# IMPACT OF FDI ON INSURANCE SECTOR IN INDIA - AN ANALYTICAL STUDY

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## ABSTRACT

*Foreign Direct Investment is fund flow between the countries in the form of inflow or outflow by which one can able to gain some benefit from the investment whereas another can exploit the opportunity to enhance the productivity and find out better position through performance. The economic reforms initiated in India in the early 90s paved the way for the growth and opening up of the financial sector. With the liberalization and entry of private companies in insurance the Indian insurance sector has started showing signs of significant change. Insurance business in India is growing at the rate of 15 -20% annually. Insurance and banking services all together adds about 7% to the country's GDP. The insurance industry was opened for private players in the year 2000 with the establishment of IRDA. Foreign Direct Investment was allowed in private insurance in India up to a limit of 26%, but on 4th October 2012, Prime Minister Manmohan Singh's Cabinet approved to enhance the FDI cap from 26% to 49% and the bill was passed in the parliament with amendment of insurance Act. In the last twelve years of period the insurance industry has moved forward on multiple fronts. At the same time the industry is faced with many challenges. By this paper an attempt is made to study the impact and consequences of FDI and to analyse the performance of public and private insurance companies in India.*

***Key words:*** *FDI, Liberalisation, Insurance industry, Private players.*

## INTRODUCTION

Foreign Direct Investment is an investment of foreign assets into domestic structures, equipment and organizations. It does not include foreign investment into the stock markets. Foreign Direct Investment is thought to be more useful to a country than investments in the equity if its companies, because Foreign direct investment is more in the nature of a long term investment. In most cases, Multi National Companies engage in foreign direct investment, because they are interested in boosting revenues, reducing costs, or both (Balasubramanya,1996). Capital is stated as the engine of economic growth. This statement has gained more importance in recent time; foreign capital played an important role in the early stage of industrialization of most of the advanced countries (Usha Bhat -2003).

Foreign Direct Investment plays a vital role in the economy because it does not only provide opportunities to host countries to enhance their economic development but also opens new vistas to home countries to optimize their earnings by employing their ideal resources. India is recognized globally for its consistent high growth of more than 8% per annum, its vibrant democracy and institutions, and cheap labour, with good English skills. It is predicted that India's economy will grow fivefold in the next 20 years (Rajagopalan-2010).

The insurance sector in India is nearly 150 years old. It is the backbone of country's risk management system. Insurance influences on the growth and development of an economy in several ways. It acts as a mobilization of savings, financial intermediary, stabilizer of financial markets and a risk manager. The availability of insurance can mitigate the impacts of risk by providing products which help organizations and individuals to minimize the consequences of risk.

Ample of studies suggests that insurance contributes materially to economic growth by improving investment climate and promoting a more efficient mix of financial activities. Insurance serves a number of valuable economic functions that are largely distinct from the functions served by other financial intermediaries. (R. Rajendran and B. Natarajan 2010, Rajagopalan Krishnamurthy (2010). Even though the country has favorable demographic profile insurance penetration is very small compared to other emerging countries. In India life insurance covers only 4 percent of the total Indian population. India needs that more players to come in insurance sector to cover a large population.

**Milestones in insurance reforms in India:**

1956 - Nationalization of insurance industry and establishment of LIC.
1957 – Framing of a code of conduct by the general insurance council to ensure fair conduct and ethical business practice.
1972- Nationalization of general insurance. Establishment of GIC with four subsidiaries.
1991 – Beginning of economic liberalization.
1993 – Malhotra committee set up to complement the reforms initiated in the financial sector.
1999 – Insurance Regulatory and Development Authority (IRDA) bill passed in parliament
2000 – IRDA incorporated as the statutory body to regulate and register private sector insurance companies.

**Objectives of the study:**

To study the impact and consequences of FDI in Insurance sector in India.

To analyze the performance of public and private insurance companies.

**Research Methodology:**

The study is made on the basis of secondary data collected from various sources. The main sources of data are Journals, Articles, Newspapers, IRDA annual reports, The Journal of Insurance Institute of India and Annual reports of LIC.

An attempt is made to analyse whether there is any significant difference in the growth of total insurance premium of public and private insurance (life and non-life) companies by the application of t- test. T-test is a parametric test, to test whether the average (mean) of two populations are the same. When the sample size is less than 30, t-test is the most appropriate technique to analyze the data.

