Appendix 1:

INTERVIEW 1

1. **Could you please give a background of your company?**

Our group is India's 5th largest financial conglomerate. The group has a net worth of Rs.5,997 crores, and we employ over 20,000 people in our various businesses. We also have a distribution network across 370 cities in India and 6 locations abroad including San Francisco, Dubai, Singapore. Our life insurance business began in 2001, and is a joint venture with Old Mutual plc, an insurance company listed on the London Stock Exchange with a global presence. We offer a wide range of Life Insurance products in both the individual and group business.

2. **Could you please talk a little about the insurance and pension market in India? Have there been any major changes in these markets in recent times?**

Insurance and pension markets have been rapidly growing in the past few years. There are around 21 players in the insurance market including the Life Insurance Corporation of India, the erstwhile state monopoly before the Sector opened to private sector in the year 2000. The market is very competitive. The insurance market is not exactly facing a slowdown, but its growth rates have fallen slightly since the past. The total life premium has now reached 4.1% of GDP after posting CAGR of 31% for last five years. In view of the highest household savings rate of 24% in the world; we still expect though a slower but still a strong growth rate of 25% for the next 5 years. There may be small hiccups due to stock market fluctuations, and various regulatory measures which have recently been implemented to reduce mis-selling, and wrong practices. These structural changes may affect our growth and we wish to look for alternative growth options.

3. **What kind of social security or pension cover do people in India have?**

Pension cover is mainly provided in our country only for government employees, and few other private company employees who invest in PFs and PPFs. However, almost 93% of the earning population in India has absolutely no sort of pension cover. This increases their risk and financial vulnerability in their old age, and is absolutely undesirable

4. **What is the current market position of your company in India?**

   Our company is one of the fastest growing insurance companies in India and has shown remarkable growth since its inception in 2001. It currently ranks 8th in the Indian insurance industry and has a 3.6% market share.

5. **Do you think entering the annuity market as part of your growth strategy is a good option? What would be the main advantages?**

We are looking for a growth of 75-100% per annum, and this requires us to look beyond solely the Savings cum protection market. The main advantage for us as a company is that we are in individual and group pension savings business which has been built upon the needs of the niche market of the mass affluent. This is going to be a prime target market for the annuity business as well. Furthermore, due to not having the immediate annuity product it is rather unfortunate those at the end of the pension savings plan term, out customers shift to other companies to invest in annuities. Hence, if we introduce annuities, we are meeting the needs of these customers within our company itself, and generating additional revenue.

6. **What do you think are the primary risks involved in this new market?**

There is an interest rate risk, and training risk leading to potential mis selling involved in the annuity market. It is possible that all the money invested in training of these agents will be unproductive if they are unable to ensure sale of these products. Furthermore, if interest rates fall in the future, the industry as a whole will be at a huge loss. Lastly, there is a mortality risk involved that if people live on for longer than the ages that we have used to determine our rates, the company will suffer.

7. **Could you please comment on competition in this potential annuity market?**

There are currently 12 players in the annuity market. LIC is the top player with a market share of over 90%. ICICI Prudential ranks second with a market share of 6%. All the other players occupy the slot of 4% market share.

8. **How profitable do you think this annuity product will be?**

We believe that the annuity product will be extremely profitable for our business. Looking at current market conditions and our ready customers, we believe that we will have a sale of 100 crores worth annuity sales in the first year. There should be a subsequent growth of around 100%, 75%, 50% and 25% in the next few years, after which we will hope to maintain the growth rate at least 20%.

9. **What will be the financial costs of diversifying into this market?**

The main costs of diversifying into this market are system costs. We need to establish a secure and efficient application software system to manage these regular payments. Furthermore, we need to train and inform our agents about this product, and hold workshops on how to sell these products, what to look out for etc. There are additional distribution costs, which may not be very high since we already have an established distribution network of 178 branches across 132 cities in India. The overall capital cost for this entire venture would be estimated at around Rs 12 crores.

10. **What external factors do you think will affect this form of growth into the annuity market?**

External factors would include interest rate fluctuations which are directly related to the rates we offer, any legislation passed by the government or the PFRDA, or change in administration requirements such as the capital cost requirement.

11. On the financial side, what do you think will be the cash flows for the next 6 years if you diversify into his market?

There will be a loss in the initial years due to the initial set up costs. Our VNB margins that is our revenue margins have been predicted to be 4.25% in the first year, and then grow every year by about 2% per annum. After adjusting the VNB margin against cost we will hit profitability in the second year itself. As we are riding on the existing distribution network particularly our promoter Kotak Bank, we are achieving significant cost efficiency leading to a solid profitability.

12. What will be the overall effect on all stakeholders as a result of this strategy?

I believe that there will be an overall positive effect for both the company, due to increased revenue and profit, and to the consumers as well, since they will be offered higher rates.

