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The Insurance Sector in Japan: An Overview and Environmental Analysis

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Abstract

Insurance is a sector which affects the public interest. The sustainable development of the insurance sector is directly related to the stability of the national financial system and has an impact on the political stability of the country. Although the bursting of Japanese economic bubble and insurance liberalization had a serious impact on the Japanese insurance sector in the 1990s, it is getting back to the right track in recent years. Under the loose monetary and low interest rate policies in Japan at present, what is the current competitive environment? And could the Japan's insurance sector has a steady growth continually? This article based on Porter's Five Force Model and PEST Model to analyze the micro-environment and macro-environment of the Japan's insurance sector and reveals its current situation and potential challenges. Findings portray the competition in Japanese insurance sector is assessed as moderate and mainly comes from industry rivalry. In both policy and economic level, the current situation has a negative impact on the Japanese insurance sector. Moreover, the interest rate sensitivity of non-life insurance is generally lower than that of life insurance. So the negative interest rate policy in Japan will seriously affect the development of the life insurance sector, while the non-life insurance sector has little influence.

Keywords: Insurance sector, Japan, Environmental analysis

Introduction

The insurance sector plays a key role in the national financial system. As a representative market in Asia, Japan accounts for more than 30% of the Asia-Pacific insurance market value. The insurance sector is in a complex and competitive market environment. In this context, the insurance sector faces enormous pressure and challenges. How to maintain competitiveness in an environment where opportunities and challenges coexist requires an environmental analysis. Analyzing the competitive environment of the sector can help companies understand the competitive advantages and difficulties of the sector, and find more effective ways to improve their business strategies. Generally speaking, the competitive environment covered both macro and micro-environment.

The purpose of this article is to provide overview about insurance sector in Japan, then to analyze the macro and micro-environment respectively in Japan's insurance sector, which is beneficial to enterprises to understand the competitive advantages and difficulties of the current sector, and to propose the impact and outlook of the insurance sector in Japan. Porter's Five Force Model and PEST Model are used in this article to analyze the insurance sector sufficiently.

Methodology

Macroenvironmental analysis

PEST model is a framework to analyze key macroenvironmental factors influencing a sector from the outside. It is a common strategic tool for understanding position and potentials of a sector. PEST represents four elements within macroenvironment analysis respectively.

P means political factors, including various policy and law, trade restrictions and political stability. Different political situation and social systems have different restrictions and requirements on organizational activities in the sector.

E means economic factors, including economic growth, interest rates, inflation rates and economic policys. They affect the sector size in the future directly.

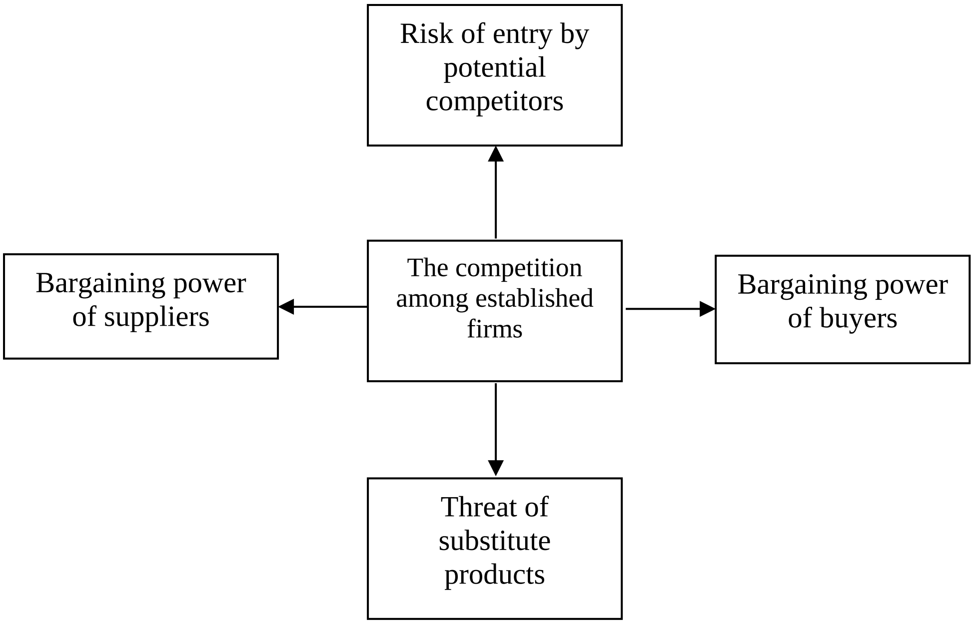
S means social-cultural factors, including population growth rate, age distribution, cultural characteristics. For example, the level of people who pay attentions to health affects significantly the development of the health care industry.

