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CONTENTS

Sr. No.	Title & Name of the Author (s)	Page No.
1.	**QUALITY OF WORK LIFE PRACTICES OF ACADEMIC PROFESSIONALS IN BANGLADESH: A FACTOR ANALYTICAL APPROACH** *BALASUNDARAM NIMALATHASAN & DR. MIR MOHAMMED NURUL ABSAR*	6
2.	**SUPPLY CHAIN INTEGRATION AND COLLABORATION USING E- BUSINESS MODEL IN TEXTILE GARMENT INDUSTRY** *DR. G. NIJAGUNA & DR. SWAROOP SIMHA*	12
3.	**TRAINING DELIVERY AND METHODOLOGY AMONG BANKS (AN EMPIRICAL STUDY)** *DR. AJAZ AKBAR & PROF. A. R. MATTOO*	28
4.	**MICRO FINANCE IN INDIA AND MILLENNIUM DEVELOPMENT GOALS: MAXIMIZING IMPACT ON POVERTY** *G. PANDI SELVI & DR. R. KARUPPASAMY*	37
5.	**COMPARATIVE FINANCIAL PERFORMANCE EVALUATION OF MARUTI AND HYUNDAI** *ASHIMA & PROF. (DR.) S. C. CHITKARA*	43
6.	**FOREIGN DIRECT INVESTMENT AND ECONOMIC GROWTH IN INDIA: AN EMPIRICAL ANALYSIS** *RAJENDER S. GODARA, MANOJ K. SIWACH & RANJAN K. ANEJA*	49
7.	**STRESS IN EDUCATION…..IS THIS THE ULTIMATE DESTINATION IN 2020?** *PROF. SUNAINA HOOGAN & PROF. DEEPA V. M*	52
8.	**SMES OF ANDHRA PRADESH: THE JOURNEY FAR AND BEYOND** *M. MADHAVI, M. SUJATHA & S. PRATIBHA*	58
9.	**IMPACT OF MACRO ECONOMIC FACTORS ON LIFE INSURANCE INNOVATION IN INDIA: AN EMPIRICAL STUDY** *VISHAL SOOD & DR. IRA BAPNA*	64
10.	**CORRELATES OF EMPLOYEE SATISFACTION WITH PERFORMANCE APPRAISAL SYSTEM: A COMPARATIVE STUDY OF INDIAN AND FOREIGN MNC BPO FIRMS** *HERALD MONIS & DR. T. N. SREEDHARA*	70
11.	**COMPARATIVE ANALYSIS ON NON-PERFORMING ASSETS (NPAS) OF PUBLIC SECTOR, PRIVATE SECTOR AND FOREIGN BANKS IN INDIA** *MS. RAJNI SALUJA & DR. ROSHAN LAL*	80
12.	**PERCEPTION OF THE POLICYHOLDERS TOWARDS THE MARKETING OF INSURANCE SERVICES BY THE LIC OF INDIA** *DR. J.ARULSURESH & DR.S.RAJAMOHAN*	89
13.	**ENTREPRENEURIAL ACTIVITIES OF WOMEN ENTREPRENEURS IN GADAG DISTRICT- A STUDY** *DR. A. S. SHIRALASHETTI*	95
14.	**IMPACT OF TELEVISION ADVERTISING ON CHILDREN** *M. VIJAYAKUMAR & S. THANALAKSHMI*	106
15.	**MIGRANT WORKERS: SOCIO ECONOMIC STATUS AND REMITTANCES** *DR. BEENA NARAYAN*	110
16.	**BRAND LOYALTY OF TOILETRY PRODUCTS-A CASE STUDY OF SIRSA DISTRICT** *DR. MONICA BANSAL & SHALLU MEHTA*	118
17.	**CONSUMER BEHAVIOUR IN THE PURCHASE PROCESS OF TELEVISION, REFRIGERATOR AND FOOD PROCESSOR WITH SPECIAL REFERENCE TO INCOME LEVEL** (A STUDY OF HOUSEHOLD PRODUCT RELATED PERCEPTIONS & MAJOR CHOICE DETERMINANTS IN CONTEXT OF CONSUMERS IN LUDHIANA CITY) *MINAKSHI THAMAN & PRIYA AHUJA*	126
18.	**WORK LIFE BALANCE –A CAUSE FOR STRESS AMONG CAREER COUPLES** *MRS. VISHAL SAMARTHA, MR. LOKESHA & MS. ASHWITHA KARKERA*	135
19.	**ATTRITION AMONG LIFE INSURANCE ADVISORS OF SELECTED LIFE INSURANCE COMPANIES IN LUDHIANA** *MS. SHILPA JAIN & MS. DEEPIKA ARORA*	142
20	**SERVICE BUYING BEHAVIOR IN BANKING INDUSTRY: A COMPARATIVE ANALYSIS OF PRIVATE AND PUBLIC SECTOR BANKS** *ESHA SHARMA*	154
	REQUEST FOR FEEDBACK	158

