

Ageing Population, Social Responsibility & Opportunities for the Corporate Sector

The case of Sri Lanka

Keynote

Most developed countries are faced with two problems - a falling birth rate and a longer living population, resulting in a rapidly ageing society supported by comparatively fewer producing workers. Treating the older folks well is one of the primary social responsibilities we face. Traditional public-funded pension schemes to support the old would be unable to meet the need. Banks and other private sector entities have a real opportunity to distribute products designed to meet this need. However, it should be noted that provision of financial security is only one aspect of "care" we need to provide for the older population. Moreover, redundancies and early retirement programmes have brought forward the retirement age for many Sri Lankans.

Background

While Sri Lanka is a developing country it shares the problems of ageing population with the more developed world. Though a developing country in terms of traditional economic indicators, it can be argued that Sri Lanka's demographics are more akin to developed countries. Low birth rates and good literacy levels have contributed to the burden of supporting the aged. Improving health care systems and the success of family planning programs in the past have been the drivers behind the falling birth rates. While in socio-economic terms these are excellent achievements they also have created challenging problems.

However, these very problems present opportunities for creative minds and organizations to develop and offer products and services that will meet the needs of an ageing society.

New Challenges

Amid political upheaval and terrorist threats Sri Lanka's successive governments have achieved significant progress in some areas of socio-economic development. A well-targeted family planning program implemented over the decades has resulted in a stable

birth rate and, given the limited resources available, the country has maintained a good health care system. The solution of managing population growth through reduced birth rates coupled with provision of a good health care system has created new problems and, perhaps, opportunities. Moreover, the immediate and extended family support structure is also under pressure from socio-economic changes. Geographical dispersion of family members within Sri Lanka and overseas has made it difficult for younger family members to care for the ageing population. The current structure of the retirement and pension system is not geared to address the issues faced by these changing population trends and family structures.

Within the overall core problem of ageing population there are other problems such as the need for increased investment in health, retirement homes, hospitals and leisure activities. The private sector may be interested in providing some of these services but the funding will be one of the public policy challenges. It is acknowledged that there will be a growing proportion of the population who are capable and willing to fund their own retirement.

Fiscal Sustainability

So far the "government" has provided retirement benefits to a large proportion of the population. But it is well documented that the benefits paid (and to be paid) exceed the means of state-controlled pension funds. This is commonly called *unfunded liability*. Moreover, there are many more people without any reasonable retirement income because they have not been state employees or members of a reasonable pension fund. Benefits from accumulated benefit schemes are unlikely to provide sufficient retirement income for most members.

Against this backdrop, the government continues to pay the benefits from its income (tax). There is a significant unfunded liability already and with the current demographic changes this liability is likely to increase. The problem is exacerbated by a number of factors:

1. The state-controlled funds have been predominantly invested in fixed income securities, often, earning below the rate

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of inflation - they are losing money in real terms.

2. The government encouraging such funds to become "deficit funding partners".
3. The members of these funds have very little control over policy matters in general and investment strategy in particular.

Against this background the looming problem of retirement planning cannot be overstated and with an increasing "gray population" the challenge is to find ways of providing for senior citizens. The other public spending needs like education, health and infrastructure, will compete with the future provisions for the senior citizens and at the same time we should consider our social responsibility in resource allocation process.

Essentially the provision of services to the younger generation and the retirement needs of the older generation will compete for the same funds. This is not only fiscally unsustainable but also morally wrong. We should consider our social responsibility in resource allocation process. On the one hand the older generation deserve a reasonable retirement but on the other hand the younger generation should not be deprived of opportunities because of poor policy decisions in the past. Policymakers have not addressed the critical issue of funding requirements for an ageing population.

Demand on Infrastructure

Aside from immediate financial and long-term wealth creation needs there are infrastructure needs created by the ageing population. The longer-term infrastructure needs include retirement villages, nursing homes, in-house health care and leisure activities.

In an era where the government and donors encourage the private sector to fund essential infrastructure like power, highways, pub-

lic transport, hospitals and water supply, it is unlikely that the infrastructure needs of the elderly will get priority. On the contrary it is highly likely that the infrastructure needs of the elderly will not be able to compete for the limited amount of funds available.