The value of **t** is calculated by using the given equation.

$$t = \frac{\bar{x}_1 - \bar{x}_2}{\sqrt{\frac{s_1^2}{n_1} + \frac{s_2^2}{n_2}}}$$

where $\bar{x}_1$ = mean of sample 1

$\bar{x}_2$ = mean of sample 2

$n_1$ = number of subjects in sample 1

$n_2$ = number of subjects in sample 2

$s_1^2$ = variance of sample 1 = $\frac{\Sigma(x_1 - \bar{x}_1)^2}{n_1}$

$s_2^2$ = variance of sample 2 = $\frac{\Sigma(x_2 - \bar{x}_2)^2}{n_2}$

## HYPOTHESES OF THE STUDY

For the purpose of this study the following hypotheses are formed

$H_{01}$ There is no significant difference in the growth rate of total insurance premium of public and private life insurance companies.

$H_{02}$ There is no significant difference in the growth rate of total insurance premium of public and private non-life insurance companies.

Most of the economists and analysts opine that FDI helps for the economic development of the nation. 'Foreign direct Investment is profitable both to the country receiving investment and the investor. For the investor company FDI offers an exclusive opportunity to enter into the international or global business, new markets and marketing channels, elusive access to new technology and expertise, and expansion of company with new or more products or services, and cheaper production facilities. The host country receives foreign funds for development, transfer of new profitable technology, wealth of expertise and experience and increased job opportunities' (T.K. Jayaram, 2007). 'FDI is considered to be the most attractive type of capital flow for emerging economies as it is expected to bring latest technology and enhance production capabilities of the economy (K S Chalapathi Rao -2011).

Following the recommendations of the Malhotra Committee report, in 1999, the Insurance Regulatory and Development Authority was constituted as an autonomous body to regulate and develop the insurance industry. The IRDA opened up the market in August 2000 for private players with the invitation for registrations. Foreign companies were allowed ownership of up to 26%. Now it is increased to 49%. In December 2000, the subsidiaries of the

General Insurance Corporation of India were restructured as independent companies and at the same time GIC was converted into a national reinsurer. Parliament passed a bill de-linking the four subsidiaries from GIC in July, 2012. The effect of insurance reforms has been positive on the insurance industry. The private companies like ICICI prudential life, SBI life, HDFC Standard life, Bajaj Allianz life etc. are taking share in the insurance market. Currently, 49 insurance companies are functioning in India.

**The table below shows the breakup of insurance companies:**

| Type of Business | No. of Public Sector Companies | No. of Private Sector Companies | Total Companies |
|---|---|---|---|
| Life Insurance | 01 | 24 | 25 |
| General Insurance | 04 | 19 | 23 |
| Re Insurance | 01 | 00 | 01 |
| Total | 08 | 41 | 49 |

Sources: IRDA reports.

In the last twelve years of period, the insurance industry has moved forward on multiple fronts. There has been progress in terms of enhanced penetration, increased coverage of lives/property, more customer friendly products, a rapid growth of distribution channels (agency, bancassurance, broking, direct corporate agency) enhanced reach, and increasing competitiveness of the market (Biswajith Dhas 2011). However, at the same time, the industry is faced with many challenges.

## OPPORTUNITIES

It is said that there will be an average annual growth of 11 to 12% in the insurance sector in the coming years (Indian Express 6th October 2012). The study shows that insurance industry has many opportunities for further growth. Following are the main strengths and opportunities for the industry.

- The country's favorable demographic profile is of special interest to insurers. 56 percent of Indians were under age 15 or over age 64. Research by **Morgan Stanley** shows that India's working-age population will increase by 136 million by 2020 (China's working-age population, by comparison, will grow by 23 million).
- India's life insurance penetration, defined as the ratio of premium underwritten to the GDP was 4.5% in 2011and non-life business was just o.70%. The large young population, combined with the current low rate of life insurance penetration and high rate of personal savings, points to the upside potential for the Indian Insurance market. Given the saving scenario in India, there is much more growth potential and the liberalized insurance sector is likely to mobilize the long term funds for infrastructural investments.

- Rising household income and risk awareness will be the key factors to promote insurance in India. Indian households save more than those in other emerging markets such as China and Brazil. Household savings were 25% of India's gross domestic savings, compared with 5% in Brazil and 15% in China.

## CHALLENGES

Of course, currently the insurance industry is facing challenging times. The big challenge with the industry is profitability. Private life insurers have accumulated losses. Following are the main challenges that are found in the insurance industry.

