to excessive selling costs and the insolvency of some insurers
- The development of the local insurance industry to promote local employment and the diversification of the national economy
- Retention for local investment of funds generated by insurance operations
- Reduction of the impact of insurance and reinsurance imports on the balance of payments
- Reduction of the country's dependence on foreign suppliers of a key financial service, and for the sociopolitical reason of religious and cultural considerations, e.g., Western forms of insurance organisations are not acceptable to some Muslims

There was also a status-quo factor. That is, some governments were not convinced that their economies would benefit from trade liberalisation and

therefore in the absence of strong evidence to the contrary believed that logic dictated the maintenance of all existing barriers to trade.

Now that Tanzania is in the process of opening up the financial services sector the foregoing considerations are no longer applicable but they have been cited specifically to demonstrate that global trading in financial services has gone a complete 360° degree revolution.

Let us, therefore, now deal with the question of how to manage the change from a governmental standpoint.

There is deficiency in a wholly reactive approach to any form of change because this does not insulate an entity from unpredicted external events. Thus at whatever level the management of change must be undertaken, it is always better to be proactive.

Liberalisation means restructuring and it also means economic growth. For such growth economists believe that there are a number of determinants which are consistent with the standard International Monetary Fund's prescriptives for market development. Growth is said to be linked to certain structures for education, savings and investment opportunities, private property rights and proper fiscal and monetary policies.

Governments can create an environment conducive to economic growth by applying these precursors nationally. Not only will they have a beneficial effect on industry as a whole, but especially so on the financial services sector inclusive of insurance.

The level of insurance education will be an important factor in determining the future development of the industry. The insurance skills of nationals must be continuously upgraded. This is essential for dealing with the increasing

complexity and values of risk. The State can play an important role by providing tangible support for insurance education through for example, the Insurance Institute of Tanzania. State officials in their public addresses should emphasise the importance of insurance education and further seek to include it as part of the commerce syllabus at the secondary school level.

The State can provide incentives to save which produces money for investment and promotes the growth of income.

The protection of private property rights encourages citizens to acquire property, provides them with incentives to save and to invest in securities without the fear of confiscation. The latter causes capital flight and the acquisition of property outside the control of the State.

Sound fiscal and monetary policy reduces the incentives to put money outside the State. Inflationary policies breed disenchantment and stimulate people to invest elsewhere. High spending exchequer policies put pressure on the State to raise taxes, which in turn results in a lowering of the rate of return on investments, thus encouraging people to look for investment in a lower tax environment.

Besides these precursors for economic growth, there are other areas in which the State could be involved and areas in which it should not be concerned.

Governments must rediscover the influences of market forces and competition. They must endeavour to bring into existence an efficient capital market which greatly benefits insurance.

Governments should refrain from imposing restrictions on foreign exchange allocations for the payment of reinsurance premiums. Reinsurance is vital for developing countries and thus the flow of capital should be guaranteed.

Neither should governments interfere in the management or the appointments of insurance executives. This is harmful to the development of the insurance industry if the companies are not directed and led by experienced insurance specialists.

Other areas where the government can be of assistance is in fostering the development of pertinent trade organisations, such as an association of insurance companies. The seeking of co-prosperity of neighbouring countries will also allow the preservation of manpower and foreign exchange.

The setting up of a facility for compiling accurate and timely statistics on the insurance industry's activities provides a basis for monitoring growth and produces timely signposts of companies that may be in difficulty. This will ensure that only those companies that provide a proper and effective service will trade in the insurance marketplace, thus strengthening the insurance industry as a whole.

5. MANAGEMENT OF CHANGE BY THE INSURANCE INDUSTRY

Management of Change from the insurance industry's point of view can be considered from two distinct approaches. The management of change by industry itself made up of the several types of companies, intermediaries and auxiliary services, through self-regulation, and management through legislation enacted to regulate the operations of companies, intermediaries and products.

