Adaptation and change in the Australian life insurance industry: An historical perspective

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Abstract

In the wake of the deregulation of the financial sector in Australia in the 1980s and 1990s the life insurance industry has undergone a period of rapid change and reorganisation. Part of this adjustment has been the move towards the integration of financial service provision and the rise of bancassurance. This paper investigates the strategies adopted by Australian life insurers as they moved into the increasingly competitive environment triggered by the lifting of government restrictions on banking practices. It compares the approach of life insurers with that adopted in an earlier period of expansion and change. During the 1950s and 1960s an influx of foreign owned insurance companies into the Australian market precipitated the diversification of life insurers. The catalyst for change in both cases was the change in information costs brought about by the change in the competitive environment. The experience of the Australian life insurance market would suggest that there is a link between changing information costs and changing organisational structures. However this link is circumscribed by the institutional environment.

I

In recent years the Australian life insurance industry has undergone a period of rapid transformation as firms adapt to changes inspired by the deregulation of the financial sector. The environment in which life insurance firms operated was altered irrevocably with the progressive lifting of regulatory controls in the last two decades. In a fifteen year period Australia moved from having one of the most regulated financial sectors to one of the least. Deregulation inspired a reorganisation of the sector and the life insurance industry. This paper investigates the direction of this restructuring and places it in an historical context which suggests there may be a pattern to the process of organisational change and renewal in the Australian life insurance industry.

Various interpretative frameworks may be adopted in evaluating the changes which have taken place in the insurance industry. New institutional theory for example, with its emphasis on transaction cost economics points to the reasons why firms adopt certain growth strategies such as vertical integration or diversification. The organisation which develops is argued to be that which deals with transactions costs most efficiently. A limitation of this approach in analysing the historical development of a particular industry or sector is that it focuses on changing strategies within the confines of existing institutional parameters. What happens when these environmental parameters change? To what extent does transaction cost theory point to the possible reactions of firms in a changing institutional environment? Evolutionary theory on the other hand considers the impact of the institutional setting. It suggests that firms adapt overtime in reaction to their environment.[1] A fundamental component of this environment is the sets of formal and informal rules within which the firm operates. Analysis of changes in the 'rules of the game' provide a key to understanding the growth and development of firms within specific sectors.[2]

The difference between the two approaches can best be described as the difference between process and content. Evolutionary theory may be classified as a process theory, describing the manner in which the strategies of the firm evolve. New institutional theories at the opposite end of the spectrum, emphasise the content of those strategies and the likely outcome.[3]

Both approaches analyse the strategic behaviour of firms from differing perspectives yet provide theoretical frameworks with something to offer. The way forward for the business historian may lie in the marriage of these models. Such an argument is put forward by Mark Casson who combines elements of transaction cost theory and evolutionary theory to develop an analytical framework based on information costs.[4] Casson argues that the organisational structure adopted by the firm can be analysed as a rational response to information costs. A clear distinction is made between transactions costs and information costs. The latter involve a much broader definition and include the costs of collecting managing and using information in the decision making process. Whilst transaction costs may occur because of informational problems, information costs are not necessarily transactions costs.

Information costs are assumed to be the key to understanding the process of development and change. As information costs change so too does the institutional structure of the economy and the firm within it. Organisational renewal is seen as a regular process within this model. Firms which do not evolve and adapt as information costs change do not have a long term future.[5]

Much of the focus of previous study has been on the behaviour of firms providing physical good. In considering the behaviour of firms providing services it is necessary to consider what types of qualifications are necessary to the prevailing orthodoxy. In this respect the use of an information costs framework may be particularly applicable to the analysis of the strategies adopted by firms in the financial sector. A similar approach has been used by Knutsen in his analysis of the Norwegian insurance industry.[6]

Hoschka argues financial services are distinct from physical goods in three ways. First they are intangible and usually consist of either an implicit or explicit contract for the delivery of specific services at a particular time. Second they often involve long term relationships between customer and supplier. These relationships are based on asymmetric information between the two parties and imply a certain degree of trust in the service provider. Thirdly there is no patent protection of financial products which can be easily copied by competitors. As a result the strategic behaviour of providers of financial services is to likely have a different emphasis than firms providing physical goods.[7] The concept of information costs provides a broader basis upon which to analyse the behaviour of firms and in doing so provides a key to interpreting the internal organisation of the firm.

