Structural adjustment and change in the Australian life insurance industry post demutualisation

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Abstract
Deregulation of financial markets has been an important platform for
government policy in recent times. It has been a catalyst in the expansion of
financial sector. The experience of Australian life insurers during this
period represents an interesting case study into the impact of regulatory
transition. The lifting of restrictions changed the institutional environment
within which life insurers operated. In doing so it precipitated changes in
strategies and organizational structures of these financial intermediaries. An
information cost framework is used to analyse the consequences of
deregulation and its implications for the Australian life insurance industry
in emerging global financial markets.
Introduction

In the last two decades the Australian financial system moved rapidly from one of the most regulated systems to one of the least in the space of a few years. The extent and speed of this change has had far reaching implications for the financial sector and the players within it. The adjustment experience provides an interesting case study into the impact of regulatory processes, particularly on specific sectors of the financial system. The Australian life insurance industry is a case in point. Mutual firms had been leaders in this market for well over a century. This form of organization was placed under pressure by the progressive deregulation of the banking sector that occurred in the 1980s and 1990s. The lifting of these restrictions changed the institutional environment within which life insurers operated. In doing so it precipitated changes in strategies and organisational structures of these financial intermediaries. Deregulation led to the emergence of new institutions that came into direct competition with established life insurers and challenged the status quo.

It is the purpose of this paper to analyse the consequences of the financial deregulation and the restructuring it engendered for Australia's mutual life insurers in the 1990s and to investigate the process of organisational change which resulted. It is argued that a spillover effect of the regulatory system imposed on Australian banks after world war two was to protect the structure of the life insurance industry from the full force of developing market pressures. These forces, which were largely technologically driven, were a key element in motivating the push for financial sector restructuring. The lifting of regulatory controls removed the obstacles to market adjustment resulting in radical change in the structure of the Australian life insurance industry. The Australian experience reflects that of other countries, such a Britain where mutual financial firms played an important role in the development of the building society industry. As in
Britain, a change in the regulatory environment was a key catalyst to the
demutualisation of these institutions which sparked further readjustments in
the financial services sector (Martin and Turner, 2000).

In developing the central argument, this paper will proceed by
outlining a theoretical framework for evaluating the process of change in
the life insurance industry. The structure of the industry as it evolved will
be reviewed and the impact of changes in the regulatory environment
assessed.

**Theoretical Explanations**

Chandler (1992) suggests that strategic plans, internal organization
and lines of communication work together to shape corporate capabilities.
The outcome determines the types of opportunities the firm can utilise
within its environmental context. In this model firms are shaped by, and
shape their environment (Boyce and Ville, 2002, p.20). Chandler's model
provides an explanation of how firms grow and diversify leading to
increasing productivity and growth in the economy.

Alternatively pressures on organisational structures to change may
be explained with reference to transaction costs. The problems of
information asymmetry and bounded rationality contribute to the cost of
transacting. Without access to all information, economic agents cannot
make informed decisions about all aspects of the transaction. Firms and
market structures that can create effective transacting frameworks will be
more efficient than those that cannot (Boyce and Ville, 2002, p. 19). A
variation of this argument is to extend the definition of transaction costs to
include the costs of collecting and processing information necessary for the
firm to conduct its business (Casson, 1997, p. 151). As these change,
pressure is brought to bear on financial intermediaries to adapt.
Organisational renewal is seen as a regular process within this model. The
framework suggests that changes in organisational structures are driven by
changes in the processes of intermediation. These in turn are a response to
changes in information costs (Casson 1997, p. 151-53). Two important
influences on information costs are technological change and regulation. Whilst technological developments ultimately reduce information costs, regulation tends to impede the flow of information and raise costs in this model. The lifting of controls, in freeing up the market mechanism alters the nature of information costs. The new and different competitive influences that arise put pressure on the organisational structure of firms and markets. The lifting of regulatory controls at a time of rapid technological innovation will create an environment in which organisational change becomes inevitable. The demutualisation of major life insurers in the 1990s is an illustration of this.

Ownership structures in the life insurance industry within a regulated financial market

Providers of life insurance in Australia have historically fallen into three categories, mutual associations, publicly listed companies and government agencies. Of the three groups, it has been the mutual associations which have historically held the largest percentage of industry assets. Although there were several publicly listed companies operating in the market prior to World War Two, it was not until the post-war period that these firms made an impression on market share. The government sector entered the market even more recently. In the 1980s government insurers, spurred on by the expansion of superannuation, branched into life insurance in a limited way. From the mid-1980s four State insurance offices offered life insurance products. However, they were constrained to operate within their particular state and unable to expand beyond it unless application was made for registration under the Federal Government Life Insurance Act.