It was mentioned before that an association of insurance companies can be formed with governmental support. However, because of the distinctive practices of general insurance as opposed to life insurance there needs to be two sub sections of the association. The use of common resources will

reduce costs. Unity is strength and common problems can be addressed constructively.

These associations not only seek to safeguard their members interests but disseminate relevant information to members on matters affecting them locally, regionally and internationally. Affiliations to regional and international organisations of similar persuasion enhances their credibility and contributes to the information base of the local association.

Brokers, agents, reinsurers and loss adjusters should also have representative associations. This, together with other professional associations representing amongst others, underwriters, actuaries, claims consultants, strengthens the entire market and provides a cohesiveness that would also earn the industry respect and improve its image locally.

Management of Change by legislation is usually initiated by governments through their parliamentary systems, but it is the judiciary and other technocrats who apply it in practice by the formulation of laws.

Because of the fiduciary nature of the insurance business there is a legitimate interest in protecting consumers from incompetent or fraudulent operators even though measures taken may deplete efficiency. The prime function of supervision is effective control and rigorous implementation of laws. This approach contributes to the building up of domestic retention capability.

To achieve effective supervision, the authorities must have suitable human and technical resources. Trained insurance persons with appropriate professional specialisations must be acquired and provided with remuneration packages that would remove the threat of recruitment from the private sector.

6. MANAGEMENT OF CHANGE AT THE COMPANY LEVEL

At the company level, management of change is more acute. While one of the main objectives of a company is survival, factors in the external environment have a significant impact on whether the company can achieve this basic objective.

The most challenging frontiers of management today are probably those in which change is occurring rapidly, where the least is known, where most speculation occurs and there are abundant opportunities for imaginative executive leadership. Such is the nature of the changes occurring in international trade, and especially so in international trading in the financial services sector.

In international insurance, important changes are occurring each day and these are shaped by social, technological, financial and regulatory influences. Factors such as inflation, new life styles, the increasing importance of working women, rising incomes, greater longevity, consumerism, among others, will have their impact.

Products will clearly have to respond to these emerging trends. There are also fundamental demographic changes taking place, such as changes in patterns and increase in divorces. Changes in the size of the school age group, the 65 year old age group becoming larger, and trends in fertility (birth rate) and mortality (death rate) with their implications for the average retirement age and income devoted to the care and education of the young and pension and annuity costs.

Whilst the foregoing can be threats they can be converted to opportunities. For example, the increased participation of women in the workforce can provide an enormous market for life insurance.

Consumer needs are also changing and many insurance companies will seek consumer loyalty to strengthen and enlarge their consumer database. To achieve consumer loyalty means aiming at excellence in service, pricing of products and constant market research to achieve a sensitivity for demand for specific products so that the response is rapid, competitive and a large measure of success is guaranteed.

The insurance company management in a revolutionary financial services situation must also be conscious of macro-economic factors such as the pace of inflation which affects real growth, employment and the composition of the workforce and its patterns, energy supplies, foreign trade, technology, communications, transportation, health and medicine, the political scenario, education and the other social indicators.

To manage change in consideration of the foregoing factors can seem impossible, but not improbable, thereby providing for the proactive exercising of executive judgement that will significantly influence the fate of the insurance organisation.

Among some of the more specific areas where the executive management of insurance companies could be more proactive are:

- Educating personnel and developing capabilities and expertise
- Aiming for a balanced portfolio of risks
- Increasing retention levels
- Forming international relationships with both insurers and reinsurers
- Exploiting the most cost effective distribution systems
- Customer services

Educating personnel is the principal vehicle for dealing with change. It is critical for companies in developing countries. Without expertise and trained

staff, service will deteriorate. Whilst all skills can not be maintained locally at all times, access to foreign experts should be a strategy with the transference of knowledge to locals an objective. Basic skills in risk analysis and risk inspection, underwriting and rating techniques, loss prevention and risk management, drafting policy wordings and conditions, portfolio administration, claims management and claims handling and accounting are some of the more important necessary disciplines.