The Australian life insurance industry has experienced two periods of major structural adjustment in the past five decades. This paper investigates the extent to which changes in information costs explain the pattern of change during these periods and the implication this has had on the emerging organisational structure of firms within the sector. It concludes that although changes in information costs precipitated a change in organisational structure amongst life insurers, institutional and regulatory constraints played an important role in influencing the scope and outcome of this change.

Two separate periods of time provide a comparative basis from which to review the life insurance industry's reaction to changing information costs. In the 1960s, when British and American firms moved into the life insurance market, Australian firms adopted a strategy of expansion into other markets using a multi subsidiary structure. In the 1990s a similar scenario was evident. A process of convergence and integration of financial services gathered pace in the wake of the lifting of regulations on the financial sector.

In developing the central argument, this paper commences with a review of the structure of the life insurance industry as it evolved in Australia. It then considers the impact of increased competition in the decade from the late 1950s.The impact of regulatory constraints are discussed before the changes occurring after deregulation are analysed.

II

The insurance sector is made up of several distinct markets each dealing with a different type of insurance. The heterogeneity of the sector is revealed in a breakdown of its constituents. At the beginning of the twenty-first century, forty-two life insurers represented around 30 per cent of the sector's assets. One hundred and sixty-eight general insurers account for a further 15 per cent. Over 200,000 superannuation funds make up for the remaining market share.[8]

Traditionally a distinction has been made between life and non-life insurers. This has largely arisen because of the historical origins of each type of insurance. The general insurance industry for example, grew out of fire and marine insurance. The life insurance industry emerged from the formation of mutual aid organisations which had more in common with friendly societies than insurance companies. Unlike the general insurance industry, there has been little direct government involvement in the provision of services. Superannuation funds formed in the 1950s and 1960s to provide more specifically for retirement income as opposed to life insurance. Australian federal legislation recognises four specialist types of insurance providers: life offices, general insurers, superannuation funds and health insurers.[9] Over the years this distinction has become blurred with life companies selling other forms of insurance and vice versa. However, the development of the various markets and the difference in ownership structures justifies the continuance of this separation. Whilst general insurance has generally been provided by publicly listed companies, life insurance has historically been dominated by mutual forms of ownership.

The life insurance industry has been characterised by high levels of concentration, although these levels had fallen in the last two decades of the twentieth century. In the 1970s the five largest firms accounted for in excess of 85 per cent of premium income. These same firms had accounted for the at least three quarters of life insurance policies sold for almost all of the preceding one hundred years. In fact one, the Australian Mutual Provident, had been the market leader since its formation in 1849.[10]

A feature of the development of the life insurance industry has been the role played by these dominant firms which have all been mutual associations. Life insurance mutuals formed in Australia between the 1850s and 1880s in response to the failure of private companies to adequately service customer needs. No new mutuals were formed after 1881 but the merger and consolidation of existing mutuals resulted in the growth of the five influential associations which dominated the market for the next one hundred years. One explanation for the longevity of this form of organization was that it was the one which most effectively dealt with the information cost problem. The failure of stock companies to provide life insurance on any scale reflected the problem of writing long term contracts under uncertainty.[11] The paucity of data on mortality rates and the inability to predict unforseen contingencies over a substantial period of time increased the possibility of loss from this form of insurance. Insurance companies viewed life policies as riskier than other types of insurance such as fire insurance which was contracted for specific periods of time. To offset the risk element, life insurance policies were full of restrictions limiting the circumstances under which a claim could be made on the policy.[12]

Furthermore it can be argued that the mutual governance system may have reduced some of the negative impact associated with information costs because it was better equipped to deal with the agency relationship.[13] This relationship arises when individuals (such as policyholders) engage agents to make decisions on their behalf. In terms of life insurance, the policy holder in taking out an insurance contract delegates some decision making authority to the insurance company. Problems may occur if decisions made by the agent deviate from those which may have been made by the individual or principal. This is known as the residual loss and represents the value of the loss to the policyholder of adverse decisions made by the agent. Mutuals, may be said to be better placed to solve this part of the agency problem because the policyholder also has rights of ownership in the firm. This link provides a mechanism for minimising the problem of residual loss to the principal.

