Chapter 1 Introduction

1. Introduction

This chapter summarizes the thesis, its context, significant phenomena, and problem statement. The research objectives, research questions, and research scope are then presented. The chapter concludes with a summary of the thesis's structure.

1.1. Background of The Study

In Indonesia, the insurance industry is thriving. Since 2012, the Indonesian Financial Services Authority ("Otoritas Jasa Keuangan, OJK") has noted significant growth in asset size. OJK has the role as an independent and integrated financial authority by Law No. 21 of 2011. It is responsible for regulating, supervising, inspecting, and investigating financial activities and institutions in Indonesia. The government is charged with implementing and integrating regulation and supervision of all financial services activities, including insurance. The insurance industry's total assets reached IDR 1,002.83 trillion in 2016 and increased to IDR 1,450.32 trillion by 2020 (OJK, 2020). Subsequently, according to OJK data from December 2021, its assets increased nearly 50% to IDR 1,590.72 trillion. According to OJK statistics from Dec 2021 (OJK, 2021), Indonesia now has 148 insurance companies, including 77 public insurance companies, 59 life insurance companies, seven reinsurance companies, and three mandatory insurance companies, and two social insurance companies.

The life insurance industry is critical because it assists in transferring risks from the insured to the policy issuer. By assisting in risk transfer, insurance enables the insured to undertake projects or engage in economic activities and transactions that they would not have undertaken otherwise due to risk. Additionally, insurance mitigates risk by pooling exposures so that aggregate losses are ultimately shared across the economy. This is especially true for long-term insurance, as life policy issuers continue to be significant investors, with funds invested primarily in debt and equity instruments. Due to the long-term nature of life insurance and its significant economic contribution (OJK, 2017) puts it at the forefront of the right to adequate consumer protection, including the disclosure of accurate and reliable information when purchasing or selling insurance. Along with its significant contribution to financial assets, both the policy issuer and the insured value consumer protection (see Figure 1.1).

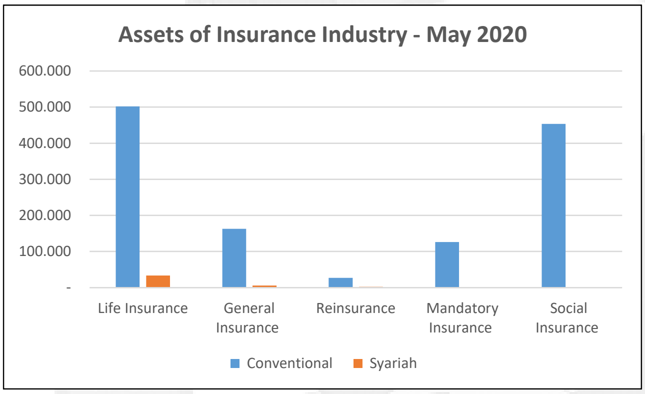

Figure 1.1 Assets of Insurance Industry – May 2020

According to OJK Statistics, in May 2020, with nearly IDR 535.16 trillion in financial assets, life insurance companies hold more than three times the financial assets of non-life insurance companies. According to Table 1, Sharia Insurance makes a minor contribution to the asset size of life insurance companies. For many families, life insurance is necessary to ensure financial security in an unexpected death. Generally, the policyholder seeking to purchase an insurance policy is expected to disclose all pertinent information in order for an intermediary to provide pertinent advice. In a similar vein, policy issuers are expected to follow a proper selling process centered on the consumer's needs. They include an adequate explanation of the policy's products, features, charges, benefits, exclusions, and illustrations.

Because Indonesia is a desirable market for the life insurance industry and there is still room to grow its penetration and density, the regulator made consumer protection a top priority in its oversight responsibilities. The OJK issued a Consumer Protection Regulation for the financial industry, emphasizing product transparency, a proper need-based selling process, consumer complaint reporting, and a mechanism for resolving consumer complaints (Otoritas Jasa Keuangan, 2013).

Additional study of Consumer Protection in the Indonesian life insurance industry is still in its infancy (Tobing, 2018), which means that miscommunication between the insured and policyholder regarding the obligation to disclose information and facts during the policy's sale results in a dispute between the insurer and policyholder, significant numbers of consumer complaints from telemarketing products and lack of assurance from OJK on the regulatory implementation. It should also be noted that the perceived benefits and risks associated with the inadequate implementation of Consumer Protection in the life insurance industry cover “no growth” on the risk culture/awareness, low level of supervision and governance over insurance products, increasing danger of consumer data security, lack of complaint handling mechanism in dispute resolution and standard provisions of insurance agreement (Tobing, 2018).

On top of that, the recent pandemic of COVID 19 has changed the practice of life insurance covering the selling process due to face-to-face restrictions by the government, digitalization of manual business processes to support non-face-to-face protocols and innovation through digital transformation as a source of competitive advantage.

