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Reforms through Research

Foreign Direct Investment in the Indian Insurance Industry: An Impact Analysis

by
Dr.S.K.Hegde[a] & Prof. Shriharsha Ranebennur[b]

Abstract

Generally speaking FDI refers to capital inflows from abroad that is invested in the production capacity of the economy and are "usually preferred over other forms of external finance because they are non-debt creating, non-volatile and their returns depend on the performance of the projects financed by the investors. FDI also facilitates international trade and transfer of knowledge, skills and technology. Foreign direct investment is of growing importance to global economic growth. The insurance sector in India has a great potential even during the downtrend and FDI flow is expected to rise in the mere future. Currently, only 26% of FDI is permitted in insurance sector. The total insurance business would touch US$ 60 billion size. If insurance sector is opened up to an extent of 49% for FDIs, it is expected that FDI's contribution to insurance business would touch nearly US$ 2 billion.

Indian Life insurance sector is growing at a faster rate. This sun rising industry has given a platform for economic growth and employment. The great extent of importance realized after it has opened to the private players in the post liberalization period. With many players in business, the insurance regulatory and development authority came with innovative and constructive guidelines for both products and services.

This paper analyses the problems that the present insurance industry is facing and the impact of foreign direct investment on private insurance sector in India. The suggestions and policy recommendations will help both academician and industry personnel to re- engineer their thought in insurance sector.

Keywords: Foreign Direct Investment, Insurance Industry, Impact Analysis

[a]**Dr.S.K.Hegde,**	[b]**Prof. Shriharsha Ranebennur**
Associate Professor	Lecturer in Commerce
Head of the Department of Economics,	M.E.S. College of Commerce
M. E. S. College of Commerce,	Sirsi (U.K) Karnataka State, IndiaSirsi (U.K)
Karnataka State, India	Email Id: hri.ranebennur@gmail.com
Email Id: drsudhakarkhegde@gmail.com	Mobile: 8095329257
Mobile: 9481048776	

1. Introduction

FDI inflow helps the developing countries to develop a transparent, broad, and effective policy environment for investment issues as well as, builds human and institutional capacities to execute the same. The insurance sector is of considerable importance to every developing economy; it inculcates the savings habit, which in turn generates long-term investible funds for infrastructure building. The nature of insurance business ensures constant inflow of funds - the payout is staggered and contingency related - thereby making it readily available for investment on infrastructure building. Its contribution to GDP is quite significant. The Union government had opened up the insurance sector for private participation in 1999, also allowing the private companies to have foreign equity up to 26 per cent. Following the opening up of the insurance sector, many private sector companies have entered the insurance business. The insurance sector has been a fast developing sector

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with substantial revenue growth in the life and non-life insurance market, but in spite of its huge population.

Insurance is one of the demanding financial products in India. Its basic motto is to protect the family of any uncertainty in life. So it is long term investment and need knowledge about that.

In the post liberalization era, insurance has attracted many private players from different parts of the world to start business in India. India as a country has potential for growth of this business. With the upcoming of regulator in the year 2000, the business in India became more streamlined. Large players along with customer choice results severe competition Life Insurance Corporation of India in one end and ICICI Prudential life insurance from private sector on the other end has taken maximum market share from both category. Product innovation, profitable growth, multi channel distribution and ethical practices in business are few factors to be considered. Regulation from government and research in this sector many times a challenge for the existing players. In this situation, a brief study of the above sector is required.

With the deregulation of insurance industry in India since 1999, private players have got an opportunity to enter into the insurance markets. Prior to its deregulation,the life insurance business was dominated by the publicsectorcompany,Life Insurance Corporation of India.While liberalization of insurance sector, as many astwelve new private life insurance companies wereentered with the help of foreign equity up to 26 per centin the life insurance business. At this juncture, an in depthstudy is essential on the insurance sector to analyse the problems, need for FDI and its impact on the performance of the private insurance sector.

2. Review of literature

Bengal Chamber of commerce and KPMG (2013) addressed the present context of insurance. The external environment changed the entire industry. Profitability, growth and risks were to be considered with respect to shareholders'view.

FICCI and BCG (2013) discussed many issues with the industry. Mindset of the people towards insurer is an important part. Distribution, cost and digitalisation are some of the key areas to be thought of.

Jain (2011) from Capegimini explored that life insurance industry need support in the area of distribution, product diversity and regulation. At the same time it was felt that outsourcing function should be from the broader perspective rather than cost.

The opening of life insurance companies also witnessedmajor changes in the insurance products beingoffered by life insurance companies and insurancecovers opted for the customers.