Appendix 1.2

1. **Could you please give a background of your company?**
Kotak Life is a JV between Kotak Bank and Old Mutual, which entered the Life Insurance Market following liberalization

2. **Could you please talk a little about the Life Insurance and Pension markets in India?**
The market is rapidly changing, as a result of strong competition. However, there is a strong push of products (with distribution driving the market). The Pension market, because of special tax status, needs less pushing (there is real demand from clients).

3. **Have there been any major changes in these markets in recent times?**
In the past 6 years, there has been a rise in Unit Linked Savings products. There has also been natural growth in the market, due to increasing salaries and growth in the working population.

4. **What kind of social security or pension cover do people in India have?**
Social security is very limited. Some large corporations and government provide employees with pension benefits. However, on the whole, a large section of the market remains without any sort of old-age cover.

5. **What is the current market position of your company in India?**
There are various measures, but on most KLI is between 6th and 10th amongst the private players. It ranks 8th in terms of premium in the Indian market. I can provide you with market share figures for the industry as well.

6. **Could you emphasize on the SWOT of your company?**
Having a tie-up to a fast growing bank is a great strength and provides opportunities. The Kotak brand is also well received in many quarters, especially amongst business men (but not so much amongst lower and middle income groups). The company is strong in the Western region of the country.

7. **Do you think entering the annuity market as part of your growth strategy is a good option? What would be the main advantages?**
Annuities in payment (i.e. excluding the deferred period), will be a growing market, as more people reach retirement. This is a commoditized product which is easy to compare. Only through superior fund performance particularly in the area of equity can lead to higher profitability which Kotak as a fund house possesses. It is also a product where clients are likely to opt for the "tried and tested" LIC, since there is no

opportunity to recover if things go wrong (so private players may struggle to compete for business).

8. What do you think are the primary risks involved in this new market?
Once annuities are in payment, the main risks are rapid improvements in mortality, and superior lives selecting the product. Finding suitable reinvestment opportunities is a lesser risk, as is default risk.

9. Could you please comment on competition in this potential annuity market?
As indicated earlier, it is easy for clients to compare the vanilla products. Companies may differentiate their products by adding features (like an increase in pension benefit if the client becomes infirm).

10. How profitable do you think this annuity product will be?
The vanilla product will have to be competitively priced, but as products are enhanced, the potential for profit will increase. Overall, since the annuities market is seeing a phenomenal growth of over 150%, we believe that the product too will show some brilliant profits.

11. 11 companies have entered the annuity market previously and failed to reach their aims; how do you think you will differentiate your product to make it a success?
I think most of the companies have launched the product together with their Savings cum protection products. As that market grew so fast the attention was not paid to the annuity products. We waited for sufficient number of accumulation product customer (who is supposed to buy annuities at the end of the maturity of their current contract) on books before the launch. With PFRDA bill which is getting introduced in the next parliament session is expected to be passed. Under the bill all the pension savers are compulsorily required to buy annuity from Life insurance companies. We are convinced that the market is ready to take off. Even there is expectation of a separate tax benefit for pension savings. Our aim is not just to get business now, but also to be ready if the market takes off.

12. What will be the financial costs of diversifying into this market?
There is relatively little cost. Obviously processes need to be adapted (regular payments to the clients and verifying that the client is alive), but these are not too challenging.

13. What external factors do you think will affect this form of growth into the annuity market?
Demand will grow if tax changes – there should be a tax break on the income. Population growth and an increasing proportion of middle income retired people will strongly feed demand.

14. On the financial side, what do you think will be the cash flows for the next 6 years if you diversify into his market?

It is hard to say – I will leave it to marketing to give the official numbers.

15. What will be the overall effect on all stakeholders as a result of this strategy?
To the extent that the product is competitively priced, consumers benefit. The regulator (IRDA) is under immense pressure to encourage companies to enter this market. Kotak will acquire some new clients and they can possibly be converted to Kotak bank clients. Increasing competition will make it easier for true brokers to get a foot in the door, and advice clients on the choices (although it is also possible that this product could be successfully sold over the Internet.

Appendix 2: SWOT ANALYSIS

Strengths:

1. KMLI currently has a pension fund market of 1 million individual customers and 422 group (Large and medium corporate in pension plans for their employees) customers, which can be immediately employed, at the end of their term, into annuities within KMLI. It also has easy access to the 5 million customers of the Kotak Bank. Hence, the company enters the market with a ready consumer base for its product.
2. An established insurance distribution network, combined with branches and franchisees of the group business, provides a ready channel for the quick and inexpensive implementation of the annuity product.
3. The company is entering the market relatively late compared to other competitors. This gives them an opportunity to differentiate their product, and better assess the risks and challenges involved in the business.
4. Being a financial conglomerate, there is high investment expertise possessed by the business particularly in the area of Equity. The 'Kotak' brand signage itself reflects their acumen and emphasis on investments-"Think investments, think Kotak"
5. The company being a 74% subsidiary of Kotak Mahindra Bank is placed in a strong financial position, as Kotak Bank is a well-established and highly profitable company. Hence, it is an available source of finance to meet the capital requirements of KMLI to venture into a new business.
6. In contrast to any other foreign company, KMLI possesses excellent in-depth local knowledge of the insurance and pension markets. Since the annuity business too requires similar skills and core competences, the organization is in a strong position.