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IMPACT OF MACRO ECONOMIC FACTORS ON LIFE INSURANCE INNOVATION IN INDIA: AN EMPIRICAL STUDY

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ABSTRACT

Financial markets are the part of the changing business scenario worldwide. In fact, the financial markets are the first to unfold the vision and imagination that lead to financial revolution in insurance industry. Today, globalizations of competencies, thinking and perspectives have been the part of Strategic Action Plan of all the major competitors in the insurance markets, globally. The intensive competitions across the market operators and the pressure to perform by the stakeholders have resulted in competition being more intense than ever before. Both the business landscape and chemistry of the competition have changed drastically over the period of time. All around, there is a fresh thinking on the financial products, structure of market players and possibilities for value creation. We can say financial markets are being redefined, reinvented and reconfigured on a persistent basis since late 2000.

Insurance innovation—like innovation elsewhere in business—is an ongoing process whereby private parties experiment to try to differentiate their products and services, responding to both sudden and gradual changes in the economy. Surely, innovation ebbs and flows with some periods exhibiting bursts of activity and others witnessing a slackening or even backlash. However, when seen from a distance, the process of innovation—in this instance, financial innovation—is a regular ongoing part of a profit maximizing economy. The present study attempts to explore the impact of GDP and WPI on the revolutionary and recent wave of insurance innovation in India.

INTRODUCTION

"The complexity and speed of financial innovation have reached the point where it is hard to grasp what is happening from moment to moment. Amateur investors and many professionals are wary of space-age trading strategies and kinky financial instruments."

Peter L. Bernstein, (1992), Capital Ideas, Free Press.

Reforms to improve efficiency and soundness of the Insurance sector in India started in the early part of the year 2000, when the global gateway for the private players was opened- in some ways anticipating the gains that would accrue from the resultant flexibility in product and factor markets. However, the process of strengthening the functioning of the financial institutions in terms of prudential framework, operational efficiency and regulatory / supervisory regimes have been gradual. It was also calibrated with the development of money, FOREX, Govt. securities and equity markets. The pace of capital & credit reforms is rapid & is transforming the scenario. The existence of a variety of financial innovations with different terms & conditions, now provide a wider range of financial assets.

The theoretical and empirical works in financial economics are considered a highly stylized world in which there are few types of securities (insurance, debt and equity, perhaps) and maybe a handful of simple financial institutions (banks or exchanges) are available. However, in reality there is a vast range of different financial products, many different types of insurance institutions and a variety of processes that these institutions employ to do business.

"**Insurance**" facilitates reimbursement during crisis time. Insurance means promise of compensation for any potential future losses. There are different insurance companies that offer wide range of insurance options and an insurance purchaser can select as per his/her own convenience and preference. The word insurance can also be inferred as effective tool of risk management. Quantified risks of different volumes can be insured. In insurance one party undertakes to indemnify or guarantee another against loss by certain specified risks.

"Innovate" is defined in *Webster's Collegiate Dictionary* as "To introduce as or *as if* new," with the root of the word deriving from the Latin word "**Novus**" or new. Economists use the word "**Innovation**" in an expensive fashion to describe shocks to the economy (e.g., "monetary policy innovations") as well as the responses to these shocks (e.g., Euro deposits). Broadly speaking, "**Insurance Innovation**" is the act of creating and then popularising new insurance instruments as well as new financial technologies, institutions and markets."