T means technological factors, including the rate of technological change, the use rate of computers. These factors can affect entry barriers of the sector. In addition, technological shifts would improve the efficiency and reduce costs for products.

Microenvironmental analysis

Although various models have been proposed to analyze the level of competition in a sector, the most famous and dominant paradigm is the Five Force Model by Michael Porter (1980). There are five elements within sector competition are considered in this model. These five potential forces have made huge impacts on managers, consultants and practitioners' views about the competitive environment (Slater & Olson 2002).

Figure 1 Porter‘s Five Force Model for microenvironmental analysis



1. The competition among established firms. This force could be measured in term of following three factors: the competitive structure, demand conditions, and exit barriers in the sector.

2. Risk of entry by potential competitors. This force could be evaluated in term of following two factors: the attractiveness of the sector (such as the market size, the number of firms and customers in the sector) and entry barriers in the sector.

3. Threat of substitute products. Substitute products can limit the price charged by the company in the sector. The number and kind of substitute products could be considered.

4. Bargaining power of buyers. Buyers could keep pressuring the price of products or demanding higher quality or better services through a purchase decision.

5. Bargaining power of suppliers. Suppliers could keep forcing up the price of products or supply lower quality of products and services through a supply decision.

Sector Analysis

Sector overview and relevance on a global scale

Financial sector is usually described as financial services through providing economic services. A financial service is the process of obtaining the financial goods instead of financial good itself (Asmundson 2012). It covers multiple types of companies which deal with money, including banks, insurance companies, credit companies, stock brokerages and so on. Among these sub-industries, the insurance sector is regarded as be very important and typical in financial sector. The insurance sector is combined by non-life insurance sector and the life insurance sector. The life insurance sector offers life insurance, pension products and annuity. The non-life sector sells other types of insurance like property and casualty insurance.

The global and regional insurance sector continued its recovery and made great contribution to economic growth in 2014. There is a growth by 3.7% in total direct premiums written during 2014 to $4,778 billion after a stagnated year of 2013 (Swiss Re, 2015). But due to the impact of low interest rates on the market, the Japanese insurance market declines in 2016 and 2017. From MarketLine (2017), the Asia-Pacific insurance market grew by 8% in 2016 to reach a value of $1,502.7 billion. Japan accounts for 30.9% of the Asia-Pacific insurance market value. In addition, there is a stable increase from 2013 to 2015 in the Japanese insurance market with 2.09% the compound annual growth rate (MarketLine, 2018). However, in the past two years, the Japanese insurance market has shrunk with the growth of -4.4% and -8.1% due to the macroeconomic downturn, which has affected the people’s wage income and disposable income. The reduction in income leads to fewer consumers willing to invest in insurance.