The public sector has not played a substantial role in the development of the industry. The focus of concern for government insurance offices has historically been in non-life insurance. Although each Australian state had an insurance office, in the post war period up to the 1980s only two operated in the life insurance market. Government insurance offices have played an important role in the provision of various types of general insurance but not life insurance. This concentration stems from the rationale for the creation of such offices. Pursell has identified three major objectives for the establishment of these offices. Firstly to underwrite government controlled insurances, secondly to underwrite government created compulsory insurance. Thirdly to compete with private firms to influence price.[14] The introduction of compulsory workers compensation insurance was the catalyst for government entry into this market. Government insurers then broadened the scope of their business to deal in compulsory third party motor vehicle insurance and the like. It was not until the 1980s that government insurers, spurred on by the expansion of superannuation, branched into life insurance in a limited way. In 1986 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 they applied for registration under the federal government life insurance act.[15] Direct competition from government agencies in the life insurance market was not nearly as significant as it was in other forms of insurance.

III

The pattern of growth and development in the life insurance industry was prescribed by the actions of the five largest firms for most of the twentieth century. The nature of the competitive relationship between these firms led to market behaviour which reinforced barriers to entry and protected the market share of established firms. Until the post war period the threat of competition from new entrants had not challenged the status quo.[16] However this changed in the late 1950s and during the 1960s the life insurance industry faced a number of pressures which precipitated a period of expansion and diversification amongst life insurance firms. Market pressure had built up progressively through the 1950s as the industry adjusted to a return to peacetime activity.

The economic environment within which life insurance companies operated after the second world war had changed dramatically from pre war patterns. Unlike the experience after the first world war, the Australian economy underwent a sustained period of prosperity. In the period from 1950 to 1970 the average rate of growth in real GDP was 4.8 per cent.[17] International demand for the country's principal exports was buoyant. In addition a period of rapid industrial development supported by increasing level of immigration contributed to rising standards of living and low levels of unemployment.[18] Increasing income and population growth led to a growing demand for life insurance products. Premiums from new policies sold in Australia rose from $319 million in 1950 to $1,600 million in 1960 and $6,209 million in 1970.[19]

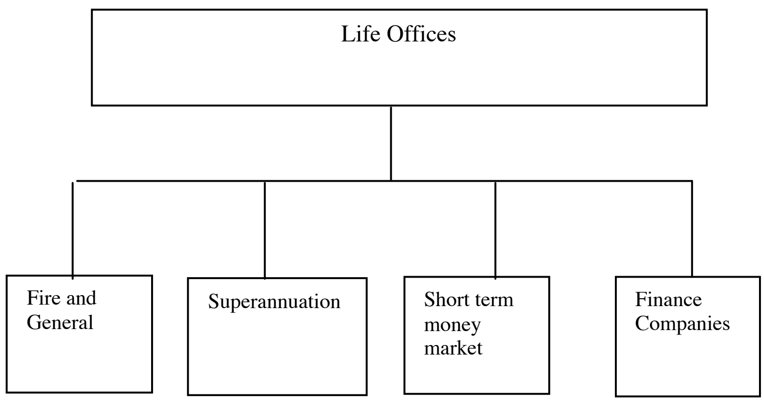
One outcome of this flourishing demand for life insurance was to attract new firms into the market. In 1950 there were a total of 22 life insurance offices operating in Australia. By 1960 this number had risen to 37 and by 1970 there were 48 firms.[20] The majority of these new firms were foreign owned companies. In 1950 only three foreign companies were registered in Australia, twenty years later the number had reached 35. Conversely the number of local offices had fallen from 19 to 13.[21]