The significance of mutual associations is a feature of the Australian life insurance industry which distinguishes it from experiences in other countries. In Britain, major life insurers evolved as departments of composite insurance companies selling a range of insurance products (Supple, 1971, p.74). In the USA, major life insurers converted to mutuals in the early part of the twentieth century in response to public pressure to
curb the perceived corporate excesses of these large firms (Keller, 1963). The leading Australian life insurers however, were established as mutuals and traced their foundations to co-operative values that had more in common with friendly societies than commercial insurers. The basis on which early mutual life offices operated was very different to that of private insurers. Mutual life offices were established as societies representing groups of concerned citizens with a common affiliation, be it religious or philanthropic and this influenced their approach to business and corporate development.

The first mutual life insurance association was the Australian Mutual Provident (AMP) formed in 1849. The aim of the Society was to set up a 'modest life office' for the benefit of clergymen and other professionals to provide for their old age and dependents (Blainey, 1999). The AMP remained the only Australian mutual society for twenty years. The second mutual life association was not formed until 1869 by which time the AMP had established its market dominance in the life insurance industry. What competition the AMP experienced between 1849 and 1869 came from the limited number of Australian proprietary and overseas general insurance companies in operation in the colonies. Four Australian companies established in the late 1850's and early 1860's sold life insurance as part of their general business. However all these companies had ceased to do so by 1889. These companies found that life insurance was not a profitable branch of business Of the overseas companies, eighteen British firms had agents who sold life insurance in Australia between 1860 and 1869. This number had been reduced by half in 1880 and by 1893 there were no British companies selling life insurance in Australia (Gray, 1977, p. 22-3).

By 1900 dominance of mutual life insurers was clearly established. Although they were only a small number they accounted for a substantial share of assets and premiums sold. Mutual associations captured and retained a large market share from a very early stage in the development of the industry. Table 1 demonstrates this point.
<table>
<thead>
<tr>
<th>Year</th>
<th>Mutuals Number</th>
<th>% of Total Assets</th>
<th>Non Mutuals Number</th>
<th>% of Total Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>1900</td>
<td>5</td>
<td>86</td>
<td>6</td>
<td>14</td>
</tr>
<tr>
<td>1920</td>
<td>5</td>
<td>85</td>
<td>11</td>
<td>15</td>
</tr>
<tr>
<td>1940</td>
<td>5</td>
<td>83</td>
<td>13</td>
<td>17</td>
</tr>
<tr>
<td>1960</td>
<td>5</td>
<td>80</td>
<td>14</td>
<td>20</td>
</tr>
<tr>
<td>1980</td>
<td>4</td>
<td>69</td>
<td>43</td>
<td>31</td>
</tr>
<tr>
<td>1990</td>
<td>4</td>
<td>72</td>
<td>57</td>
<td>18</td>
</tr>
<tr>
<td>1995</td>
<td>3</td>
<td>54</td>
<td>45</td>
<td>46</td>
</tr>
<tr>
<td>2000</td>
<td>0</td>
<td>0</td>
<td>42</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Australasian Insurance and Banking Record, 1900-60, Life Insurance Commission, 1980 APRA, 2000

This table highlights a number of features of the Australian life insurance market. The number of life insurers in the market was historically very small and it was not until the 1970s that any significant increase occurred. In addition a small number of mutual offices traditionally accounted for around four fifths of industry assets although this began to fall in the 1980s. These firms were the market leaders for a significant period of time. The decade of the 1990s was a period of substantial organisational adjustment which saw a reversal of patterns in ownership structures with the disappearance of mutual life offices by the turn of the century.

One explanation for the formation of the mutual form of organization was that it was the one that dealt with the information cost problem most effectively. It has been argued that the mutual governance system reduced some of the negative impact associated with information costs because it was better equipped to deal with the agency relationship (Fama and Jensen, 1983, p. 347). The policy holder in taking out an insurance contract delegated some decision making authority to the insurance company. A residual loss occurred if decisions made by the agent deviated from those which may have been made by the individual or principal. Mutuals, in which policy holders also have rights of ownership, could be argued to be better placed to solve this type of agency problem.
Smith (1986, p. 708) argues that the long term survival of mutuals in competition with other ownership structures is indicative of the efficiency of this governance structure. Empirical studies of American companies which have switched from stock to mutual ownership support this conclusion (Mayers and Smith, 1986, p.74). McNamara and Rhee (1992, p.222) cite a number of studies which suggest that the mutual organisation is not necessarily inefficient. Efficiency gains may also accrue because of the absence of a third party (the shareholder) in the ownership structure. In a mutual association the policyholder is also an owner of the company’s assets. The potential for policy holder/shareholder conflicts to occur are non-existent (Smith, 1986, p. 707-8). Gains in this respect may be countered by losses accruing from owner/manager conflicts. However Smith (1986) argues that mutuals have a definite comparative advantage in areas that require little managerial discretion. Life insurance policies based on predetermined formulae built on actuarial data fall into this category.