Table 1 Japan insurance market value: $ billion, 2013–2017

Year	$billion	￥billion	% Growth
2013	457.7	51,299.8	
2014	463.8	51,980.3	1.3
2015	477.0	53,470.6	2.9
2016	456.0	51,107.7	-4.4
2017	419.0	46,964.7	-8.1
CAGR			-2.2

Source: MarketLine (2018)

Microenvironmental analysis

Insurance sector in Japan is becoming moderately competitive

- **Industry rivalry**

The competition from rivals of Japanese insurance sector is assessed as moderate in following three reasons. The amount of successful insurance companies in Japan is not small but there are several key players. According to Fortune Magazine (2017), six Japanese insurance companies honored are on the list in Ranking of the World’s Top 500 Company. It has been illustrated that these companies are all regarded as key players in the Japanese insurance sector. As seen from the table 2, the average revenue of these companies are about $50,199 million and Nippon Life Insurance at top with $67,388.3

million. Apparently, Japanese insurance market has been dominated by these heading players, so the competition between insurers is evaluated to be not so intense.

Table 2 Ranking of the World's Top 500 Company in 2017 (only show Japanese Insurance Companies parts)

Rank	Company name	Revenue ($ million)	Net Income ($ million)
111	Nippon Life Insurance	67,388.3	2,786.9
142	Dai-Ichi Life Holdings	59,589.7	2,134.5
188	MS&AD Insurance Group Holdings	49,238.8	1,942.2
193	Tokio Marine Holdings	48,291.6	2,527.4
242	Sumitomo Life Insurance	40,920.8	517.5
297	Meiji Yasuda Life Insurance	35,766.6	2,064.8

Source: Fortune Magazine (2017)

Comparing entry barriers and exit barriers, the former is lower than the latter, leading to further competition within the insurance sector. It means that cost to exit the market is higher than cost to entry the market. For instance, the capital adequacy regulation is implemented to prevent insurers from exiting market in order to avoid damaging the interests of the insured people. As the result, Japanese insurance companies are willing to stay in the market and compete to save money. In this situation, fierce competition would happen in the Japanese insurance sector.

In addition, there are two main reasons for increased market competition in recent years: firstly, due to the frequent occurrence of natural disasters in Japan, the increase in the amount of insurance claims has caused a drop in company profits. Secondly, weak insurance demand brought by the low interest policy has led to a decrease in the income of insurance companies.

Overall, the industry rivalry is assessed to be fierce.

- **Competition from new entrants**

The competition from new entrants is assessed not strong. On the one hand, online insurance companies are deemed to be new entrants in insurance sector due to the rapid development of Internet (Garven, 2010). There are two obvious advantages for them: the lower price for products and the more convenient buying process, which means that customers can buy insurance through simply clicking on the website. However, the market share of online insurance is still small with immature technology platform (Zhang et al., 2011). Moreover, compared with heading companies, online insurance companies are constrained by capital shortage, limited scale and immature organization structure. So online insurance should be defined as a potential new entrant but do not have huge impacts to insurance sector now.

On the other hand, other financial institutions such as banks begin to offer insurance services. Some people are used to accepting services from banks or avoiding risks may choose the insurance services in the bank. So new entrants intensify the competition in Japan's insurance sector. To face this challenge, higher returns are needed to be guaranteed, or investment returns should be distributed to the insured people, although these measures force investment income down (Greene & Segal, 2004).

- **Substitutes**

Some products like pension insurance can be substituted by financial products with the same effects. For example, stocks, bonds or some investment products are also able to make more money in the future or to be as the annuity. Wills could make contributions to risk accounting and family member protection after death (MarketLine, 2015). However, the complete substitute to some other insurance products is non-existent such as life insurance and motor vehicle insurance. Overall, the threat of substitutes in Japan's insurance sector is assessed as weak.

- **Bargaining power of customers**

Consumers in insurance sector consist of individual consumers, different size companies and some organizations. Talking about buyers power, although the number of individual consumers obtains an absolute dominance in total consumers, products consumed by per consumer occupy small proportion of total products, so the impact of losing one customer on insurance players is minimal. To these medium companies, the negotiation ability of them is also limited due to lack of buying power so that market players dominate the price eventually. In contrast, large companies and organization with huge bargaining power are welcomed by insurance companies. In other words, these consumers are the most essential consumers with high profits, so insurance companies try to improve their loyalty and sell more products.