Co-inciding with the increase in the number of life insurers there was growing pressure on the life insurance market from other parts of the financial sector. Progressive product development and diversification in the 1960s brought life offices into increasing competition with other financial institutions. The growth of superannuation products is one case in point. Superannuation evolved in the early post war years from the provision of endowment policies. Over time schemes developed which were designed to cater more specifically for retirement saving. By the end of the 1960s the superannuation business had taken over from ordinary business as a major area of activity for life insurance firms. The growth of separately constituted superannuation funds competed for the superannuation business of life offices. By the 1980s the assets of superannuation funds were equivalent to those of life insurance firms. [22] In a similar manner the growth of new products such as investment linked contracts during the 1970s brought life offices into competition with other financial intermediaries.

In Australia there had historically been a clear division between firms which undertook life insurance and those that undertook general insurance business. This demarcation was broken down as the number of foreign firms in the life market grew. The majority of these new entrants were British companies who did not have this same tradition. British insurers, who had dominated the general insurance market in Australia, had branches of both life and general insurance. However up to the late 1950s they had concentrated their efforts in the general insurance market. One reason for this was that past forays into life insurance had not been successful in competing with the large mutuals which commanded a high degree of customer loyalty.[23] In 1957 the implicit separation between the two markets was broken down when the British firm the Legal and General Assurance Society Ltd. applied to the Insurance Commissioner for registration and commenced selling life insurance.[24] This company succeeded where previous attempts had failed. In doing so it initiated a trend which led to a major change in the corporate structure of life insurance firms.

The growing competition posed by overseas companies was also associated with changes in relative information costs. New entrants, were largely composite companies selling other forms of insurance as well as life insurance. These firms could be assumed to have lower information costs in the sense that they had more information on their customers and could sell bundles of products rather than single policies. This cost advantage posed a threat to the established life insurers and provided a catalyst for change. The reactions of life offices to increasing competition in the sixties mirrored that two decades later. Namely in the face of such market pressures firms looked to diversify in a bid to a broaden their consumer base. However, the institutional environment influenced the direction of change. Regulatory and financial constraints created barriers to entry into certain markets and prescribed attempts by life insurers to diversify. Initially they ventured into the fire and general insurance market in response to the expansion of Legal and General and other general insurance firms into the life market. This became a stepping stone to progressive diversification into other financial markets. The approach adopted by the major life insurers was that of a multi subsidiary insurance model. The model is summarised in the diagram below.

Figure 1 The Expansion of Life Insurance Firms in the 1960s



Typically subsidiary companies would be created to compete in other areas of the financial sector. Thus by 1970 the major life insurers had general insurance subsidiaries, separately constituted superannuation funds, finance companies and dealerships in the short term money market. The degree of diversification can be seen in the following table.

Table 1 The growth of financial subsidiaries and associations within major life insurance offices 1958 - 1975.

Life Office	Fire & General	Official STMM	Unofficial STMM	Finance Company	Building Society	Superannuation
AMP	AMP & General	AMP Discount Co	AMP Acceptances, AMP Morgan Grenfell	Beneficial Finance C co		
National Mutual	National Mutual Fire & General	National Discount Corp	Citinational Holdings	Mercantile Credits	Nat Mutual Permanent Building Society	
	National Mutual Casualty					
Aust T & G	T&G Fire and General	Capel Court Securities	Capel Court Corp.	Aust Finance and Securities		T&G Superannuation
City Mutual	City Mutual General Insurance Trans City Holdings	Trans City Holdings				
Colonial Mutual	CML Fire and General	Delfin Discount, AUC Discount	Development Finance Corp	Trade Credits	Argus Permanent Building Society	CML Superannuation
MLC	MLC Fire & General	Trans city Discount	Trans city Discount	Alliance Holdings		

Source; The Campbell Inquiry 1981; Grant, 1974: 172-3.