However opinion is divided upon which form of ownership performs better. On the negative side, mutuals have been found to have number of features which could contribute to inefficiencies. Frech (cited in Mayers and Smith, 1986, p.74) argues that the actual property rights structure of mutuals indicates that policy holders may not have full property rights. For example, policyholders may participate in the returns of the mutuals assets but they cannot transfer ownership of these assets independently.

Without full property rights mutuals may perform less efficiently than stock companies. The potential for owner/manager conflict is an example of this. In a stock insurance company the behaviour of management can be tempered by outside market forces. The threat of takeover can reduce the costs management can impose on other stakeholders of the firm. Competitive forces limit the extent to which management can take unilateral decisions which impact adversely on shareholders. The control mechanism which restricts the level of such conflict in stock firms is absent in the mutual which is not subject to the
same degree of market constraint. The removal of management is more
difficult and costly in a mutual (Mayers and Smith, 1986, p.76).

The long term success of mutual life insurers in Australia would
suggest that these negative factors were not significant and that there was a
high degree of efficiency in this method of ownership. In the life insurance
market where mutual firms operate in direct competition with stock
companies competitive pressures would ensure that unprofitable and
inefficient structures of ownership did not survive in the long run. The fact
that the major mutuals were also consistently among the market leaders
would also suggest that this form of organisation was an efficient method of
delivering life insurance products.³

The implications of deregulation for the life insurance sector

A feature of the Australian financial sector in the post war era was
the prescriptive and very rigid controls placed on the banking industry. For
35 years the banking sector was one of the most highly regulated in the
Western world. Whilst life insurers were not the direct target of these
controls, they were nonetheless affected by them. Controls placed on
Australian banks during the second world war were extended in the post
war period to facilitate the implementation of the government’s
macroeconomic policy agenda. Direct control of banking was the main
monetary policy tool used to moderate fluctuations in trade cycle (Merrett,
2002, p. 277). However regulation also had far reaching implications for the
development of the finance sector and the behaviour of financial entities. It
defined the boundaries within which financial sector firms could operate
and in doing so perpetuated market segmentation. The result of this
segmentation was that banks and other large financial institutions could not
compete directly in the life insurance market. They were forced to do so
indirectly through the use of subsidiary companies which had to be
accredited with a license to sell life insurance. This meant that banks were
not able to make full use of their information network and thus had higher
information costs than if they had been able to compete directly. Likewise it also meant that life insurers were not able to compete directly in other parts of the financial sector. They too, had to do so indirectly through subsidiary companies (Keneley, 2004). Under this type of regime, protected by their historical position and the regulatory environment, the organisational structure of mutual life offices was not greatly challenged.

The environment within which life insurance firms operated was altered with the progressive lifting of regulatory controls in the financial sector which began in the mid 1980s. The catalyst for this shift was the growing lack of competitiveness of banks both domestically and abroad as other financial institutions grew to provide the services banks were barred from. The process of disintermediation which had gathered strength in the preceding decades was also seriously impacting on the Australian government’s ability to implement an effective monetary policy regime. The course of deregulation, inspired by the recommendation of the Committee of Inquiry into the Financial System (1981), was cumulative and an ongoing feature of the sector for most of the 1980s and 1990s. During this time interest rate and exchange rate controls were lifted, restrictions on the commercial activities of banks abolished and ‘captive’ market requirements on banks and life insurers removed (Davis, 1997, p. 4). Deregulation had far reaching implications for the structure and conduct of financial markets in Australia. With this opening up of the sector, barriers to entry and the segmentation of markets were reduced. The industry reorganisation which resulted from the lifting of restrictions led to the emergence of new institutions which no longer focused on the provision of one bundle of products. The growth of financial conglomerates which encompassed a range of activities was a feature of the Australian finance market in the 1990’s (Davis, 1997, p. 12).

Within the life insurance market, deregulation was associated with a shake up of the industry. The number of insurers initially increased from 45 in 1980 to 58 in 1990. The reduction in barriers to entry allowed institutions to enter the market and compete directly with established firms. Banks,
which had previously only been able to compete indirectly in the life insurance market, rapidly gained market share from the mid 1980s. The first bank to register as a life insurer was the National Australia Bank in 1985. Over the next three to four years the other major banks followed suit. In 1990 they accounted for 9 per cent of industry assets, a decade later this had risen to 44 per cent (ISC, 1990, APRA, 2000).