In addition, insurance products have low differentiation with lower consumer loyalty. It means that consumers can buy the same products in different sellers easily, so buyers are willing to compare with different sellers to get the best deal, the price is the most important element to buying.

Overall, the competition from customers is assessed to be not intense.

- **Bargaining power of suppliers**

The characteristics of the insurance sector are different from those of the manufacturing industry whose suppliers are required to supply raw materials. In order to provide high-quality services with big data, insurance companies rely on customized IT systems suitable for their products and services in daily operations. Suppliers in insurance sector consist of software houses and

Information and Communication Technology (ICT) companies. With the increasing demand of specialized software for dealing with information and online database, software houses have larger suppliers power for designing special software to meet the demand of insurance companies. In addition, a safe and reliable ICT infrastructure is needed, so ICT companies also are important suppliers. MarketLine (2015) reveals that some large ICT companies like IBM have own special systems, and training employees to use new systems creates extra cost, which prevents insurance companies from changing the supplier of the system and improves suppliers power. The size of suppliers has connection with the strength of negotiating position (MarketLine, 2015). Because large companies have expensive new system switching fees and more unique resources which small companies could not offer. Overall, the competition from suppliers is assessed to be moderate.

Macroenvironmental analysis

Expansionary fiscal policy stimulate economic growth in Japan but the insurance sector faces challenges from the negative interest rate policy

In Japan, after the serious financial crisis in 2008, the government tries to get rid of economic stagnation and end deflation as soon as possible. Under this circumstance, "three-arrows" strategy known as "Abenomics" is set to achieve this goal (Japanese Statistics Bureau, 2018). One of "arrow" is expansionary monetary policy, which describes that a new consumer price index with two percent growth rate is set to stabilize commodity price. In addition, quantitative and qualitative monetary easing is also presented to double the monetary base over two years and weaken the yen (Siwss Re, 2015). The next "arrow" is flexible fiscal policy, which proposed that large-scale money approximate 10 trillion yen would be invested. In other words, the government would expand fiscal expenditure to stimulate the economy in Japan. The last "arrow" is growth strategy that promotes private investment, which means that private corporations are encouraged to make investments based on the easing of regulations.

Moreover, The Bank of Japan launched a negative interest rate in 2016. The central bank is currently guiding short-term interest rates at -0.1% and long-term government bond yields near zero to achieve the inflation target of 2% (Yoshino et al., 2017). The inflation rate is in the doldrums, causing the Bank of Japan to take radical economic-stimulus measures, despite these measures lead to the increase in costs, such as financial institutions in Japan have been hit by the near-zero interest rates for years.