All executives must have a positive attitude to training which must be on-going and of course the executives themselves must also have on-going training in management, finance and development of the organisation itself. Since the image of the company is to a great extent determined by its agents, it follows that the sales force must also be well trained. Expertise that is unavailable locally can be 'bought' from the international market by way of trade-in from reinsurance cessions.

The structural imbalance of portfolios is a major problem in developing markets. Imbalances between very large insured risks and the premium volume is one of the examples. Even with extensive co-insurance, substantial reinsurance is necessary.

Imbalance between the highly complex, sophisticated risks and lack of technical expertise to deal with it is another example. Access to international know-how is imperative.

Increased retention brings motivation and attention to the quality and rating of the business written. However some companies do not have the requisite capital and reserves and therefore need more reinsurance and this frustrates an effort to retain more domestically. If ten undercapitalised companies are replaced by two which are strong and have ample surpluses, there is an immediate increase in retention capability. Furthermore if incentives to

reinsure are eliminated an insurance company can function as a true risk taker rather than as a conduit through which the business passes. By “incentives” is meant high commissions and profit commissions which guarantee a profit after deduction of costs.

Underrating is harmful to the national economy and hinders balance sheet growth leading to decrease in retention in real terms and weakens both insurer and reinsurer. Proper rating will encourage increase in retention.

A correctly conceived reinsurance arrangement is a joint effort of both insurer and reinsurer. It is the quality of services which distinguishes one reinsurer from another and developing markets need assistance to succeed. A company can obtain from its reinsurer, which is its partner, not only an underwriting and claims service but also training expertise and reinsurance capacity and not many reinsurers have the scope to provide all these services. When a reinsurance partner feels that he has the insurer's confidence he will reward such insurer with long-term support. Such close co-operation grows from a substantial and long-lasting relationship and involves the usual “give and take”. In such a close partnership there must be assurances that fair value will be received for the reinsurance price which may in the long run well be lower in view of the cost-effectiveness and long-term aspects involved.

Today's high cost of traditional distribution clearly indicates that “direct” channels based on new technology will have cost advantages over traditional distribution systems. As a result these systems will grow, both company initiated and customer initiated. Distribution through telephone and direct mail could be considered a first generation solution. It is thought that 50% of the traditional branch distribution is already a `de facto' telephone distribution, a figure doubled in five years. Internet and other on-line services constitute a second generation, whereas interactive video/TV may represent a third

generation. Common for all are substantially lower contact costs per customer, higher revenue potential as well as increased flexibility and higher customer satisfaction.

Domestic companies will necessarily have to consider the foregoing developments. Further, banks are increasingly presenting greater competition for insurers and they have the distinct advantage that the customer comes to their premises and they have ample knowledge of his/her financial background.

The importance of customer retention can not be over stressed. This is not a new concept and is based on the premise that keeping a customer is more desirable, easier and more profitable than attracting new customers. More significantly, the rate at which customers stay or come back to an organisation, is perhaps the best way to measure the competitiveness of a company's products and services, as ultimately it will determine bottom line profitability.

In developing countries the customer is no different than elsewhere, and is becoming more and more knowledgeable about insurance products. Companies in Tanzania should take note of the changing trends in customer relationship management. Customer retention is linked to quality service which itself means meeting or exceeding customer expectations. Service quality has the dimensions of reliability, responsiveness, competence, access, courtesy, communication, credibility, security, understanding the customer and the appearance of the service environment.

7. CONCLUSION

I have attempted to demonstrate most of the areas I believe that are important in a dynamic and changeable financial services environment where

trading is liberalised together with deregulation. I have also stressed the necessity to be proactive and be prepared. There is a need for a changing corporate strategy to counter threats and convert them to opportunities. Planning is essential and many traditional approaches to management will become obsolete as the changes need imaginative responses. Effective management of exterior phenomena impacting on a company's operations is a challenging facet of modern management. Those insurers that do not pay heed to the several areas cited earlier will find that the changes on the horizon are intimidating. But for those that develop strategies to respond and participate in the changes, the future should be interesting and a profitable destination could be the outcome.

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