Weakness:

1. KMLI is only a mid-size company[54], implying that it has comparatively lesser internal economies of scale and its overall risk-taking ability might also be inhibited by its comparatively smaller size
2. Compared to potential competitors[55] who have around 2000 branches all across the country, KMLI has only 178 branches. This size of 1/5th the distribution capacity of others may limit its ability to reach customers over a wide spread.

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[55] Bajaj Allianz, ICICI Prudential, LIC, ING Vyasa, TATA AIG, MET Life, SBI, HDFC Standard life

Furthermore, it is largely an urban and semi-urban market player, which restricts its ability to tap a rural market.

<u>Opportunity:</u>

1. Life expectancy of Indians has gone up from 57.4 years (1991) to 63.9 years (2007), and the urban mass affluent is expected to live till 80 years or more. The increase in life expectancy will lead to a greater urge to secure or cover the risk of living too long, and hence increase demand for the annuity product.
2. The pension and annuity market in the country is largely untapped. 93% of the earning population doesn't have pension funds in the country, and as there is no provision for social security in the country, there is very high potential for penetration. Furthermore, this suggests that even though there are many players which are already established in the market, it is still far from saturated.
3. The number of elderly persons is projected to increase to 113 million by 2016. This not only means an immediate larger market but also that with rising costs of healthcare (which a research shows accounts for 2/3rd of the total cost of the aged in our country) would further increase the keenness to purchase annuity.
4. Cultural changes in the family systems, primarily the break down of joint families is leading to fewer earning members, combined with an uncertainty of financial support from the young. This will push the aged to invest in annuities.
5. The new PFRDA[56] Bill has raised general awareness for the product. Furthermore, the act when passed will help create a pool of savings which will translate into future annuity sale
6. The current pension product sale by the life companies is estimated at a value of Rs 22562 crores, while the annuity market is only worth Rs 1975 crores. This means that there are a lot of available funds in the market to be invested in the annuity business.

<u>Threats:</u>

1. If the economy enters a high interest rate cycle, it may affect the sale adversely. This is because high interest rates mean an increase in the opportunity cost for the customers for buying annuities, who may prefer to invest in other fixed interest instruments particularly with banks. Hence sales will fall, and profits for the company may suffer. Besides that fixed rate annuities are offered for a longer period and need to be sufficiently hedged against the future reduction in interests.
2. In the past 4 years, 11 companies have entered the market, and failed to attain material success. This is primarily because Life Insurance Corporation (LIC), the erstwhile state monopoly for 45 years, has a strong foothold over the market, and in spite of KMLI planning to offer more attractive rates, there is a risk of it failing like some of its competitors.

[56] (Pension Fund Regulation and Development Authority)

3. The Indian annuity industry has extremely high capital requirements, last raised in 2005, that are greater than those of various international markets. This raises the initial costs for the business.
4. The mortality rates used for calculating annuity rates are developed according to the 94-96 time series released by the LIC. This rate is highly likely to have changed over the span of 12 years. Hence, this data may be redundant, reducing the accuracy and validity of the mortality rates, and could adversely affect profit margins.

Appendix 3: PEST ANALYSIS

Economic factors:

1. The interest rate fluctuations in the market greatly influence the organization in the annuity business. If a higher interest rate is offered in the market, it means the opportunity cost of investing in annuities is higher. This pushes the rate of return offered by the company higher, and also means that in the future, a fall in interest rates would be a huge blow on profit margins for the organization.
2. Inflation would corrode the net present value for the organization, making the cash flow and profit predictions inaccurate.
3. The capital requirements for the business are determined by regulations. If there is an increase in this requirement, the company's outflow would increase, and costs would rise.

Social factors:

1. The demography of the Indian population is an important factor in determining the annuity demand. As the number of people over the age of 55 or 60 goes up, the need for annuities will also increase.
2. As mortality rates change, the rates offered by the annuity organization, will also fluctuate accordingly. If mortality rates fall, which has been the general trend since the past few years, the rates that can be offered for the annuity product are also likely to fall.
3. Dynamic social factors such as the breakdown of the joint system and rise of the nuclear family, increases the social need for an annuity product to safeguard the payment of expenses and more particularly maintaining the standard of living in the latter years of one's life.