H. Sadhak (2009) in his book, "Life Insurance in India, opportunities, challenges and strategic perspective" reported that deregulation and liberalization of national economy had significant impact on institutional investor such as life insurance, pension fund and investment institution.

Kamlesh Gabhar (2006) in his book, "Foreign Direct Investment in India" reported about Foreign Direct Investment in India and its nature and scope of investment in Indian companies and various sector through collaboration, merger, acquisition and joint venture of equity.

Usha Bhat (2003) in her book, "FDI Contemporary Issue" revealed that capital is stated as the engine of economic growth. This statement has gained more importance in the recent time, in which foreign capital played an important role in the early stage of industrialization of most of the advanced countries.

R.K. Uppal (2008) in his book, "Financial Sector in India, Emerging Challenges" reviewed that with the initiation of the deregulation of insurance sector, the insurance sector plays a vital role in the process of the economic development of any economy. It has a positive correlation with economic development.

3. Problems facing the Indian Insurance Sector

The government's intention was to create a monopoly and protect it from foreign and private competition. So, what were the implications of such a conservative approach? Insurance sector faced problems such as capital scarcity, poor product quality and technological obsolescence. In the year 2000, life insurance penetration in India stood at an abysmal 2.4%.

The major problems are

- There is a huge lack of proper awareness regarding the need of insurance.
- Insurance premiums are looked at as a means of tax evasion and savings. The true importance of insurance often gets overlooked. In addition to this, India is a country with a huge lower middle class section. In their daily struggle to try and get both the ends meet, insurance premiums come as a luxury.
- 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. A small fraction of the people have bank accounts, and the concept of insurance is very much alien. People have little disposable income, and the only form of life insurance is joint family.

4. Significance of fdi in insurance sector

FDI could play on important role in the rapid development of the insurance sector.

1**. Capital for expansion**: FDI has the potential to meet India's long term capital requirements to fund the building of infrastructures which is critical for the development of the country. Infrastructure has been the major factor which has restricted the progress of the Indian economy. Insurance sector has the capability of raising long term capital from the masses as it is the only avenue where people put in money for as long as 30 years and even more. An increase in FDI in insurance would indirectly be a boon for the Indian economy, the investments not withstanding but by making more people invest in long term funds to fuel the growth of the Indian economy.

2**. Wider Scope for Growth**: FDI in insurance would increase the penetration of insurance in India, where the penetration of insurance is abysmally low with insurance premium at about 3% of GDP against about 8% global average. This would be better through marketing effort by MNCs, better product innovation, consumer education etc.

3. **Moving towards Global Practices**: India's insurance market lags behind other economies in the baseline measure of insurance penetration. At only 3.1%, India is well behind the 12.5% for the UK, 10.5% for Japan, 10.3% for Korea and 9.2% for the US.

4. **Provide customers with competitive products, more options and better service levels**: Opening the FDI in the insurance sector would be good for the consumers, in a lot of ways. Increasing FDI limit would impact a lot of industries in a positive way and that we could even do without the FDI in many other sectors like real estate.

5. Objectives of the study

The following are the objectives of the study

i) To studythe problems faced by the insurance sector in India.
ii) To study the significance of FDI for Indian insurance industry.
iii) To analyse the impact of FDI on the private life insurance sector in India.
iv) To suggest policy recommendations in the light of the findings of the study.

6. Hypothesis

The following hypothesis has been framed in the study.

FDI has substantially improved the performance of private insurance sector. It means, higher the FDI, greater would be the performing efficiency of insurance sector.

7. Methodology and data base

The study is based on secondary data

The scope of the study is based on the FDI and its impact on the selected working private life insurancecompanies in India. Some of the variables like premium growth, business growth, business expansion etc, have been considered. The relevant statistics are gathered from the selectedlife insurance companies and other secondary source of IRDA. Both published and unpublished information have been used for analysis.

Percentage and averages have been used for result analysis.

8. Result analysis

Impact analysis of FDI

Table 1: Distribution of offices of all life insurers companies in India as on March 31.2008

Insurer	Metro	Urban	Semi-urban	Others	Total
Public sector	311	468	848	895	2522
Private sector	628	1169	2692	1902	6391
Total	939	1637	3540	2797	8913

Source: - IRDA Journals

Diagram 1: Distribution of offices of all life insurers companies in India as on March 31.2008

