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CONTENTS

Sr. No.	TITLE & NAME OF THE AUTHOR (S)	Page No.
1.	**LITERACY & POVERTY AMONG MINORITIES IN INDIA** *Dr. KEWAL KRISHAN & SHILPA CHAUHAN*	1
2.	**CUSTOMER CENTRICITY: A MULTIDIMENSIONAL PERSPECTIVE** *ISHA BHATT*	7
3.	**ROLE OF FOREIGN DIRECT INVESTMENT IN INSURANCE SECTOR IN INDIA: AN ANALYTICAL STUDY** *PREETI SHARMA*	12
	REQUEST FOR FEEDBACK & DISCLAIMER	16

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HYPOTHESIS (ES)

RESEARCH METHODOLOGY

RESULTS & DISCUSSION

FINDINGS

RECOMMENDATIONS/SUGGESTIONS

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- Bowersox, Donald J., Closs, David J., (1996), "Logistical Management." Tata McGraw, Hill, New Delhi.
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ROLE OF FOREIGN DIRECT INVESTMENT IN INSURANCE SECTOR IN INDIA: AN ANALYTICAL STUDY

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ABSTRACT

International Economic Integration plays a vital role in Economic Development of any country. Foreign Direct Investment is one and only major instrument of attracting International Economic Integration in any economy. It serves as a link between investment and saving. Many developing countries like India are facing the deficit of savings. This problem can be solved with the help of Foreign Direct Investment. Foreign investment helps in reducing the defect of BOP. The flow of foreign investment is a profit-making industry like insurance, real estate and business services and serving as a catalyst for the growth of economy in India. India is no doubt a growth economy and many consider it an attractive country to invest in, particularly in its rapidly growing and changing insurance market. Indian insurance industry is one of the sunrise sectors with huge growth potential. Foreign direct investment plays an important role in the economic development of the country. However, the Government is gradually taking steps to open the sector. Due to economic liberalization in India by lowering trade barriers for the free flow of technology, intellectual and financial capital. Thus, liberalization of insurance creates an environment for the generation of long-term contractual funds for infrastructural investments. This paper's objectives are to investigate the Indian insurance industry and review current policy and regulations with a viewpoint of foreign investors so as to gain an understanding of the current position on FDI, as well as an overview of the Indian Policy and Regulatory Environment.

KEYWORDS

foreign direct investment, foreign indirect investment, internal personal disparity, portfolio investment policy, balance of payment.

JEL CODES

F30, G22.

INTRODUCTION

Foreign investment plays a significant role in development of any economy as like India many countries provide many incentives for attracting the foreign direct investment (FDI). Need of FDI depends on saving and investment rate in any country. Foreign Direct investment acts as a bridge to fulfill the gap between investment and saving. In the process of economic development foreign capital helps to cover the domestic saving constraint and provide access to the superior technology that promote efficiency and productivity of the existing production capacity and generate new production opportunity.

OBJECTIVES OF STUDY

To know the requirement of amount of foreign investment by India, for its economic Development and to analyze the trend and role of FDI & FIIs in improving the quality of and availability of goods has been beyond doubt. To analyze all these objectives data has been gathered through secondary sources like reports and publication of Govt. and RBI relating to foreign Investment. After analyzing all the facts, it may be concluded that maximum global foreign investment's flows are attracted by the developed countries rather than developing and under developing countries. The specific objectives of the study are as per following:

1. To study the significance of FDI in bridging the gap between the saving and Investment.
2. To analyze the impact of FDI in insurance sector in India.
3. To study the issues and challenges of FDI in insurance sector.

RESEARCH METHODOLOGY

The present study is based on the objectives like how much amount of foreign investment is required India‟ economic growth and to analysis the trend of FDI & FIIs for economic development and how the status of economy has improved after economic reforms. To fulfill all above said objectives data has been gathered from secondary sources like reports and publication of Govt.

The FDI can take any route or form to enter into any nation. The three principal forms of FDI in India are joint ventures, acquisition of assets in a country and Greenfield ventures. According to the international monetary fund, FDI is defined as "Investment that is made to acquire lasting interest in an enterprise operating in an economy other than that of investor.

Foreign investment comes in host country in through various route and many forms. Rather than attracting as much FDI as possible host country governments would be well advised to focus their efforts in inviting the "right" kind of FDI.

Among all various routes the two main routes are:

1. Foreign Direct investment (FDI)
2. Foreign indirect investment (FIIs)

The Inflow of Foreign Investment Comes Through Various Routes.