Technological:

1. Improved technology can help reduce distribution and administrative costs. A secure system of online purchase of the product, as well as online payment of premiums will help control costs for the company as well as make the entire system faster and more efficient.
2. An electronic clearing system (ECS) will allow the company to spread its product across a wider range of locations. Furthermore, promotion can also be done through websites in an inexpensive and effective manner.

Legal:

1. The legal framework of the annuity is still in its nascent stage. New acts and laws passed could help raise awareness, and hence sales for the annuity business. Legal acts in favour of tax exemptions could further increase demand for the product.
2. If the legal framework and administrative and legal requirements increase, the entire process will be made more cumbersome and due to rising costs, profit margins may also be adversely affected.

Appendix 4: Market share details:

Rank	Insurer	Premiums 01-04-08 to 31-07-08 (in Rs. crores)	Market Share among Pvt Players	Market Share overall
1	ICICI Prudential	2,192.33	23.37%	10.86%
2	SBI Life	1,457.65	15.54%	7.22%
3	Bajaj Allianz	1,197.95	12.77%	5.94%
4	Reliance Life	838.22	8.94%	4.15%
5	Birla Sunlife	706.07	7.53%	3.50%
6	HDFC Standard	685.15	7.30%	3.40%
7	Max New York	641.84	6.84%	3.18%
8	Kotak Mahindra Old Mutual	345.15	3.68%	1.71%
9	Tata AIG	333.88	3.56%	1.65%
10	Met Life	254.26	2.71%	1.26%
11	Aviva	224.87	2.40%	1.11%
12	ING Vysya	220.74	2.35%	1.09%
13	Shriram Life	105.95	1.13%	0.53%
14	Bharti Axa Life	67.27	0.72%	0.33%
15	IDBI Fortis Life	57.38	0.61%	0.28%
16	Sahara Life	33.85	0.36%	0.17%
17	Canara HSBC OBC Life	12.69	0.14%	0.06%
18	Future Generali Life	5.57	0.06%	0.03%
19	Aegon Religare	0.08	0.00%	0.00%
	Total Pvt.	9,380.92	100.00%	46.49%
	LIC	10,797.10		53.51%
	Total	20,178.02		100.00%

Appendix 5: FINANCIAL ANALYSIS

PAYBACK PERIOD:

$$PAYBACK\ PERIOD = \frac{Cost\ of\ initial\ investment}{Cash\ inflow}$$

Cash inflow for year 1: 1.25 crores
Cash inflow for year 2: 4.18 crores
Cash inflow for year 3: 10.675 crores

Therefore payback period = 2 years and $\frac{6.57}{10.675} \times 365\,\text{days}$

= 2 years and 234 days

ARR:

$$\text{ARR} = \frac{\text{Cash inflows} - \text{Capital costs}}{\text{Capital costs} \times \text{number of years}} \times 100$$

$$= \frac{85.742 - 12}{12 \times 6} \times 100$$

= 102.419%

Appendix 6: MARKET RESEARCH: Survey for potential customers

A stratified random sample of 30 people was taken, using only the current insurance customers who fall into the prime age group, (40-65). 30 people were selected at random out of those and questioned.

Gender:
Male
Female

Age:
40-45
45-50
50-55
55-60
60-65
65-70

Are you familiar with the idea of an annuity purchase would help ensure a steady income in the latter years of your life?

Yes
No
Have a vague idea, but not entirely clear about all its details

Would you be interested in purchasing an annuity product?
Yes
No

If no, why not?

1. Do not feel the need for it
2. Alternative investment will get more returns
3. Want to have control over own savings
4. Annuities are too inflexible

Gender	Age	Informed	Interested	Reason for disinterest
Male	40-45	Yes	Yes	
Male	60-65	Yes	Yes	
Female	60-65	Partially	Yes	
Male	45-50	Yes	Yes	
Male	45-50	Partially	Yes	
Male	40-45	Partially	Yes	
Male	40-45	Yes	No	Do not feel the need for it
Male	45-50	No	No	Want to have control over own savings
Male	60-65	No	Yes	
Male	55-60	Yes	No	Alternative investment will get more returns
Female	55-60	Partially	Yes	
Male	45-50	Yes	Yes	
Male	45-50	Yes	Yes	
Male	50-55	Yes	Yes	
Female	50-55	Yes	No	Do not feel the need for it
Female	50-55	No	Yes	
Male	60-65	Partially	Yes	
Male	60-65	Yes	Yes	
Male	55-60	Yes	Yes	
Male	45-50	Partially	Yes	
Male	50-55	No	Yes	
Male	50-55	Yes	Yes	
Male	50-55	Partially	Yes	
Female	60-65	No	Yes	
Male	55-60	Yes	Yes	
Male	40-45	Partially	Yes	