The market trend both in Australia and overseas was for financial firms to become larger, spreading into other financial markets in a bid to exploit opportunities for related diversification and improve their competitive advantage. Realignment in the financial sector in the 1990s was associated with the rise of conglomerates. The Reserve Bank (1996, p.3) reported that by 1996 conglomerates accounted for around 80 per cent of financial system assets. The largest 25 held close to 70 per cent of assets. The Australian experience was part of a global trend whereby financial enterprises sought economies of scope in the sale of new financial products (De Souza, 1995, p. 21)

In line with financial sector trends major life insurers also embarked on the process of expansion and diversification. Taking advantage of the relaxation in entry requirements the large life offices sought to enter the banking sector. The Colonial Mutual acquired the State Bank of New South Wales to form the Colonial Bank. The AMP attempted to negotiate a joint venture with the Chase Manhattan Bank (Blainey, 1999, pp. 288-9). In the decade of the 1990's the leading life insurance firms moved into the areas of integrated financial services. Firms such as the AMP, National Mutual and Colonial reorganized to become institutions that offered a full range of financial services from banking to insurance and financial planning. This was achieved through a series of mergers, acquisitions and takeovers that witnessed a restructure of the industry.

The growth of mega institutions in the life insurance industry placed pressure on the mutual form of organization. The process has been part of an ongoing global trend to demutualisation that has been evident since the 1980's (Garber, 1986). Demutualisation of insurance offices, building
societies and other thrift institutions occurred in Britain, Canada, South Africa and the USA (RBA, 1999, pp. 2-3). The Canadian experience in the 1990’s for example, was very similar to that in Australia with the public listing of four of the largest life insurance mutuals (Anon, 1999). In Britain, alteration to the regulation of building societies with the Building Societies Act 1986 paved the way for the demutualisation of larger building societies in the 1990s (Martin and Turner, 2000, pp. 225-7).

Alongside the impact of financial deregulation, technological development in the production and distribution of financial services impacted on the traditional providers of life insurance. New technology altered the way in which services could be provided to consumers. This in turn allowed financial institutions to differentiate between the products they provided and their various customer groups (Llewellyn, 1996, p.168). The deconstruction of services into component parts opened the way for firms to focus on the provision of services for which they had a comparative advantage in (Llewellyn, 1996, p.157). The unbundling of insurance products, a trend that began in the 1970s, gained pace in the 1980s. The separation of life insurance products into mortality risk and investment earnings led to the creation of a whole range of investment linked products. This led the industry to become more closely linked with the financial services market than previously (ISC, 1990). Not only were life insurers offering similar products to other types of financial institutions, these firms also began providing substitutes for life insurance. New technology and new marketing techniques also meant that life insurers were required to invest and adapt to maintain market share.

The unprecedented requirement for capital to support the transformation of life insurance associations into providers of integrated financial services to global markets was a critical factor in the push for demutualisation. The lifting of regulatory controls cleared the way for the growth of mega financial institutions and called into question the essence of mutual ownership structures. Mutuality had evolved as a response to market failure. Both buyers and sellers faced particular informational problems in
distinguishing and defining risks associated with life insurance products (Hansmann, 1985). The mutual form of organization was able initially to minimise many of adverse consequences associated with asymmetric information. A century later the development of actuarial and insurance practice had overcome many of these problems. In the words of the chairman of one major mutual insurer the mutual organization had become 'irrelevant and inappropriate' (Colonial Annual Report, 1998).

Demutualisation became inevitable as the financial sector adjusted to the combined changes in the regulatory environment and technological advances in product and distribution systems. These factors and the accompanying globalisation of financial markets made old business structures obsolete. To compete with new forms of intermediation emerging in financial markets organizational change was needed. The listing of the major mutual life insurers as private companies occurred progressively throughout the 1990s as Table 2 indicates,

Table 2: Life Insurance Demutualisation in the 1990s

<table>
<thead>
<tr>
<th>Life Insurer</th>
<th>Date of Demutualisation</th>
<th>Institution Established</th>
<th>Form of Demutualisation</th>
</tr>
</thead>
<tbody>
<tr>
<td>City Mutual</td>
<td>October 1990</td>
<td>ML.C Life</td>
<td>Acquisition by another insurer</td>
</tr>
<tr>
<td>National Mutual Life Association of Australasia</td>
<td>September 1996</td>
<td>National Mutual Holdings</td>
<td>Share issue to members and sale to foreign interests</td>
</tr>
<tr>
<td>Colonial Mutual Life Association</td>
<td>December 1996</td>
<td>Colonial Ltd.</td>
<td>Share issue to members</td>
</tr>
<tr>
<td>Australian Mutual Provident Society</td>
<td>January 1998</td>
<td>AMP Ltd.</td>
<td>Share issue to members</td>
</tr>
</tbody>
</table>