If the world had been free from all "**Imperfections**"—such as taxes, regulation, information asymmetries, transaction costs, and moral hazard—and if markets were complete in the sense that existing securities spanned all states of nature, we could have arrived at an M&M-like corollary regarding financial innovation. Insurance innovations would benefit neither private parties nor society and would simply be neutral mutations. Against this backdrop, a sizeable body of literature attempts to understand how various "imperfections" (and changes in these imperfections) stimulate insurance innovation. These *imperfections* prevent participants in the economy from efficiently obtaining the *functions* they need from the financial system. Generally, authors establish how financial innovations are optimal responses to various basic problem or opportunities, such as incomplete markets that prevent risk shifting or asymmetric information. The institutionally-grounded explanations study the parts played by insurance industries using innovation to compete.

LITERATURE REVIEW

Functional decomposition identifies six functions of financial systems as, moving funds across time and space, pooling of funds, managing risk, extracting information to support decision-making, addressing moral hazard and asymmetric information problems. (Merton's, 1992)

Innovation exists to complete inherently incomplete markets. In an incomplete market, not all states of nature can be spanned, and as a result, parties are not able to move funds freely across time and space, nor to manage risk. (Peter Tufano, 2002)
Innovation persists to address inherent agency concerns and information asymmetries: Much of contracting theory (or the security design literature) explores how contracts can be written to better align the interests of different parties or to force the revelation of private information by managers.
Innovation exists so that parties can minimize transaction, search or marketing costs. The presence of transaction costs provides a critical role for financial intermediaries. Financial intermediaries permit households facing transaction costs to achieve their optimal consumption-investment program. (Merton, 1987) Many of the process innovations in payment systems technologies are aimed at lowering transaction costs. ATMs, smart cards, ACH technologies, e-401k programs and many other new businesses are legitimate financial innovations that seek to dramatically lower the sheer costs of processing transactions.
Innovation is a response to taxes and regulation, (Miller, 1986). The list of tax and regulatory induced products would include zero coupon bonds, Eurodollar Eurobonds, various equity-linked structures used to monetize asset holdings without triggering immediate capital gains taxes, and trust preferred structures.
With increasing globalisation and risk motivate innovation; increasing volatility has been identified as drivers of innovation. With increase in globalization, firms, investors and governments are exposed to newer level of risks (exchange rates or political risks), and innovation help to manage these risks.
Technological shocks stimulate innovation. Advances in information technology support sophisticated pooling schemes that we observe in securitization. IT and improvements in telecommunications (and more recently the Internet) have facilitated a number of innovations (not all successful), including new methods of underwriting securities (e.g., OpenIPO), new methods of assembling portfolios of stocks (folioFN), new markets for securities and new means of executing security transactions.

RATIONALE OF THE STUDY

India has been maintaining significant growth rate for past few years. The growth dynamics have dramatically shifted in the last three to four years and the economy is poised to break from an intermediate growth rate of around 6 percent to a high growth rate regime of well above 8 percent. Despite high levels of internal resource generation and access to external borrowings, credit demand across sectors also has picked up quite substantially pushing the rate of investment to new heights.
Real GDP growth has averaged 8.7 per cent per annum during the 5-year period ending 2007-08. The present domestic investment rate of around 36-37 per cent is expected to help sustain the current growth momentum. In Indian economic history, there has never been this order of growth for five consecutive years; this has been achieved while keeping inflation low and stable and anchoring inflationary expectations.
From the above facts, it is evident that Gross Domestic Product (GDP) & Wholesale Price Index (WPI) of India are having impact on the Life insurance innovation. The present study attempts to find the individual and combined impact of both the factors GDP, & WPI on the insurance innovation in India and their inter relationship.

OBJECTIVES OF THE STUDY

1. To study the collision of GDP on Life Insurance Innovation in India.
2. To investigate the force of WPI on Insurance Innovation in India.
3. To study the combined influence of GDP, & WPI on Indian Insurance Innovation.

LIMITATION OF STUDY

- Study is confined only for the period of eight years as intruders in the field of insurance knocked the door of India in 2000.
- Private players started playing in the market in 2000.

RESEARCH DESIGN

HYPOTHESIS

H_{01}: There is no significant relationship between GDP and Life Insurance Innovation.
Ho2: There is no significant relationship between WPI and Life Insurance Innovation.
Ho3: There exists no inter dependency among the variables viz, GDP, WIP and Life, Insurance innovation.

PERIOD OF THE STUDY

Private players in the veil of innovation knocked the Indian market in later part of 2000. The Research base of the present study is considering the data since from 1999 to 2008.