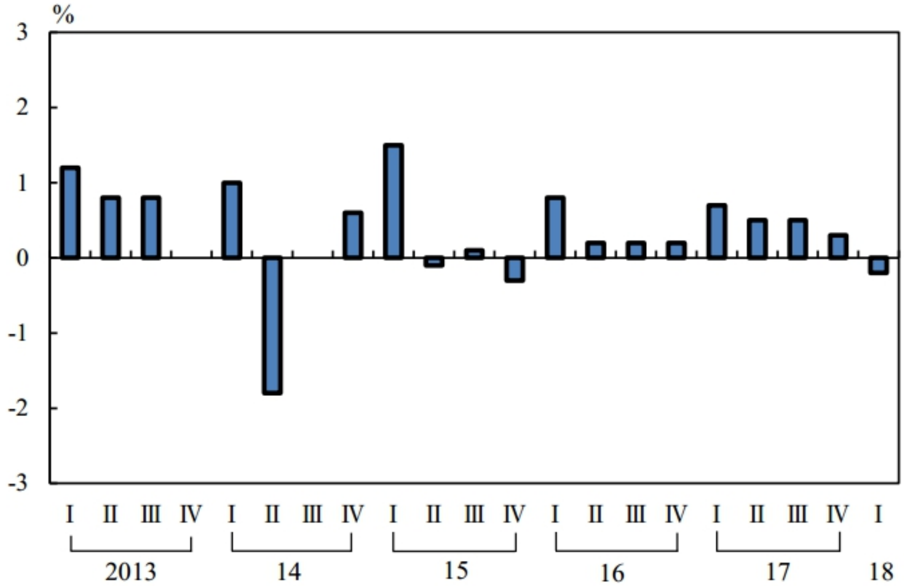
It seems that impacts of these policies on insurance sector are strong. The low interest rate policy will have a negative effect on insurance companies (Berdin&Gründl, 2015). Interest rate is an important parameter in the actuarial assumption of insurance, which affects the pricing of insurance products, insurance demand and profitability of insurance companies. However, different types of insurance are affected by the risk of interest rates at different level. The interest rate sensitivity of non-life insurance is generally lower than that of life insurance. Because many of the non-life insurance are short-term insurance, and short-term insurance is usually re-priced every year and considers the impact of interest rate levels in pricing, so its sensitivity to interest rate fluctuations is small. For insurers, they have to adjust themselves to this situation accordingly. Insurers are shifting their liabilities to foreign-denominated savings and protection products in a bid to negate the low domestic interest rates (MarketLine, 2018).

Overall, Japan's political environment is negative for the insurance sector to develop in the future.

The inflation rate revealed a general trend of fluctuation in 2015 to 2017

Economic growth rates in Japan are not stable. As seen from the graph 1, rates of economic growth in Japan are fluctuant in 2013-2017. In fluctuant economics, the increase happens on income and buying power slowly, so there is uncertainty in the demand of products and services, it is not a positive environment for insurance sector to develop.

Graph 1 Economic Growth Rates in Japan (Quarterly changes)



Source: Statistical Handbook of Japan 2018

From the table 3, the increase of the inflation rate in Japan is witnessed from 2012 to 2014, and reaches the peak at 2.8%. It illustrates that Japan begins to get away from economic growth stalled for many years. Economic resurgence is appealing to insurance sector to develop rapidly in the future.

International competition between insurers is undermined by increasing inflation rates because the cost and price of products rises. It means that insurance companies lose the price competitiveness. If employees require to raise wages under this circumstance, this process would be more deteriorated. However, the inflation rate revealed a general trend of fluctuation in 2015 to 2017, though the margins of the rise and drop varied. The Inflation rate reflects a reduction in the purchasing power per unit of money. The sluggish inflation rate shows a low level of disposable income, it means less buyers are interested in buying the life insurance or pension products.

Table 3 Inflation Rate in Japan, 2012-2017

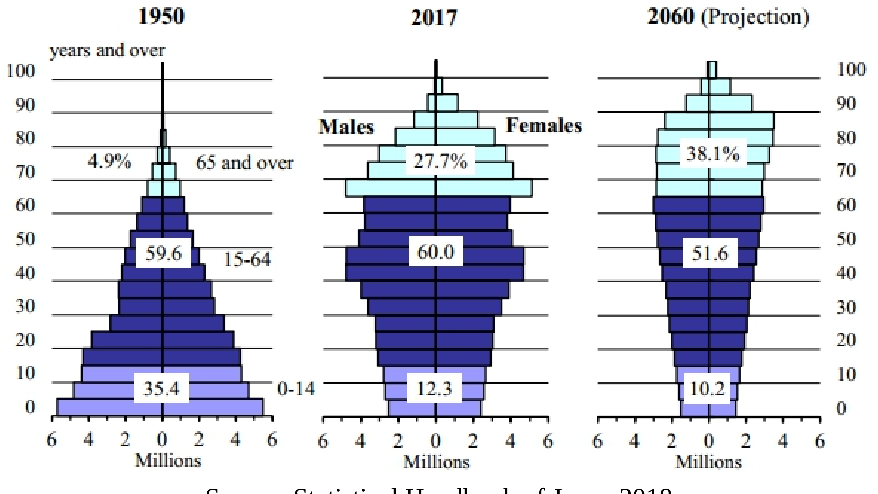
	2012	2013	2014	2015	2016	2017
Inflation	0.2	0.4	2.8	0.8	-0.1	0.5