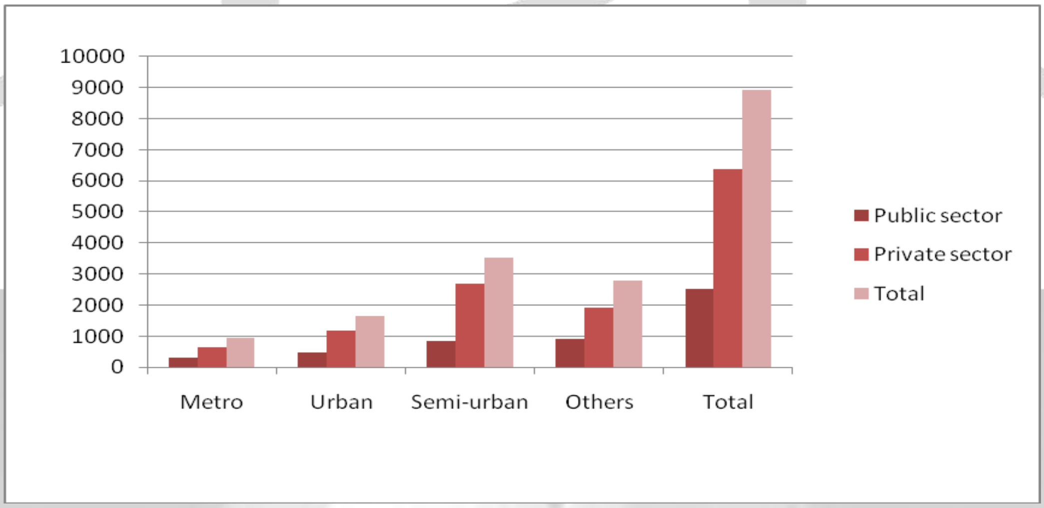


Table1 and Diagram 1 presented the public company and private life insurance companies'distributional office in all rural to metropolitan area. This data is revealing private companies on a fast pace in comparison with public company life insurance corporation in every field to open new distribution channel. It might be foreign investor helping private players to expand their own life insurance business in every state and village areas with lucrative offer.

The table 2 gives the numerical data of the selected life insurance companies' premium growth. In the year 2004-05 the total significant collection of public company was Rs.75127cr and in case of the selected private companies there were total collection of premium around Rs.4402 cr. In the year 2007-08 while the total collection of public companies was Rs.149789 cr and selected private companies collected the premium of Rs27979 cr. In the last session 2009-10, public company has collected total premium around Rs.185985 cr and in case of the selected private companies, the total collection of premium was Rs.16495 cr. The huge premium collection have increased the insurance business in India on fast pace.

Table 2:Premium collected by the selected life insurance companies. **(Amount in Rs.Crore)**

Name of the life insurance company	2004-05	2007-08	2009-10
LIC	75127	149790	185985
ICICI PRU	2364	13561	6334
HDFC	687	4859	1001
SBI	601	5622	7041
TATA AIG	497	2046	1321
AVIVA	253	1892	799
TOTAL	79529	177770	202481

Source: - IRDA Journal

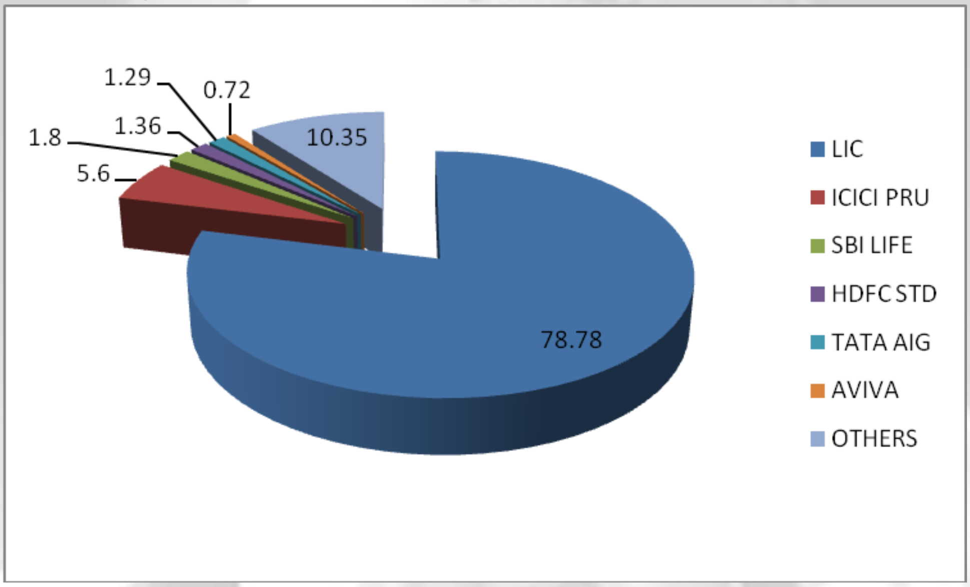
In the comparison of public company's (LIC) andselected private life insurance companies the givendata revealing the impact of foreign direct investmentin private sector companies. Itis not a banebut it is a boon for lifeinsurance companies.