DATA COLLECTION

The present study is empirical and analytical in nature, designed to analyse the impact of GDP & WPI on Insurance Innovation in India.The study is focused on economic contribution made by the intruders in the market. The present study is confined to the macro economic factors, thus, secondary data have been collected to explore the study and conclude the relationships & inter dependency of variables within. Website is www.indiabudget.nic.in.

TOOLS APPLIED

Every study requires some gear to justify the hypothesis which can be carried on by using few specific statistical techniques. The present study uses multiple correlation and multiple regression through spss to conclude the objectives and to prove the hypothesis.

ANALYSIS & INTERPRETATION

In the present study Life Insurance innovation (X) is dependent variable while WPI (Y) & GDP (Z) are independent variables. With the help of multiple correlation and multiple regression technique, relationship is being measured with the life insurance innovation.

1. Coefficient of correlation of GDP with Life insurance innovation is (r=0.827). This shows the higher degree of correlation between the two variables being value lies between 0.75 to 1. In other words it can be concluded that with a slight change in GDP there will be a radical change in life insurance innovation. The study also reveals that endogenous factor is showing greater dependability to exogenous factors i.e. GDP. This inference is being drawn from the calculated value of correlation which is 0.847.

Thus the hypothesis stands rejected that there is no significant relationship between the GDP and life insurance innovation as both the variables are having higher degree of correlation being 0.827

2. Coefficient of correlation of WPI with Life insurance innovation is (r=0.847). This test also reveals that there is higher degree of correlation between the two variables viz WIP and Life insurance innovation as value is in the range of 0.75 to 1. This implies that the influencing factors among the variables are enormous. The dependency of WPI on the exogenous variables is 0.972, which depicts that the intensity of dependency is very high.

Thus, the hypothesis stands rejected that there is no significant relationship between the WPI and Life insurance innovation as both the variables are having higher degree of correlation and thus, higher inter dependability being 0.847

3. The changes in WPI and GDP are in the positive direction which is a resultant effect or influence of innovation in life insurance. The study proves the dependency among all the desired factors applying multiple regression analysis. The regression line can be drawn from the given variables viz, GDP, WIP and Life insurance innovation as

$X1 = 0.847 + 0.972\ X2 + 0.972\ X3$

Here X1= Life insurance innovation,

X2= GDP, & X3= WPI

The positivity reflected by the regression line proves the stated hypothesis being rejected as there exist inter dependency and influence of variables over one another.

FINDINGS

The transparent conclusion on the basis of analysis and interpretation is that the proposed hypotheses are being stand rejected as there exist a significant relationship between GDP and WPI as macroeconomic factors and insurance innovation at 95% level of significance. Slight change in one variable affects significantly to another variable.

Analysis and interpretation of the data, unfold the transparent out come. The hypothesis stating that there is no correlation and dependency among the variables also stands rejected. The results are not in support of the assumptions but the research proved that there exists a high degree of Correlation on each other. They are so responsive that a slight change in one will affect the other positively.

IMPLICATIONS OF LIFE INSURANCE INNOVATION

To maintain the transparency is crucial task. More likely, products will be designed, based on liquid underlying assets. US and European financial institutions will be scrutinized more for their financial products. Regulators will focus on : Transparency, Liquidity and Valuation. Governance of Institutions designing products will be stressed.

CONCLUSION

With the increase in Innovation in Life insurance sector there is an increase in WPI and GDP of Indian Economy. Thus, present study infers that the GDP & WPI are having positive impact in contributing towards life insurance innovation in India. The important point to think and find the way is the critical factor prevailing in this situation as market is becoming volatile day by day as risks are increasing, such conditions favour economic growth and innovation but such a growth is inorganic growth. India being a developing country must follow a long term sustainable development policy. It is only possible when it maintains low inflation rate.

Need is to pursue somewhat counter cyclical monetary and fiscal policies with appropriate external sector management, ensuring overall financial stability – price stability, low inflation, low inflation expectations and low inflation volatility. It is only under these conditions, the investment, innovation and growth can be maintained in a sustainable fashion. It is to be ensured on continuous basis that the growth momentum is sustained with price stability.