Source: Statistics Bureau of Japan (2018)

The population of Japan is 126.71 million with high density in 2017 and people pay attentions to health

Japan is confronted with the enormous challenge from aging of population. Graph 2 displays the proportion of people over 65 rises rapidly from 4.9% to 27.7% for the 67 years begin at 1950, and it is expected to be 38.1% in 2060. In addition, the birth rate is falling, the percent of the children is projected to decrease from 12.3% to 10.2% at the period of 2017 to 2060. The increasing number of elderly people brings chance for insurance sector in Japan. The demand of thelife insurance is going to be in expansion in the future. Nevertheless, the change of population structure also makes insurance sector face new challenges. It means that some new products or demand are ready to be satisfied. For example, the shifted demand begins to focus on less profitable life policies and towards products that transfer the investment risk, along with its return, to the customer (Greene & Segal, 2004).

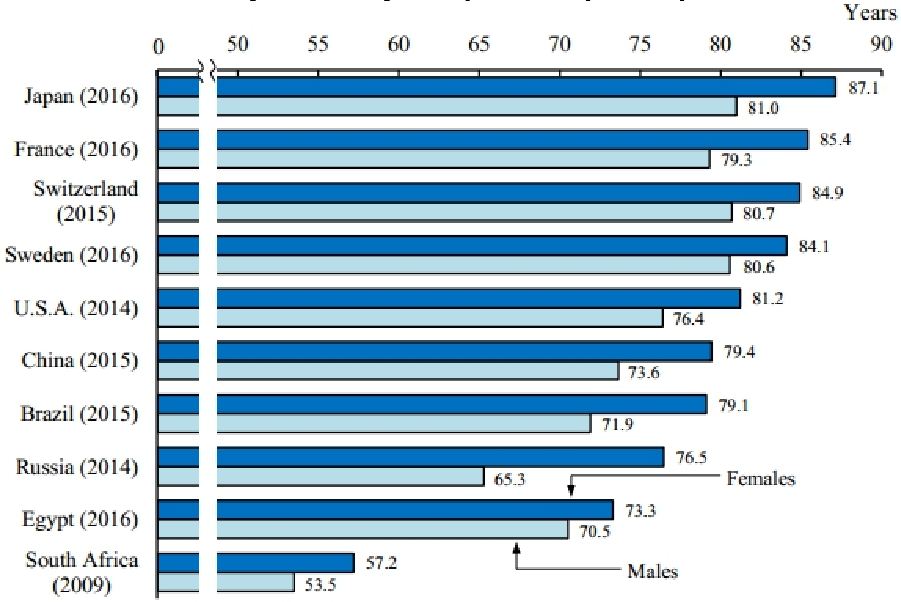
Graph 2 Changes in the population pyramid in Japan in 1950, 2017 and 2060(projection)



Source: Statistical Handbook of Japan 2018

From Japanese Statistics Bureau (2018), it reveals that the life expectancy of Japanese is at the top of the world with 87.1 years for females and 81.0 years for males in 2016. It is obvious that there is the relationship between the life expectancy and health concept. Japanese tend to pay more attention to health and have higher sensitivity to health. Therefore, insurance is easier for Japan people to be interested and accepted, so the Japanese insurance market value would grow continually in the future.