1. Equity (Government, RBI, NRI, Acquisition, shares, Equity capital of unincorporated bodies); Re-invested earning; other capital.
2. Portfolio investment (GDR/ADR, FIIs, OFF shore funds and others)

ROLE OF FDI IN INSURANCE SECTOR

Even after the liberalization of the insurance sector, the public sector insurance companies have continued to dominate the insurance market, enjoying over 90 per cent of the market share. FDI is the process whereby residents of one country acquire ownership of assets for the purpose of controlling the production, distribution and other activities of a firm in another country.

A major role played by the insurance sector is to mobilize national savings and channelize them into investments in different sectors of the economy. FDI in insurance would increase the penetration of insurance in India; FDI can meet India's long-term capital requirements to fund the building of infrastructures. 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 even more. An increase in FDI in insurance would indirectly be a boon for the Indian economy.

The insurance sector has also been fast developing with substantial revenue growth in the non-life insurance market. Over the years, FDI inflow in the country is increasing. However, India has tremendous potential for absorbing greater flow of FDI in the coming years. The role of Foreign Direct Investment in the present world is noteworthy. It acts as the lifeblood in the growth of the developing nations. The wave of liberalization and globalization sweeping across the world has opened many national markets for international business.

Insurance Regulatory & Development Authority (IRDA) is in favor of an increase in foreign equity capital in the insurance joint ventures. The public sector Insurance companies have continued to dominate the insurance market. India is among the most promising emerging insurance markets in the world.

FDI IN INSURANCE –A HISTORICAL PERSPECTIVE

Insurance in India started without any regulations in the nineteenth century. After the independence, the Life Insurance Company was nationalized in 1956, and then the general insurance business was nationalized in 1972. The LIC had monopoly till the late 90swhen the insurance sector was reopened to the private sector. In 1998 the cabinet decides to allow 40% foreign equity in private insurance companies and 26% to foreign companies and 14% to non-resident &investors (FIIs) but again in 1999 the committee decides that foreign equity in private insurance should be limited to 26%. In 1999, the Insurance Regulatory and Development Authority (IRDA) were constituted as an autonomous body to regulate and develop the insurance industry. Since end of 2000; While Life insurance has been privatized. Indian Government has opened the entry door for foreign players with a maximum of 26 per cent of foreign holding and private companies in Life insurance sector (World Bank Economic Review 2000). At present there are 44 private insurance companies authorized by the Insurance Act.

POLICY AND REGULATORY ENVIRONMENT

(IRDA) operating in the country. These comprise of 23 life insurance, 17 general insurance and four health insurance companies, since the insurance sector was opened for private sector in the year 2000. These are all joint ventures between the Indian promoters who hold up to 76% and foreign insurance companies who hold up to 26% as mandated by the law.

The government created a specific Board to deal with promotion of FDI in India and to be the sole agency to handle matters related to FDI. The 'Foreign Investment Promotion Board' (FIPB) as it is known, is chaired by the Secretary Industry (Department of Industrial Policy & Promotion or DIPP) within the office of the Prime Minister. Its key objectives are to promote FDI in India with investment promotion activities both domestically and internationally by facilitating investment in the country via international companies, NRIs (non-resident Indians) and other forms of foreign investors.

Key Regulatory Changes are:

TABLE 1

Year	Key Regulatory Changes
1999	IRDA Bill cleared and liberalization of the sector & formation of an independent regulator
2001	IRDA issues Third Party Administrator regulations (TPAs) & foreign players allowed to enter with FDI limit of 26%.
2002	IRDA insurance brokers and corporate agent regulation.
2006	Entry of Standalone health insurance Players allowed.
2007	Creation of Indian Motor Third party Insurance Pool & Price Destratification
2011	Merger Acquisition Guidelines.
2012	Introduction of Declined Risk pool, TP premium increase. FDI in the Insurance Industry, as prescribed in the Insurance Act, 1938

Some of the key legislation that could have a potential impact on foreign investors setting up in India are listed as below:

(i) Insurance Act, 1938;
(ii) Life Insurance Corporation Act, 1956
(iii) General Insurance Business (Nationalization) Act, 1972
(iv) Insurance Regulatory and Development Authority (IRDA) Act, 1999
(v) Actuaries Act, 2006

FDI IN INSURANCE SECTOR

All of us are well aware of the recent debate about FDI and whether it should be allowed in India and to what extent! Many experts have many suggestions about the positive and negative effects of foreign direct investment in various business sectors in India. Amongst all the debate and heated discussion, Indian government has just approved 49% of foreign direct investment (FDI) in insurance. Some sectors welcomed this decision with whole heart while the rest have their pensive views about the same. Truly, FDI will definitely going to impact in both positive and negative ways on various sectors in India.