The opportunity zones in financial markets are contracting somewhere and at the same time expanding elsewhere. Both change and the pace of change in the financial markets would be different tomorrow. Continuous exploration of scopes and exploitation of values would demand a brilliant focus on emerging opportunities, competence building, strategies for the leadership position in the opportunity zones and principles centered business practices. Financial innovation is viewed as the “engine” driving the financial system towards its goal for improving the performance of what economists call the “real economy. Therefore, we need to create a culture, which embraces change and moves ahead with an objective to lead.

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ANNEXURE

MULTIPLE CORRELATION ANALYSIS

$$R_{1.23} = \sqrt{\frac{r_{12}^2 + r_{13}^2 - 2r_{12}r_{13}r_{23}}{1 - r_{23}^2}}$$

$$R_{2.13} = \sqrt{\frac{r_{21}^2 + r_{23}^2 - 2r_{12}r_{13}r_{23}}{1 - r_{13}^2}}$$

$$R_{3.12} = \sqrt{\frac{r_{31}^2 + r_{32}^2 - 2r_{12}r_{13}r_{23}}{1 - r_{12}^2}}$$

R = Multiple Correlation Coefficient
r = Correlation Coefficient
x = Financial Innovation
y = WPI
z = GDP

MULTIPLE REGRESSION ANALYSIS

The multiple regression analysis is analysis of two or more independent variables on one dependent variable.

Table I - Correlation among three variables

	X	Y	Z
Mean	70.44	178.89	2805099
S_d	40.09	23.97	964531.18
$r_{x.yz}$	1	.847	.827
Significance 2 (Tailed)	-	.004	.006
$r_{y.xz}$	.847	1	.972
Significance 2 (Tailed)	.004	-	.000

$r_{z.xy}$	.827	.972	1
Significance 2 (Tailed)	.006	.000	-

Table II - Regression among three variables

Variables	R	R^2	Adjusted R^2	Standard Error
Insurance Innovation	.847	.717	.687	24.50
WPI	.972	.944	.936	6.06
GDP	.972	.944	.936	243871.44

TableIII – Innovation in Insurance sector data from year 1999 – 2008 [*Insurance Innovation (x)]

YEAR	X	dx = (x-X)	x^2
1999-00	4	-66.44444444	16
2000-01	24	-46.44444444	576
2001-02	56	-14.44444444	3136
2002-03	81	10.55555556	6561
2003-04	86	15.55555556	7396
2004-05	64	-6.444444444	4096
2005-06	56	-14.44444444	3136
2006-07	134	63.55555556	17956
2007-08	129	58.55555556	16641
TOTAL	**634**	**0**	**59514**

Table IV –Wholesale Price Index (WPI) data from year 1999 – 2008 [*WPI (y)]

YEAR	Y	dy = (y-Y)	y^2
1999-00	145.3	-33.58888889	21112.09
2000-01	155.7	-23.18888889	24242.49
2001-02	161.3	-17.58888889	26017.69
2002-03	166.8	-12.08888889	27822.24
2003-04	175.9	-2.988888889	30940.81
2004-05	187.3	8.411111111	35081.29
2005-06	195.6	16.71111111	38259.36

2006-07	206.2	27.31111111	42518.44
2007-08	215.9	37.01111111	46612.81
TOTAL	**1610**	**0.00**	**292607.22**

Table V - Gross Domestic Product (GDP) data from year 1999 – 2008 [* GDP (z)]

YEAR	Z	dz = (z-Z)	z^2	xy	Xz	Yz
1999-00	1786525	-1018574.444	3191671575625.0	581.2	7146100	259582082.5
2000-01	1925017	-880082.4444	3705690450289.0	3736.8	46200408	299725146.9
2001-02	2097726	-707373.4444	4400454371076.0	9032.8	117472656	338363203.8
2002-03	2261415	-543684.4444	5113997802225.0	13510.8	183174615	377204022
2003-04	2538171	-266928.4444	6442312025241.0	15127.4	218282706	446464278.9
2004-05	2877706	72606.55556	8281191822436.0	11987.2	184173184	538994333.8
2005-06	3275670	470570.5556	10730013948900.0	10953.6	183437520	640721052
2006-07	3790063	984963.5556	14364577543969.0	27630.8	507868442	781510990.6
2007-08	4693602	1888502.556	22029899734404.0	27851.1	605474658	1013348672
TOTAL	**25245895**	**0**	**25221571310029.0**	**28,432.3**	**612,620,758.0**	**1,272,930,754.3**

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