The changing institutional environment as overseas firms entered the Australian market precipitated changes in the organisational structures of domestic firms. The evolution of holding companies with multi subsidiaries was the outcome of this shift. When the major life insurers began to diversify they did so developing subsidiary companies sometimes in partnership or joint venture with firms already operating in that market. This path was influenced by two critical constraints namely, access to the required capital and the regulatory control of the broader financial sector. The dominant life insurers in the market were all mutuals and as such access to new equity funds and debt capital was limited. Capital for expansion and diversification could not be obtained from share releases but must predominantly stem from policy revenue and investment earnings. To a certain extent this prescribed the courses of action open to firms. In the 1960s the retained earnings of life insurers were large enough to enable life insurers to diversify in the manner they did. That is gradually, and in partnership or joint venture with other firms, although in many cases these partners were bought out over time.

IV

The extent to which diversification could proceed beyond certain boundaries was constrained by the regulation of the financial sector. In this respect two types of regulatory influences can be identified. In the first instance industry specific controls set the parameters within which life insurers could operate. However, it was not so much this regulation which influenced further expansion, but the controls imposed on other financial institutions, specifically the banking sector.

The life insurance industry had grown and become established in a very loosely regulated market. Prior to the end of the second world war there was no consistent regulation of the industry, with each state determining its own level of control. Most states (with the notable exception of New South Wales) had enacted some legislation which related either directly or indirectly to the life insurance industry. Despite efforts to obtain a uniform approach, as recommended by the 1910 Royal Commission on Insurance, there was no federal regulation of the industry until the passing of the Life Insurance Act of 1945. The focus of this legislation was on ensuring the prudential requirements necessary to maintain solvency and ensure insurance contracts were met. The Act required that all life insurance companies be registered and report annually to the Life Insurance Commissioner. The Act further mandated that the accounts of the life insurance business of insurance companies be separated from other types of business. Insurers could not use revenue raised from life insurance business to offset losses from fire and general business. By entrenching the separation of different classes of business, regulation perpetuated the multi subsidiary organisational structure that had emerged in the 1960s. Whilst the revenue earned from the sale of policies had to be strictly accounted for, the investment policies of life insurance companies were not subject to stringent control. Aside from a restraint prohibiting investment in other life insurance companies they were free to invest in a full range of assets. However in the 1960s the federal government endeavoured to influence the direction of investment through the introduction of what was known as the 30/20 rule. In the immediate post war period life offices invested over 52 per cent of their assets in government and semi government securities, providing a significant source of long term funds for government. By 1960 this investment had fallen to just over 35 per cent. In a bid to halt this trend life insurers were induced back with the promise of significant tax concessions if they invested a minimum of 30 per cent of their assets in the securities of public authorities including 20 per cent in Commonwealth government securities.[25]

In comparison to the life insurance industry, regulation of Australian banks in the post war period was far more prescriptive and placed very rigid controls on the way they conducted their business. For 35 years the banking sector was one of the most highly regulated in the western world. A key motivation in the extension of controls on banks after world war two was the adoption of direct macroeconomic management by government with a view to stabilising variations in the business cycle.

Whilst life insurers were not the direct target of these controls, they were nonetheless affected by them. Regulation perpetuated market segmentation in the financial sector and in doing so afforded the life insurance industry a degree of protection from competition from other financial institutions. Regulation defined the boundaries within which the financial sector firms could operate.

The banking acts of 1945 which formulised the role of the central bank also gave it 'a cold war scale of armoury'[26] which was used to direct the lending ability of banks. In this respect a distinction was made between trading banks and savings banks which were seen as separate entities catering for differing segments of the market. Savings banks provided financial services to the household sector and were primarily dominated by government owned banks. They were prohibited from making commercial loans.[27] Trading banks provided this facility but could not offer services to households unless they had a savings bank licence. Both the availability of funds which banks had to lend and the rates at which they lent were regulated. The resulting market distortion encouraged the process of disintermediation and the growth of non bank financial institutions during the 1960s and 1970s. The expansion of building societies is a case in point. Building societies were regulated at the state level and as such were not subject to the same degree of control. They were able to charge varying rates of interest and offer more competitive terms for borrowers and lenders.[28]