Source: RBA 1999

By 2000 there were no mutual providers of life insurance. The mutual system of life insurance which had dominated the Australian market for 150 years had ceased to exist. The organisational approach adopted by the mutual life insurers was that of the multi subsidiary company model. Firms such as the Australian Mutual Provident Ltd, National Mutual Life Ltd and the Colonial Ltd. evolved to become 'allfinanz' institutions offering a full range of financial services from banking to insurance and wealth management to customers. Figure 1 synthesises the corporate model which evolved amongst the major life insurers.
With demutualisation the newly formed companies moved rapidly to become integrated service providers. Various activities which had been undertaken by subsidiaries in the past were brought under the umbrella of the principal company. New activities such as banking and stockbroking were initiated as these firms moved to establish themselves as major players within the financial sector. This in itself created pressures for further organisational change as the costs associated with entering new markets rose.

Initial data available on the performance of demutualised life insurers indicated that a period of instability followed the transition process with the major firms experiencing fluctuations in profitability and efficiency measures. Whilst financial markets expected the major mutual life insurers to continue to be market leaders this was not necessarily the case (*AFR*, 4
October 1997, pp.35-6; BRW 26 January 1990, pp.30-33). Measures used to analyse the performance of life insurers include changes in market size and share, profitability and efficiency. These measures are based on similar yardsticks used by Hogan (1991) and KPMG (1997) to evaluate the performance of other financial institutions. They are derived from data collected by Australian Prudential Regulation Authority (APRA) in accordance with the Life Insurance Act 1995.  

Table 3 indicates the trend in the size and market share of the major life insurers that demutualised in the 1990’s. The former mutuels still accounted for more than half industry assets.

<table>
<thead>
<tr>
<th>Financial Year</th>
<th>Total Assets $m</th>
<th>Percentage of Industry Assets</th>
<th>Percentage of Premium Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Demutualised Firms</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1997/98</td>
<td>94,687</td>
<td>55.6</td>
<td>40.2</td>
</tr>
<tr>
<td>1998/99</td>
<td>86,152</td>
<td>51.5</td>
<td>40.1</td>
</tr>
<tr>
<td>1999/00</td>
<td>104,597</td>
<td>53.7</td>
<td>37.0</td>
</tr>
<tr>
<td>Non-Mutuals</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1997/98</td>
<td>75,364</td>
<td>44.4</td>
<td>59.8</td>
</tr>
<tr>
<td>1998/99</td>
<td>80,934</td>
<td>48.5</td>
<td>59.9</td>
</tr>
<tr>
<td>1999/00</td>
<td>90,171</td>
<td>46.3</td>
<td>63</td>
</tr>
</tbody>
</table>


However, the growth in the assets of demutualised firms varied considerably in comparison to the non mutuals. From experiencing negative growth between 1998 and 1999 the trend reversed to a rapid positive growth in 1999/2000. The performance of certain firms highlight the extent of destabilisation they underwent post demutualisation. After demutualisation the two largest firms, the AMP and National Mutual Life, experienced a fall in the value of their assets during 1998-99. The value of these firm’s assets fell by 15.2 per cent and 8.2 percent respectively (APRA 1999). This was
also reflected in the declining share of premium income attributed to the ex mutuals.

The mixed performance of demutualised firms was mirrored in their profit outcomes. Profitability measures include operating profit before and after tax and as a proportion of net assets. They can be broken down to reflect the two main sources of the firm's income; premium income and investment income.

Table 4: Profitability Measures

<table>
<thead>
<tr>
<th></th>
<th>Demutualised Firms</th>
<th>Operating Profit Before Tax $m</th>
<th>Operating Profit After Tax $m</th>
<th>Net Interest Income/Total Assets %</th>
<th>Premium Income/ Total Assets %</th>
<th>After Tax Operating Profit/ Net Assets %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997/98</td>
<td></td>
<td>4,135</td>
<td>2,605</td>
<td>11.0</td>
<td>13.2</td>
<td>21.6</td>
</tr>
<tr>
<td>1998/99</td>
<td></td>
<td>2,257</td>
<td>1,762</td>
<td>8.4</td>
<td>17.0</td>
<td>28.6</td>
</tr>
<tr>
<td>1999/00</td>
<td></td>
<td>544</td>
<td>215</td>
<td>7.5</td>
<td>11.9</td>
<td>2.7</td>
</tr>
<tr>
<td>1997/98</td>
<td></td>
<td>2,275</td>
<td>1,385</td>
<td>13.8</td>
<td>24.6</td>
<td>25.4</td>
</tr>
<tr>
<td>1998/99</td>
<td></td>
<td>1,865</td>
<td>1,232</td>
<td>7.1</td>
<td>27</td>
<td>23.4</td>
</tr>
<tr>
<td>1999/00</td>
<td></td>
<td>2,557</td>
<td>1,913</td>
<td>7.8</td>
<td>23</td>
<td>19.9</td>
</tr>
</tbody>
</table>


Table 4 highlights the contrast between the performance of the demutualised firms and non mutuals. Whilst both experienced declining profits, for the non mutuals this was relatively short term and a strong recovery was evident within the next financial year. For demutualised firms recovery was not evident with both before and after tax profit declining by over 90 per cent between 1997 and 2000. In the same period the profitability of non mutuals grew 38 per cent before tax and 24 per cent after tax.