Graph 3 Life Expectancy at Birth by Country



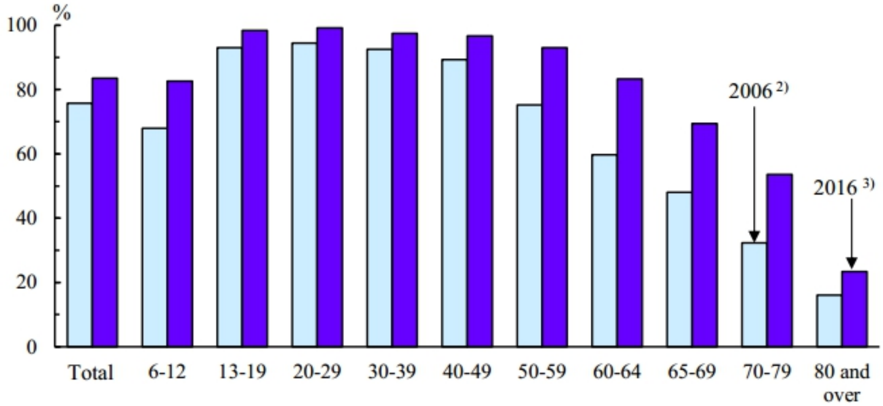
Source: Statistical Handbook of Japan 2018

Internet is growing rapidly in Japan over 90% of Japanese and 99.9% enterprises use the Internet

Network technology is important to the insurance sector. The number of users with Internet in Japan rise continually and get 100.8 million as of the end of 2016. According to graph 4, the number of Internet users outnumbers 100 million people, taking up more than 90 percent in age group between 13 to 59 years old (Japanese Statistics Bureau, 2018). These data shows that Internet is used widely and develops rapidly in Japan. In insurance sector, Insurance related IT service provider are recognized as suppliers because some unique and efficient online database and operational software are required to process insurance companies' information. So the development of Internet has positive impacts on improving technological information system by insurance companies.

According to Japanese Statistics Bureau (2018), the number of users with Internet among enterprises was 99.9 percent in 2017 which was the same rate as that of the previous year. Trends in the Internet usage rate keep stable, showing that Internet is fully diffused with huge coverage among enterprises in Japan. High Internet usage rate is beneficial for insurance companies to develop some new marketing channels and maintain the relationship with customers. Overall, Japan’s technological environment is fit for insurance sector to develop in the future.

Graph 4 Trends in Internet Usage Rate by Age Group in Japan in 2006 and 2016



Source: Statistical Handbook of Japan 2018

Conclusion

In general, the Japanese insurance sector is still in a period of volatility. The non-life insurance business is developing steadily, but the life insurance business is struggling due to the losses caused by the negative interest rate policy and frequent natural disasters in recent years. In the micro-environmental analysis, based on the Porter's five-force model, the overall assessment of the Japanese insurance sector's competitive intensity is moderate, and the competition mainly comes from the existing competitors. Due to high entry barriers, lack of perfect substitutes, and fragmentation of individual customers, the competition from new entrants, substitutes, and bargaining power of buyers is not strong. After that, based on the PEST model, this paper conducts macro-environmental analysis from the perspectives of policy, economy, society-population and technology. Among them, in both policy and economic level, the current situation has a negative impact on the Japanese insurance sector in recent years due to the negative interest rate policy, unstable economic growth, a decline in inflation rate and lower disposable income. While in both society-population and technology level, the current situation is beneficial to the Japanese insurance sector due to population aging, the improvement of health awareness, and the rapid development of technology.

Looking to the future, the impact of the negative interest rate policy on the life insurance business will continue. However, there are two recommendations to deal with the increasing cost of frequent disasters in recent years. Insurance companies can consider raising premiums to cover the cost. In addition, severe disaster reserve funds could be drawn to prepare for accidental disaster claims. Although the fiscal policy has little impact on the non-life insurance business, the development of technology will have a huge impact on its prospects, such as the impact of automotive technology on auto insurance. So the non-life insurance companies should pay attention to the space for improvement in related technology.

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