Banking regulation did not specifically prohibit the entry of new domestically owned banks. However it did not encourage it either. One commentator put it very succinctly when he stated, '... it would be easier for a camel to pass through the eye of a needle than for an insurance company in Australia to form a trading or savings bank subsidiary.'[29]

Under section 9 of the Banking Act 1945 a new bank could not operate without the written authorisation of the Governor General on the advice of the Treasurer. Between 1945 until the period of deregulation occurred in the 1980s, only one application for a new banking license was received.[30] The Campbell committee of inquiry into the financial system attributed lack of applications primarily to the 'differentially heavy' regulation of the banking sector arguing there was no conclusive evidence that economies of scale were a significant barrier to entry.[31]

V

The environment within which life insurance firms operated was altered irrevocably with the progressive lifting of regulatory controls in the financial sector. The process of deregulation, inspired by the recommendation of the Campbell inquiry, 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.[32] Deregulation had far reaching implications for the structure and conduct of financial markets. 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.

Deregulation initiated a period of restructure within the financial sector. Banking groups began to make up ground progressively lost during the 1960s and 1970s as the regulatory regime became less efficient. However this was done at the expense of other components of the financial sector. Building Societies in particular experienced a large fall in representation.[33]

Within the life insurance industry deregulation was associated with a shake up of the industry. The number of insurers initially increased from 45 in 1980 to 58 in 1990. However in the next decade a rationalisation occurred and the total number had fallen to 42 by 2000.[34] The decline in the number of firms was also accompanied by a shift in market power amongst these firms. Historically the industry had been highly concentrated with the top three firms accounting for in excess of seventy per cent of industry assets. Notably these firms were all mutuals. Whilst the number of foreign owned companies had increased since the 1980s they had not succeeded in capturing a significant market share. Levels of concentration fell in the decade from 1980 when the deregulation of the financial sector occurred. This trend is indicated in Table 2.

Table 2 The change in ownership structure within the life insurance market 1980-2000

Industry Structure	Percentage of Industry Assets		
	1980	1990	2000
Top 3 Insurers	64	55	60
Top 10 Insurers	89.5	82	91
Australian Mutuals	78	72	0
Bank Owned Insurers	0	9	44

Source: ISC, 1990,APRA

Table 2 also points to a more dramatic change in industry structure, namely the decline in mutual representation and the increase in bank owned insurers share of assets. The decline in mutual representation occurred as a result of the demutualisation of life offices which in itself was an outcome of deregulation.[35] The rise in the influence of banks within the industry occurred when deregulation allowed banks to market life insurance products directly instead of indirectly though a subsidiary arrangement.

The major banks had been moving indirectly into other financial markets for many years. Like insurance companies, they began to diversify their interests and expand into other markets in the post war period. In the 1950s and 1960s they bought into hire purchase companies.[36] The provision of consumer credit was easily tied to general insurance and banks developed subsidiaries in that market. In a similar way banks also moved into the superannuation market by establishing specialist subsidiary companies. With deregulation banks were able to directly enter the life insurance market and register as providers of life insurance products. The first bank to do so was the National Australia Bank in 1985 and over the next three to four years the other major banks followed suit. The speed at which banks moved into the life insurance industry was very rapid as is indicated in Table 2. Bank owned life companies increased their share of industry assets from 9 per cent in 1998 to 44 per cent in 2000.[37] Banks had a number of advantages which allowed lower information costs and economies of scale in mixing banking and insurance products. The existence of an established marketing network through bank offices and branches provided a platform from which to launch insurance products.

In addition to increased competition from banks, life insurers faced a number of other pressures at this time. The unbundling of insurance products, a trend which began in the 1970s, had brought life companies into more direct competition with other savings and investment institutions. The separation of life insurance products between mortality risk and investment earnings led to the creation of a whole range of investment linked products and placed a much greater emphasis on short term performance than had previously been the case in the life insurance industry. In the uncertain climate after the stock market crash of 1987 life insurers were forced to susbsidise short term returns with either an injection of capital, forgoing dividends or the use of reserves. The latter was of particular concern to the Insurance and Superannuation Commission who viewed it as a 'worrying trend'.[38] The need for capital in non shareholder firms such as the major mutuals led to the need to seek new methods of finance and hastened the move to demutualise in the next decade.