The fall in the profitability is reflected in the ratio of operating profit to net assets. Here the volatility in the performance of the demutualised firms is also evident. After increasing sharply, the ratio fell dramatically largely because of the negative operating profit recorded by a major life insurer.

Table 4 indicates that the profitability record of demutualised firms was erratic after the change in ownership structure. Table 5 suggests that
there were no great efficiency gains in this time frame. In Table 5 efficiency is measured in three ways, operating expenses as a proportion of total assets, percentage of operating expenses to operating income and operating profit as a ratio of operating expenses.

Table 5: Efficiency

<table>
<thead>
<tr>
<th>Year</th>
<th>Demutualised Firms</th>
<th>Non Mutuals</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Operating Expenses/Total Assets</td>
<td>Operating Expenses/Operating Income %</td>
</tr>
<tr>
<td>1997/98</td>
<td>2.03</td>
<td>8.3</td>
</tr>
<tr>
<td>1998/99</td>
<td>2.07</td>
<td>8.1</td>
</tr>
<tr>
<td>1999/00</td>
<td>2.04</td>
<td>10.5</td>
</tr>
<tr>
<td></td>
<td>Non Mutuals</td>
<td>2.22</td>
</tr>
<tr>
<td>1997/98</td>
<td>2.28</td>
<td>6.6</td>
</tr>
<tr>
<td>1998/99</td>
<td>2.31</td>
<td>7.4</td>
</tr>
</tbody>
</table>


This table indicates that whilst the ratio of operating expenses to assets was marginally lower amongst demutualised firms, the proportion of operating expenses to income was much higher. The poor performance of the operating profit to expenses ratio is a common feature of all firms in the industry. It suggests that there was no immediate decrease in information costs following the change in organisational structure. The findings are consistent with those made by Yates (2005, pp.621-2). Yates, in investigating the impact of technological change in the American life insurance industry, found that there was a considerable lag (in some cases up to two decades) between the introduction of computerised technologies and efficiency gains. One reason for this was that organisational changes were needed to realise productivity gains. A similar argument could be made in respect to demutualised life insurers, further changes to operational structures were needed before any efficiency gains associated with demutualisation could be fully realised.

Table 5 indicates that the returns to owners in respect to outlays were weak. This is a reflection of an industry in transition. The transformation of firms from insurance companies to financial conglomerates put pressure on
returns at a time when industry profits were squeezed. This can be seen in a breakdown of available data for the three major demutualised life insurers.

Table 6: Return on Equity and Return on Assets for former Mutual Life Insurers

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ROE %</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>AMP</td>
<td>12.53</td>
<td>6.37</td>
<td>6.87</td>
<td>7.04</td>
<td>3.55</td>
</tr>
<tr>
<td>National Mutual</td>
<td>4.2</td>
<td>5.69</td>
<td>9.78</td>
<td>-22.52</td>
<td>11.54</td>
</tr>
<tr>
<td>Colonial Mutual</td>
<td>10.6</td>
<td>7.93</td>
<td>9.29</td>
<td>Delisted</td>
<td></td>
</tr>
<tr>
<td><strong>ROA %</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>AMP</td>
<td>13.32</td>
<td>1.17</td>
<td>1.02</td>
<td>1.03</td>
<td>0.72</td>
</tr>
<tr>
<td>National Mutual</td>
<td>4.81</td>
<td>4.72</td>
<td>1.55</td>
<td>-1.44</td>
<td>1.79</td>
</tr>
<tr>
<td>Colonial Mutual</td>
<td>2.49</td>
<td>1.81</td>
<td>2.03</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: AspectHuntley FinAnalysis

The pattern of instability both in returns on equity and returns on assets is evident in all the major demutualised life insurers. One reason for the erratic performance of demutualised insurers was that the process of organizational change did not halt with demutualisation. Further adjustments continued as financial markets developed strategies to enable them to compete in an increasingly broader range of markets. The pressures within the financial sector towards conglomeration gathered momentum in the late 1990s, demutualised insurers were susceptible to these forces.