Table 3: Market share of the selected insurance companies in percentage

Name of players	Market share in 2004-05	Market share in 2007-08	Market share in 2009-10
LIC	78.78	74.39	64.00
ICICI PRU	5.6	8.93	11.8
SBI LIFE	1.8	6.12	6.2
HDFC STD	1.36	2.88	7.4
TATA AIG	1.29	2.53	3.3
AVIVA	0.72	1.25	2.5
OTHERS	10.35	3.89	3.9
TOTAL	100	100	100

Source: - IRDA Journal

Diagram 2: Market share of the selected insurance companies in percentage



The table 3 and diagram 2 presents the resultant figure of the insurance companies and their market share which indicates the penetration of life insurance companies in Indian markets. Such penetration indicates the fruitful growth and its positive result of utilizationof foreign investment in life insurance sector. The new players have improvedthe service quality of the life insurance. In the financial year 2009- 10, LIC still hold 64% market share among doing business of life insurance companies in India and the remaining by private sector companies.

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TABLE 4: Share holding pattern of ICICI PRU and HDFC STD in percentage

Name of the insurance company → Promoter ↓	ICICI PRU	HDFC STD
INDIAN YEAR 2005	-----------------------------	79.44
FOREIGN	----------------------------	14.85
OTHER	----------------------------	5.71
INDIAN YEAR 2007	73.87	81.90
FOREIGN	25.95	15.82
OTHER	0.18	2.28
INDIAN YEAR 2009	73.93	72.43
FOREIGN	25.97	26.00
OTHER	0.10	1.57

Source: - IRDA Journal

The table 4 showsthe share holding pattern of the two selected private life insurance companies in which investment of foreign player in the Indian life insurance companies as well as a part of share investment by Indian promoters.They are revealing life insurance companies' investment in long term and short term investment in various sectors such as government securities, government bonds and other approved securities and other investment share, mutual fund, derivatives etc. They are investing in short term government securities, government guaranteed bondsincluding treasury bills, other approved securities and other investment in share equity, preference share and investment in other securities (term deposit) investment properties, real estate etc. for the purpose to enhance the financial position of insurer companies. Thus with the above analysis we can conclude that FDI has been playing an important role in improving the overall performance of the private sector insurance companies in India. Therefore the hypothesis framed in the present study"FDI has substantially improved the performance of private insurance sector i.e., higher the FDI, greater would be the performing efficiency of insurance sector has been proved and accepted.

9. Findings and Conclusions

Evaluation to the relevant data of the selectedworking private life insurance companies in India,revealslacking of funds. They need moreFDI for business expansion. But we can find that all theselected private life insurance companies are improving theirbusiness and their life insurance businessesareexpanding in urban, semi urban and rural areas. The foreigndirect investment (FDI) has not a reverse impact on theworking of private life insurance companies business inIndia, but it assists for infrastructure development, assistsin better facilities and techniques for sales person,broker etc.The private sector companies have beenbreaking market share of public company since 2000 and onward. The penetration strength of private lifeinsurance companies is greater than the public company's(LIC) in case of development of infrastructure. They havebeen opening more new branch office in rural areas,tapping niche markets for business growth. These areultimately a profit solution.

Life insurance business in India needs a special care as compared to other business. Both theory and practice to be integrated to provide the best services to the policy holders. This industry is going to face more challenges due to change in economy and employment. More no of players around the world have planned to enter into India looking to the potential available here. Probably understanding the customer expectation and attitude for this product is important. This isthe time to re-engineer the business model.

Increased role of foreign capital may lead to the possibility of exposing the economy to the vulnerabilities of the global market by way of likely inheritance of unsound balance sheets and financial health of the foreign partners through joint ventures and subsidiary routes, flight of capital outside the country and also endangering the interest of the policy holders. The present global economic scenario, any further hike in FDI at this juncture may not be in the interest of the Indian insurance industry, whereby the common man too would not stand to gain through insurance, particularly as a means of social security.

10. Suggestions and Policy Recommendations

Life insurance in India is in growing stage and to maintain it, the following suggestions are to be considered

- Corporate must go to the basics of service marketing such as "under promise and over delivery"
- Customization of offerings, mainly in product and distribution
- "Pockets of service" is to be done for quicker service and other operation
- Advanced knowledge in the insurance is to be imparted to the employees in insurance industry
- "Digitalization and Relationship" is to be kept in policy marketing

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