Owing to the steady and fast-growing Indian economy, India has become one of the most famous destinations for foreign direct investments. The rapid growth in all the business sectors in India is reciprocated by liberal trade policies, development in telecommunication and technology, expansion of markets and loosened restrictions from FDI. Indian FDI that started with less than one-billion-dollar baseline has now become the second most wanted foreign direct investment destinations in the world, after China. This is revealed in the recent survey performed by UNCTAD (United Nations Conference on Trade and Development)

BENEFITS OF FDI IN INSURANCE

According to the experts, the benefits of all kinds of FDI investments are likely to be seen only in the future. FDI and its results is a long term process and it will reap the benefits after a few years of initiating it. As we know, the government has approved as much as 49% of foreign direct investments in the Indian insurance sector from 26%. This is an extremely positive sign! Now more and more key players on global insurance market will make their debut in the very active Indian insurance market. Present foreign companies will increase their shareholding, benefiting the investors all the more Indian insurance sector, especially the life insurance sector is totally dominated by the government owned insurance company - Life Insurance Corporation, General Insurance Corporation and several of its subsidiaries. However, with the increased percentage of FDI various private insurance companies are likely to benefit the most. These companies include Max, Reliance Life, Aegon Religare, Birla Sun life, etc.

CURRENT STATUS OF FDI IN INSURANCE SECTOR

Since end of 2000, While Life insurance has been privatized. Indian Government has opened the entry door for foreign players and private companies in Life insurance sector. In the present scenario has revealed 22 Private Life Insurance Companies working in Indian markets, Private life insurance companies have been keeping behind Indian largest public company's (LIC) in an innovative products, smart marketing, and aggressive distribution attracts customer toward the private life insurance companies, sign up Indian customers faster than anyone expected. Indian, who had always seen life insurance as a tax saving device, are now suddenly turning to the private sector and snapping up the new innovative products offer to customers and investment plans. The Life Insurance companies in India have grew by an impressive 36% with premium income in the year 2003-2004 Rs 24.29billion from new business Rs253.43 billion during the fiscal year 2004-2005 in this duration have been braving stiff completion from Private Life Insurance Companies. In which LIC has clocked21.87% growth in business at Rs 197.86 billion by selling2.4 billion in new polices in the year 2004-2005, but this was still enough the fall. Its market share as Private Player grew 129% Rs 55.57 billion in the year 2004-2005 with annual growth rate 15-20 %, the largest number of Life Insurance Policies in force, the potential of the Indian Insurance industry is huge. The total value of insurance market estimated Rs 450 billion in 2004-2005.Theinsurance business grow in India 17% in Fiscal year2008-2009 $ 30 billion. The country economy clocks GDP 7.6%. In Fiscal year 2007-2008 Life Insurance has been grown up their business 23.3%Rs 930 billion, The Private Life Insurance Companies have made a record first quarter year in 2009, has recorded 13.22% growth in first year premium and 20.36% number of polices increase after the considering to extend the limit of FDI in insurance industry. In the year 2002-03 public company's (LIC) was collected 546228.49 cr. in the comparison with five selected private sector companies there were total collection 733.52 cr. we can discus in the year 2004-05 while total significant collection of public company was 75127.29 and in a comparative with selected private companies there were total collection of premium around 4402.29 cr. In the year 2007-08 while total collection of public companies was 149789.99 cr. and selected private companies there were total collection of premium 27979.99 cr. In during the last session 2009-10 public company has been collected total premium around 1, 85,985, its comparison of selected private companies, there were total collection of premium 16,495.86 cr. The huge premium collection has increased every financial year that was gearing insurance business in India on fast pace.