In the immediate period after demutualisation, life insurers aggressively pursued expansionary strategies and moved to acquire market share in related markets. All acquired interests in banking and expanded their operations in general insurance and funds management both domestically and overseas. Appendix 1 provides a snapshot of the types of activities these firms undertook in the immediate period after demutualisation. The extent and pace of expansion is a reflection of the transitional state of the Australian financial sector. Whilst these firms expanded into other markets, competition from other financial service providers increased in the life insurance market. The degree of restructuring...
saw the ex mutuals broaden their organizational base to become international players in the financial sector. However it also made them vulnerable to take over pressures from other larger firms. These pressures culminated in another round of adjustments at the end of the decade of the 1990s. Table 7 traces the outcome of these changes that saw most of the demutualised life insurers disappear from the insurance market.

Table 7: The progress of demutualised life insurers

<table>
<thead>
<tr>
<th>Life Insurer</th>
<th>Date of Demutualisation</th>
<th>Institution Established</th>
<th>Merged Entity</th>
</tr>
</thead>
<tbody>
<tr>
<td>City Mutual</td>
<td>October 1990</td>
<td>Acquired MLC Life Ltd.</td>
<td>National Australia Bank 2000</td>
</tr>
<tr>
<td>Australian Mutual Provident Society</td>
<td>January 1998</td>
<td>AMP Ltd.</td>
<td>AMP Ltd</td>
</tr>
</tbody>
</table>

Two of the four were taken over by major Australian banks. A third was originally partially acquired by foreign interests. With a re-organization of this company in 2000 the emphasis shifted more firmly to an Asia/Pacific wealth management and insurance outlook. Whilst the Australian life insurance brand name was retained the company is now part of a global financial services enterprise. These mergers have contributed to the newly emerging structure of the life insurance sector which can be segmented into three groups. The main group consists of financial conglomerates which represent the bulk of market share and are comprised of the major bank owned and foreign owned wealth management institutions. The top ten in this group account for 93 per cent of industry assets. All firms with a link to a mutual heritage are ranked amongst the top 10 life insurers by assets and by premium income (APRA 2004a). Table 8 indicates the industry share of the four firms that have a link to the mutual structure.
Table 8: Four Mutual Heritage Firms Share of the Australian Life Insurance Market

<table>
<thead>
<tr>
<th>Year</th>
<th>Percentage of Industry Assets</th>
<th>Percentage of Total Premium Income (Australian Business)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995</td>
<td>53.5</td>
<td>61</td>
</tr>
<tr>
<td>2000/01</td>
<td>50.5</td>
<td>51.1</td>
</tr>
<tr>
<td>2001/02</td>
<td>68.6</td>
<td>59.2</td>
</tr>
<tr>
<td>2002/03</td>
<td>67.9</td>
<td>59.2</td>
</tr>
<tr>
<td>2003/04</td>
<td>68</td>
<td>61.1</td>
</tr>
<tr>
<td>2004/05</td>
<td>67.8</td>
<td>60.0</td>
</tr>
</tbody>
</table>


Table 8 points to an increase in the market share of ex mutuals suggesting the new enterprises created have been able to build on the legacy of the mutuals to become major players in the Australian life insurance market.

The second market segment comprises smaller insurers who aspire to be 'full service' wealth management institutions but do not have the scale advantages of the financial conglomerates (APRA, 2004b, p. 4). They account for less than five per cent of industry assets but are numerically the largest section of the market. The final group are a small number of 'boutique' insurers who cater for a specific market niche and are not in direct competition with the major players.

Whilst the life insurance industry has traditionally been fairly highly concentrated, the nature of this concentration has changed with the expansion of the financial conglomerates. Associated with this has been a relative decline in the importance of the life insurance industry within the financial sector. Between 1998 and 2003 the life insurance industry share of total assets in the financial sector fell from 14 per cent to 10 per cent (APRA, 2004b, p. 4). The significance of this shift will have broader implications if this trend continues. Traditionally the life insurance sector has been an important source of institutional funds which government has come to depend upon to provide finance for capital expenditure programs. The extent of change within the industry suggests that this may no longer be the case in the future.
Conclusion

Mutual organizations formed in the Australian life insurance industry in response to the failure of the market to provide a suitable resolution to agency problems associated with selling life insurance products.

The deregulation of the Australian financial sector in the last two decades initiated a major structural and organisational change within the life insurance industry of that country. Up until the 1990s the regulatory environment which governed the Australian financial sector contributed to the preservation of an industry structure which had dominated the life insurance market for the previous 150 years. The process of deregulation in reducing barriers to entry into this industry altered the manner in which information costs impacted on life insurers. The concurrent advances in information processing and marketing of insurance products changed the nature of information costs. Together these two factors placed pressure on existing organisational structure of the major players within the life insurance market. The path to the demutualisation of the major life insurers became inevitable as the need for capital to transform their organisational structures grew. During the 1990s all mutual life insurers demutualised and the newly formed companies moved rapidly to become integrated financial service providers.