- Multi-Channel distribution: Managing the expectations of channel partners, viz.,banks, corporate agents brokers and advisory force and keeping the acquisition costs at manageable proportions are major challenges for insurance companies.
- Technological advancement: The functions like data management, underwriting, fund management etc., needs knowledge and application of updated technology. Again the technology helps to provide better services to policy holders. Insurance sector needs to have advanced information technology to improve its communication and management system.
- Increase in costs: In the long run other forms of non-price competition like aggressive advertisement wars are likely to lead to increasing costs, which ultimately harms the interest of customers.
- Tax savings scheme: Insurance premiums are looked at as a means of tax savings schemes. The true importance of insurance often gets overlooked.
- The inflexible and expensive plans offered in the market make it more difficult for the common people to invest.
- The situation in rural India is even worse. Small fractions of the people have bank accounts and the concept of insurance is very hard to understand. There is a huge lack of proper awareness regarding the need of insurance.

### Analysis of data

In the last twelve years of period there is a rapid progress in insurance business in India. Due to increased competition public and private players are adopting innovative marketing strategies and advanced technology in their business. There is a significant growth in insurance business and insurance penetration. Insurance offices have been extended to rural area to provide insurance coverage to low and average income people.

**The table shows the details of total insurance premium of public and private life insurance companies (in crores)**

| Year | LIC(public) | Growth rate (%) | Private | Growth rate (%) |
|---|---|---|---|---|
| 2004-05 | 75127.29 | 18.25 | 7727.51 | 147.65 |
| 2005-06 | 90792.22 | 20.85 | 15083.54 | 95.19 |
| 2006-07 | 127822.84 | 40.79 | 28242.48 | 87.24 |
| 2007-08 | 149789.99 | 17.19 | 51561.42 | 82.57 |
| 2008-09 | 157288.04 | 5.01 | 64497.43 | 25.09 |
| 2009-10 | 186077.31 | 18.30 | 79373.06 | 19.69 |
| 2010-11 | 203473.40 | 09.35 | 88131.60 | 11.04 |
| 2011-2012 | 202889.28 | -0.28 | 84182.82 | -4.48 |

Source: IRDA annual reports.

The above table shows that the growth rate of private players was very attractive in the beginning of liberalization. As life insurance is long term contract it needs time to understand the progress of business. The only public insurance company, LIC is continuous to dominate the market by maintaining consistency in its growth rate.

**Table shows the details of total insurance premium of public and private nonlife insurance companies. ( in crores)**

| year | Public (GIC) | Growth rate (%) | private | Growth Rate (%) |
|---|---|---|---|---|
| 2008-09 | 18030.75 | 7.13 | 12321.08 | 12.10 |
| 2009-10 | 20643.45 | 14.50 | 13977.00 | 13.44 |
| 2010-11 | 25151.83 | 21.83 | 17424.63 | 24.67 |
| 2011-12 | 30560.74 | 21.50 | 22315.03 | 28.0 |

Sources: IRDA annual reports.

The above table shows that there is an increased rate of growth in insurance premium of public and private companies. The competitive environment has increased the scope of general insurance in India.

**Analysis of results**

T-test was used to know whether there is any significant difference in the growth rates of public and private life insurance companies and to assess the growth rates of non-life insurance companies. To test the null hypothesis t value was calculated and compared to table value at 5% significance level. The results of t- tests are given below.

| Hypothesis | Particulars | t-value | critical value | Result |
|---|---|---|---|---|
| $H_{01}$ | Total insurance premium of life insurance company | 1.957 | 2.145 | accepted |
| $H_{02}$ | Total insurance premium of non-life insurance companies | 0.807 | 2.447 | accepted |

$H_{01}$ The critical value of t at 5% level of significance for the degree of freedom of 14 is 2.145.The calculated t value is 1.957, which is less than the critical value and hence null hypothesis is accepted. That there is no significant difference in the growth rate of insurance premium of public and private life insurance companies.

$H_{02}$ The critical value of t at 5% level of significance for the degree of freedom of 6 is 2.447 and the calculated value is 0.807. As the calculated t value 0.807 is less than the critical value of 2.447 the null hypothesis is accepted. The result shows that there is no significant difference in the growth rate of total insurance premium of public and private non-life insurance companies.

## CONCLUSION:

Foreign Direct Investment in Insurance has led to the entry of private players who have created competitive environment in the industry. Customers are privileged with product innovation and technological advancement. The study reveals that Life insurance Corporation of India (LIC) the only public sector life insurance company continuous to dominate the sector. Private players are also improving their efficiency to increase their market share. However the Government, IRDA, and the regulators have the most important role to govern and to regulate insurance business in India to protect the interest of policy holders and other stakeholders.

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