Concurrent with the greater emphasis on short term results, continually high inflation was leading to expense overrun and placing pressure on traditional life insurance business where the margin for expenses allocated from premium income was not sufficient.[39]

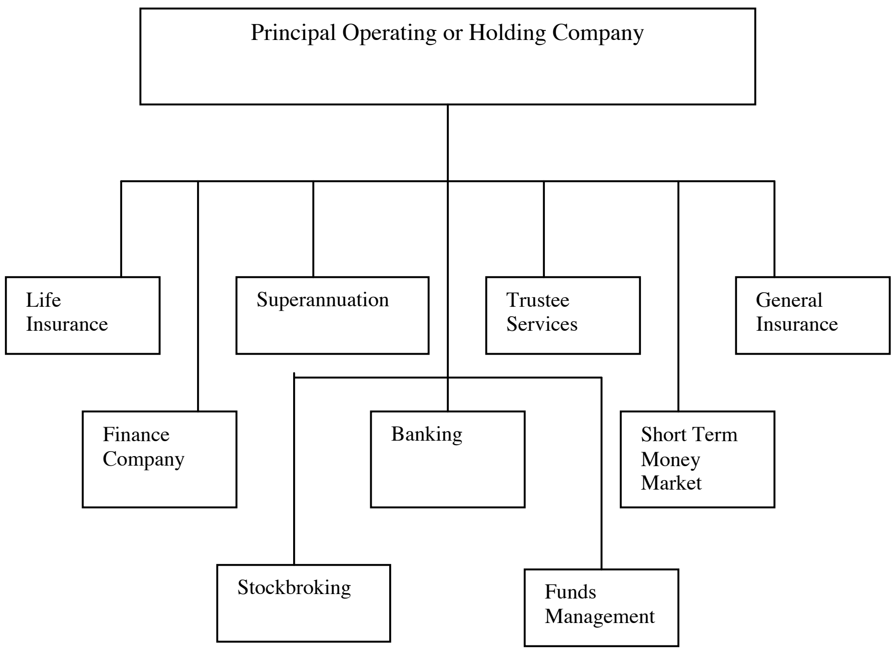
As a result of the combined effect of increased competition and performance pressures, a period of industry rationalisation occurred after 1990. The number of life insurers fell progressively throughout the next decade as some foreign companies exited the market and smaller firms merged or sold out to larger ones.

Against this background the larger life insurers moved to diversify their activities in recognition of the growing competitive pressures from banks. The large life offices sought to enter the banking sector. The AMP for example, attempted to negotiate a joint venture with the Chase Manhattan Bank and when this fell through they moved to obtain their own banking license.[40] The Colonial Mutual acquired the State Bank of New South Wales to form the Colonial Bank.[41] During the 1990s the distinctions between life insurance offices and other financial institutions such as banks were reduced. The movement to convergence broke down the traditional boundaries separating the providers of financial services and saw the emergence of ‘bancassurance’ as a new system of service provision. The bancassurance model which evolved in Europe provided a direction for the Australian financial sector to follow. However the antipodean experience was typically influenced by the on going restructuring of the financial sector and as such was different to that in other parts of the world.

Integrated financial services can be achieved in a number of ways. These include de novo entry, the setting up of a new enterprise; joint venture with the creation of a jointly owned legal entity; merger and acquisition; distribution alliances and a multi subsidiary company model. In the European context, joint ventures were the most popular form of entry.[42] In early forays into bancassurance in Australia, life companies did attempt to create strategic alliances and joint ventures. This usually involved alliances between life insurers and banks such as that of the AMP with Westpac. The agreement formed between the two companies in the early 1990s gave the AMP access to the bank’s distribution network, however it failed to provide the life insurer with the expected expansion in business. The agreement was dismantled within four years of its inception.[43] The failure of ventures such the AMP/Westpac agreement highlighted the problems associated with relying on different types of organisations to market life insurance whilst remaining in competition in the provision of other financial products. Whilst major life insurers toyed with the concept of joint ventures and strategic alliances in the 1990s these were largely abandoned in favour of more direct control.