However the process of organisational change did not halt at this point. The continuance of technologically induced pressures on information costs and the process of intermediation, together with the poor performance of the newly demutualised insurers sparked further adjustment. Demutualised firms struggled to compete in the new market environment. The market share of these firms fell both in terms of assets and premium income. Measures of profitability pointed not only to a fall in profit but an increased volatility in the performance of these firms. In addition there appeared to be no great efficiency gains immediately apparent. Returns on Assets and Returns on Equity indicated erratic trends. At the same time
demutualised insurers moved rapidly to acquire stakes in related markets. The pace and degree of reorganization made them vulnerable takeover targets. A further round of restructuring became inevitable as demutualised life insurers struggled to compete with the emerging banking conglomerates.

Mergers and takeovers within the Australian industry led to further structural and organisational change which resulted in a three tier structure in the industry. The industry has become dominated by first tier firms represented by the large banking and foreign owned wealth management institutions. The information cost model suggests that in the deregulated environment further structural adjustment will continue whilst information costs differential exist between firms within the industry. The Australian experience is in line with overseas trends. A study of the US life insurance sector by Cummins, Tennyson and Weiss (1998) concluded that consolidation within the industry would continue as long as life insurers lose out to non traditional providers.

The experience of organisational change within the Australian life insurance industry in the last decade illustrates the complex and in some cases unforeseen impacts regulatory and deregulatory policies have on the nature of financial markets. When these policies are implemented in times of rapid technological innovation the outcomes are even more involved and difficult to predict. The information cost approach provides a useful format for understanding and interpreting this complicated process of change.

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APPENDIX 1 Selected Activities of Demutualised Insurers 1996-2000

AMP Ltd
Listed January 1998
1998
- acquired UK funds manager
- acquired Australian property trust
- acquired NZ retail bank
- registered AMP Bank in NZ
- acquired UK mutual pension fund
- acquired Australian financial services company

1999
- acquired major Australian general insurer
- created global investment management business
- restructured general insurance business
- introduced new retail products including low interest credit card

2000
- expanded global asset business in Europe
- entered partnership with UK firm to launch new financial services business

Colonial Ltd
Listed 9 January 1997
1997
- acquired interest in large Asia/Pacific life insurer
- commenced stockbroking division
- entered partnership to sell general insurance in NZ

1998
- entered joint venture to provided industry funds administration business
- completed integration of Australian financial services division
- established life insurance business in China
- consolidated funds management business
- acquired Australian business of major UK insurer
- acquired Hong Kong business of UK insurer
- acquired Australian and NZ business of UK insurer

1999
- acquired 51% share in National Bank of Fiji
- acquired Asian and UK business of US fund manager
- formed life insurance company in Shanghai with Chinese insurer
- introduced new investment product in Australia
- obtained license to operate joint venture life insurance business in Vietnam

2000
- Company delisted after merger with Commonwealth Bank

NML Holdings
Listed 8 October 1996
1996
- expanded range of unit trusts in Australia and NZ

1997
- entered Indonesian life insurance market
- granted life insurance license in Thailand
- opened life insurance branch in China

1998
- acquired three Asian life insurers (Philippines, Hong Kong, Singapore)
1999

- acquired interest in Shanghai life insurer
- introduced new superannuation product
- combined group insurance business of NMLA with other subsidiary insurer
- acquired Singapore life insurer
- acquired balance of shares in Chinese subsidiary life insurer

2000

- Reorganization of parent company, name changed to AXA Asia Pacific Holdings

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Endnotes

1 The mutual form of organization was based on co-operation and pooling of resources. Ownership is derived from membership. Policyholders were also owners of the firm’s assets however they are unable to trade their interest in these assets (RBA, 1999, p.1).
2 State insurance offices were not covered under the federal act. Only one state office applied for registration, that was the Government Insurance Office of N.S.W. in 1988.
3 Mayer and Smith (1986) examined 30 life insurers that switched to mutual ownership, their findings confirm the general hypothesis that mutual companies must be efficient to survive in competition with non mutuals.
4 Following that two leading banks sought to acquire the AMP and Colonial (Australian Financial Review April 3- 5 2000). While the merger between the National Australia Bank and the AMP was aborted under some controversy, that between the Commonwealth Bank and Colonial has gone ahead.
5 Demutualization is defined as the process of changing a mutual association into a public company. It is the conversion of members’ interests into shareholdings.
6 The Life Insurance Act 1995 introduced more specific reporting requirements for life insurers. Much of the information now collected was not required before this date, this makes a meaningful comparison with the period prior to this point difficult.