Wealth Management and Social Security

Social security is a basic right that the senior citizens of a country should enjoy. Yet only one in five people in the world has adequate coverage, while more than half the world's population has no social security protection at all. Providing for the old age is a key role in any social security plan.

A good wealth management plan during the working life and beyond is a key driver behind any good retirement investment and income plan. It is often poor planning, investment and management of what people earn and own that results in inadequate provisions for retirement.

The assertion that populations in developing countries have little or no capacity for saving is not valid because a significant proportion of the population is asset rich and cash poor. Even the investments they hold are predominantly in low return fixed interest savings.

The state alone cannot solve this problem. It needs cultural change, good investment opportunities and effective communication programmes.

Overseas Experience

Most of the OECD countries have encouraged the financial institutions to find solutions to problems (opportunities) created by the ageing populations. Private and public sector participation is common in most cases. While there are state pensions in most countries, employer-funded pensions and independent self-funded pensions are common. It is common in countries like Australia to offer more defined contribution (DC) plans than defined benefit (DB) plans.

The dependency ratio – the ratio of the dependent population to the working population – is forecast to increase significantly in all OECD countries in coming decades. Between now and 2050 the dependency ratio is likely to increase by an average of over 25% in the OECD, and it will remain the organization's most critical social policy issue. In addition to the domestic retirement market segment, Sri Lankan corporate sector would be able to capture a proportion of "sun loving retirees" of these countries.

Warmer climate, beautiful beaches, improving health care sector and stronger buying power should bode well for the expected flood of "sun loving retirees".

A reduction in the state sector's involvement and an increase in the private sector's involvement are common in many countries. While the traditional private sector players were large insurance companies, the profit potential of this segment has attracted a range of non-insurance finance sector players including banks. In countries like Australia the large wealth management businesses are now owned by banks and insurance companies.

Sri Lanka's Ageing Problem

The following statistics show that the funding problem in Sri Lanka is similar to that in OECD countries and it may even be more complex:

- * Percentage of population under 18 years of age fell from 49.6% in 1971 to 32.9% in 2001
- * Percentage of population over 18 years of age increased from 50.4% in 1971 to 67.1% in 2001
- * Average number of births per woman fell from 5 in 1953 to 2 in 2000
- * Proportion of the population over 65 years increased from 3.6% in 1963 to 7% in 2001

The general trend in Sri Lanka is an increasing proportion of older people. Moreover, the recent employment trends show a tendency towards early retirement. If we bring forward retirement age to 55 years and the life expectancy increases then the "retired population" will increase further.

The economics of this growing trend can be expressed as follows:

Total GDP = Working population GDP + Non-working population GDP.

The alarming trends are clear from the forecasts in the Table below:

From a macro perspective, the pension system

Year	Child Dependency	Old Age Dependency	Total Dependency
2001	38.0	15.3	53.3
2006	35.4	17.2	52.6
2011	33.9	20.1	54.0
2016	32.1	24.0	56.1
2021	29.8	28.2	58.0
2026	27.0	32.1	59.1
2031	24.6	36.0	60.6
2036	24.1	41.1	65.2
2041	24.6	47.9	72.5

is essentially a method of allocating current GDP between the working population and beneficiaries like retirees, war veterans, the permanently disabled etc. From an individual viewpoint, the income and pension system is a way to allocate income over the life cycle of a person. It is a process of accumulation during employment and de-accumulation during retirement.

If the non-working population requires an increasing proportion of the GDP then the rest of the population will have a decreasing proportion of the GDP. Then, it can be argued, if the problem of retirement savings is not addressed the standard of living of the working population will eventually decrease. Therefore, it is in the interest of the current working population and future generations to solve the retirement issues today. This is where the opportunities for the corporate sector lie.

What are the solutions?

Although successive governments have attempted to solve the social security and retirement problems of Sri Lanka there have not been significant achievements thus far. The total contributions (including taxation) should equal the total benefits at macro level to avoid an unfunded liability. This leads to an additional burden on the tax system that in turn will dampen growth. This is a dangerous cycle.

To achieve equilibrium the pensions that the working population buys (in terms of contributions) and the accumulated rights that the retired generation sells should be equal. That is, the present value (PV) of the sum of benefits paid out should equal the present value of the contributions paid in. Alternatively this can be expressed as-

$$PV(\text{benefits}) = PV(\text{contributions})$$

The current problem is that the PV (benefits) is much greater than the PV (contributions).