The principle approach adopted by the major Australian life insurers and banks was that of the multi subsidiary company model. This can be seen as an extension of the approach to diversification adopted in the 1960s and illustrated in Figure 1. In the decade of the 1990s the leading life insurance firms moved into the areas of integrated financial services. Firms such as the AMP, National Mutual and Colonial evolved to become 'allfinanz' institutions offering a full range of financial services from banking to insurance and financial planning to customers Figure 2 synthesises the model adopted to highlight the corollary between the two periods of diversification.

Figure 2 The diversification of life insurers 1990-2000[44]



It is evident from Table 2 that in changing the institutional environment, the deregulation process was associated with a major industry restructure.

Amongst the changes was the growth of financial conglomerates which encompassed a range of activities.[45] The similarities between the approach to diversification taken by life insurers in the 1960s and that of the 1990s are apparent in a comparison of Figures 1 and 2. In the earlier period the use of subsidiary companies by life insurers to move into other markets was influenced by institutional and regulatory environment. Whilst regulation inhibited direct competition with deposit taking institutions it also afforded life insurance companies a degree of protection from these same institutions. Within this environment the major insurance offices were able to gradually acquire and expand their influence over subsidiary companies without overtaxing the capital constraints they faced as mutual associations. The growth of subsidiaries created a financial chain and allowed the linking of the activities of these firms. In doing so information costs were lowered. The provision of credit to consumers for example could be tied to the provision of general insurance and through this life insurance and superannuation.

In the 1990s a similar model was adopted in reaction to the growing competitive pressures as banks expanded into traditional life insurance markets. A further expansion of this chain could be reasonably expected to further lower information costs. The extension of the multi subsidiary model into banking and other financial services was seen as a logical outcome. However, unlike the previous period of diversification the regulatory system no longer afforded the protection for life insurers to gradually establish and build up a subsidiary. Deregulation and the ensuing growth in competition from the banking sector placed mounting pressure on life insurers to diversify as rapidly as possible. The need for capital to do this precipitated the demutualisation of the major life insurers in the 1990s which was to change the structure of the industry irrevocably.

VI

This paper considered the strategies adopted by Australian life insurance companies in two separate time periods when competitive forces challenged the prevailing status quo within the market. The first period under review covered the decade from the late 1950s to 1960s when the influx of foreign owned insurance firms moved into the life insurance market. The second period from the mid 1980s to the mid 1990s analysed the impact of increased competition arising from the deregulation of financial market. The strategies adopted in both periods were similar. In this respect the seeds of the trend to the integration of financial services were evident in the 1960s when Australian life insurers adopted a multi-subsidiary governance system in reaction to the encroachment of new competitors.

The catalyst for change in both cases was the change in information cost brought about by the changing competitive environment. However in the 1960s regulation of the finance sector was a constraining factor in the continued expansion of life insurers into other markets. It also offered a degree of protection to these firms perpetuating the established status quo. The lifting of regulatory restrictions on the banking sector changed the institutional environment within which life insurers operated. In doing so it precipitated further changes in strategies and organisational structures. Deregulation led to the emergence of new institutions which came into direct competition with established life insurers. The emerging trend to bancassurance was an outcome of the changing market forces. The extent and pace of adjustment which occurred in the financial sector put pressure on the mutual firms which dominated the market. The wave of demutualisation which occurred in the 1990s is tied directly to the need for firms to adapt to the changing environment. In this respect demutualisation was an inevitable outcome of the regulation process. Life insurers firms had to adapt organisational structures and strategies in response to changing institutional parameters. The experience of the Australian life insurance market would suggest that there is a link between changing information costs and changing organisational structures. However it also suggests that consideration should also be given to link between the institutional environment and it role in influencing information costs.

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[41]More recently the two leading banks have 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.
[42] Hoschka, Bancassurance, pp.20-21.
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