1.2. Key Phenomena

Based on the above introduction to life insurance context, there are several observed growing phenomena in Indonesia's Life Insurance industry that also triggered the idea to conduct this study, as follows:

- **Low penetration rate** - As of December 2020, the life insurance industry accounted for 1.21 percent of GDP. Despite the density, the average Indonesian population spends IDR 0.85 million per year on insurance. Based on OECD statistics in December 2020 (OECD, 2022), this penetration rate remains lower than in regional countries such as Singapore (10.9%) and Malaysia (5%).
- **Low Trust in insurance products due to poor implementation of consumer protection** - In 2018, there were cases of fraudulent claims made by organized crime syndicates using hospital income insurance products, putting the regulator's neutrality to the test. In these cases, a former Chief Executive Officer (CEO) of a joint venture life insurance company and a former Head of Claim have been named as suspects in connection with a police report filed by a consumer (Mei, 2018). Moreover, recently OJK also faced a series of big cases involving life insurance companies, such as poor investment governance PT Asuransi Jiwasraya, mismanagement in AJB Bumiputera and recent massive customer complaints due to misselling of Investment-Linked Product (ILP) in Prudential, AIA Indonesia and AXA Indonesia.
- **Poor financial literacy in insurance industry** – The financial literacy index in insurance deteriorated to 15.8% in 2016 compared with 17.8% in 2013 (OJK, 2017). There was a perception in the community that insurance is a product that can only be used by people who understand risk and its mitigation. The financial literacy

index survey in insurance was contrary to the survey results of the financial inclusion index in insurance, in which the financial inclusion index showed an increase from 11.8% (2013) to 12.1% (2016). The conclusion is the decrease did not match the increase in access to financial productsrease in financial literacy across Indonesia.

- **<u>Low affordability and saturated customers in life insurance</u>** – According to data collected from the Lembaga Penjaminan Simpanan (LPS), as of April 2020, only 1.77 percent of bank customers have more than IDR 100 million in bank deposits. Life insurance products are bought based on customers' affordability. This data indicates that all banks, life insurance companies, asset management and multi-finance are targeting the same markets for their products. In contrast, the remaining 98.23 percent who have less than IDR 100 million in their deposits might not be able to purchase the unit-linked product, which is inherently more expensive than the traditional insurance product (Lembaga Penjamin Simpanan, 2018).
- **<u>The misperception of insurance products as an investment (not as protection)</u>** – Based on the Indonesia Life Insurance Association, the Investment Link Product (ILP) contributed to 63% of the total premium generated during 2019 (AAJI, 2019). This data indicates the perception that life insurance is an investment instead of protection to its policyholder. This is also contrary to the abovementioned phenomenon in which the financial literacy in insurance is still exceptionally low (15.8%). This might also support the other phenomena in which only a small portion of saturated customers might be able to buy the ILP products (1.77%).

This observation, supported by the above-identified phenomena, has provided a call for more rigorous research to understand what is going on in the Indonesia Life Insurance industry. Therefore, this study will strongly seek to link the strategies for gaining sustainable competitive advantage amongst life insurance firms in Indonesia, considering the identified phenomena.

1.3.Problem Statement

The above conditions and growing phenomena outlined in Section 1.2 raise **how life insurance companies create their sustainable competitive advantages through digital and service provisioning transformation capabilities and what can be learned from these capabilities to adapt to Indonesia's condition.** The life insurance industry in Indonesia must develop these capabilities to create and deliver new value to customers through transformational and digital-based innovation capabilities.

The problem statement promotes a claim that the sustainable competitive advantage of the life insurance companies can be assessed from the digital-based initiatives and the service provisioning transformational initiatives. The following research questions have been formulated to be addressed in light of the study's objectives:

RQ1. How do companies in the Indonesian life insurance industry achieve a sustainable competitive advantage?

RQ2. How do these insurance companies define and operationalize the sustainable competitive advantage using transformational digital-based dynamic capabilities and transformational service provision?

RQ3. Can other life insurance companies substantiate the case study's conceptual model?

1.4.Research Objective

This study examines the following: (1) the ability of life insurance companies in Indonesia to create a sustainable competitive advantage using digital-based capabilities and service provisioning transformation capabilities; (2) the conceptual framework emerging from the literature review that illustrates how digital-based capability and service provisioning transformational capability will support in creating a sustainable competitive advantage; and (3) the implications of these findings for the life insurance industry.

The conceptual framework is intended to assist life insurance companies in Indonesia in identifying their digital-based and transformational capabilities and determining the gaps between their current and desired states of digital-based and transformational capability. As a result, this framework enables the Indonesian life insurance industry to be more adaptable to disruption and market changes, which would trigger them to be more innovative in creating a digital sustainable competitive advantage to survive with Indonesia's life insurance market and phenomena.

1.5. Research Scope

The conceptual framework developed from the literature review is explored and validated in two stages through a case study. The case study began with seventeen Boards of Directors (BODs) from the eleven life insurance companies. This stage seeks to ascertain the existence of initiatives to develop both digital and transformational capabilities. The second stage involved thirteen BODs from five insurance companies that differed from the first stage. The second stage aims to test the propositions generated in the first stage.

1.6. Outline of The Paper

This thesis follows the structure as follows. First, it gives an overview of the research on the service-dominant logic, agency theory, resource-based view, dynamic capability, digital transformation, digital-based capabilities, transformational capabilities, sustainable competitive advantage, and the conceptual framework that shows how both capabilities can create a sustainable competitive advantage. Second, it discusses the research methods using the case study method. Third, it presents the findings of the explorative study of insurers' senior management team and generates the propositions as a result of the exploratory study. Fourth, it discusses the logic used to connect the data to the developed propositions and interpret the findings. Finally, it summarizes the qualitative study's findings.