There is a range of alternative solutions to this problem:

1. A universal system covering the entire population which is funded by the taxation system. This will increase the rate of tax.
2. Individualised accounts managed by the public sector to support the universal payment.
3. Individualised accounts managed by the private sector to deliver a pension or a lump sum in retirement.
4. Increasing return on funds over a period to meet the additional funding re-

quirements, e.g. taking a higher risk through the financial markets to deliver a higher return.

From the above, alternatives 3 and 4 provide opportunities for the corporate sector. While these are specific retirement funding related opportunities there are wider opportunities in retirement-related areas including provision of infrastructure for this segment.

Opportunities for the Corporate Sector

Provided that the corporate sector look beyond their immediate profit objectives the ageing population in Sri Lanka will present attractive opportunities. It will be a growing market segment with accumulated wealth. The challenge is to unlock the full commercial potential of this market. It is acknowledged that the corporate sector will not be able to find commercially viable solutions to all segments of the market. However, if the private sector can assist with an increasing proportion of the middle class segment, the role of the state will be reduced to that of providing a welfare net to the lower end of the market.

Some of the key areas of interest in the middle and upper-middle segments are:

1. Retirement planning products
2. Wealth creation strategies
3. Lifestyle financial planning
4. Reverse mortgages
5. Annuities
6. Pensions
7. Travel and leisure
8. Residential accommodation units including retirement villages
9. Self-care units
10. Nursing homes
11. Health insurance
12. Geriatric care

In the above areas there will be opportunities for corporate sector to partner with public sector institutions.

New Banking Paradigm – Total Relationship Approach

The new banking paradigm will have to move beyond "bancassurance". It has to go beyond satisfying the banking and insurance needs of target customer segments. The objective is to serve the total customer need. Banks and other financial institutions will ultimately become only some of the providers of retirement solutions. Other corporate sector play-

ers with effective distribution capabilities will benefit from this growing sector. Examples in other parts of the world are many. The foray of Kerry Packer controlled Challenger Group into the wealth management sector in Australia is a good example.

The basic business model of banking, borrowing and lending, have remained the same for centuries. Today, banks face constant challenges from globalisation, technology developments, deregulation and increased competition that challenge the ongoing profitability of banks. Some financial institutions even see themselves



Providing welfare for ageing population is a worrying problem all over the world.

as "distributors" of products and services developed within their organisation and others.

To provide a total solution to its customer base a provider will not have to develop all the solutions but it should have a good platform to deliver those solutions and strengthen its customer relationships.

Against this background, the following macro-, micro- and socio-economic factors make a compelling case for provision of products and services to the retirement sector:

- * Ageing population
- * Government's intention to introduce more private sector involvement in socio-economic development
- * Fiscal deficit forcing the government to "privatise" pension sector to have a self-funded pension sector
- * Progressive reduction of state involvement in commercial entities and the utilities sector
- * Internationalisation of financial markets
- * Increasing awareness of the need for wealth management for retirement, education and health funding
- * Fee income of "distribution" of products and services will support the revenue streams in a declining interest margin environment.
- * Risk exposure of wealth management

products and services is minimal compared to the risk of bad debts.

Banks, non bank financial institutions and other companies with existing infrastructure such as IT platforms, customer relationships, staff, call centers, the branch network, etc., are well placed to profit from the "ageing problem".

Concluding Comments

The ageing population in Sri Lanka is likely to pose some challenges and provide some opportunities. There are opportunities for private sector institutions to take an increasing role in developing and delivering products and services to this ever increasing "retirement market".

There may not be commercially viable solutions attractive enough to the private sector to provide products and services to the bottom end of the market. However, if private sector involvement efficiently reduces the strain on government finances in terms of providing benefits to the middle-income group, then the state and

NGO's can focus on lower income groups. Participation between the private and public sector appears to be one of the most effective ways to bring about solutions to the problems of the ageing population in Sri Lanka.

With careful planning and thinking beyond the traditional banking paradigm, banks and other private sector institutions can position themselves to profitably service the "retirement market" while ultimately assisting to reduce public expenditure in this sector.

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