EFFECTS ON INDIAN ECONOMY

- Following will be the effect of the increase in the threshold in the Indian economy:
- Firstly, through this Insurance Laws (Amendment) Bill, a rise to 49% will be a composite cap – which means that foreign capital can flow in either as direct investment or via the portfolio route, or as a combination of both. So foreign investors can either directly buy equity from the company or can buy shares on the stock market.
- Secondly, it will lead to hike foreign holding in insurance joint ventures to 49 per cent which means that there will lot of foreign player coming to Indian market for direct investment.
- Thirdly, the laws will also provide for insurance companies to list on stock exchanges, which in turn will lead to barring public sector insurance companies, all other insurance companies will potentially benefit from a higher FDI cap. So, there might be a possibility that public sector undertakings will face huge competition from the private sector undertakings.
- Fourthly, there was huge cry in the Indian market that through this increase there will be a situation where in the Indian entities might lose control but the bill provides that management must remain with India companies and the companies will have to go for approval of the Foreign Investment Promotion Board (FIPB) will be needed on any investment over 26 per cent.
- Fifthly there will be a huge inflow of money once the bill will be cleared in the parliament, which will in turn, infuse a higher foreign direct investment limit in insurance which could result in inflows of Rs. 40,000 crores to Rs. 60,000 crores over time, and immediate inflows of around Rs. 20,000 crores.
- Sixthly the increase in the Cap will help to increase Infra Investment with the help of private players or the foreign entities, in the Indian Market.
- Seventhly, with the increase in the cap, there will be enough chances to bring in new technologies and products in the insurance market, which was not available during the cap of 26%. Public Sector Undertakings were unable to provide enough chances to its customers to invest in their various policies. But now due to increase in the cap, the private entities will definitely provide new policies which will in turn bring lead to opening up the Insurance sector.

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%.

- 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 has 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
- UPA claims that to improve insurance penetration in country additional capital of Rs.60,000 crores required over 2010-2015 based on IRDA projections. Since constraints of Indian partners to currently contribute 74% of capital are a hurdle, foreign partners will contribute if cap relaxed. BUT IRDA Chairman's deposition to Parliamentary Standing Committee itself states these projections are "not very accurate" and "just arithmetic".

Public Sector insurance companies are confident of being able to raise money from domestic capital markets as and when required. No need for hiking cap.

ISSUES IN FDI IN INSURANCE SECTOR

1. **Efficiency of the companies with FDI**: The opening up of this sector for private participation in 1999, allowed the private companies to have foreign equity up to 26 per cent. Following this up 12 private sector companies have entered the life insurance business. Apart from the HDFC, which has foreign equity of 18.6%, all the other private companies have foreign equity of 26 per cent. In general insurance 8 private companies have entered, 6 of which have foreign equity of 26 per cent. Among the private players in general insurance, Reliance and Cholamandalam does not have any foreign equity. The aggregate loss of the private life insurers amounted to Rs. 38633 lakhs in contrast to the Rs.9620 crores surplus (after tax) earned by the LIC. In general insurance, 4 out of the 8 private insurers suffered losses in 2002-03, with the Reliance, a company with no foreign equity, emerging as the most profitable player. In fact, the 6 private players with foreign equity made an aggregate loss of Rs. 294lakhs. on the other hand, the public sector insurers in general insurance made aggregate after tax profits of Rs. 62570 lakhs.
2. **Credibility of foreign companies**: The argument that foreign companies shall bring in more expertise and professionalism into the existing system is debatable after the recent incidents of the global financial crisis where firms like AIG, Lehman Brothers and Goldman Sachs collapsed. Earlier too, The Prudential Financial Services (ICICI's partner in India) faced an enquiry by the securities and insurance regulators in the U.S. based upon allegations of having falsified documents and forged signatures and asking their clients to sign blank forms. A recent report by Mercer Oliver Wyman, a consultancy, found that European life insurance companies are short of capital by a whopping 60 billion Euros. According to the Mercer Oliver Wyman Report the German, Swiss, French and British insurers suffer from severe capital inadequacy, which is a result of undertaking risky investments in equity and debt instruments in the past. Hence FDI in Insurance in India would expose our financial markets to the dubious and speculative activities of the foreign insurance companies at a time when the virtues of regulating such activities are being discussed in the advanced countries.
3. **Greater channelization of savings to insurance**: One of the most important duties played by the insurance sector is to mobilize national savings and channelize them into investments in different sectors of the economy. However, no significant change seems to have occurred as far as mobilizing savings by the insurance sector is concerned even after the liberalization of the insurance sector in 1999. Therefore, the private or foreign participation has not been able to achieve the goal.
4. **Flow of funds to infrastructure**: The primary aim of life insurance is about mobilizing the savings for the development of the economy in long term investment in social and infrastructure sectors. The same vision was argued for the opening up of insurance market would enable huge flow of funds into infrastructure. But more than fifty percent of the policies they sell are ULIPS where the investments go into the equity markets. As report, 95% of policies sold by Birla Sun Life and over 80 percent of policies sold by ICICI Prudential were unit-linked policies. Under these schemes, nearly 50 percent of the funds are invested in equities thus limiting the fund availability for infrastructural investments. On the other hand, the LIC has invested Rs.40,000 crore at in power generation, road transport, water supply, housing and other social sector activities. IRDA figures further imply that the share of the public sector life and non-life insurance companies in investment in infrastructure is greater than their market share. Despite the FDI cap being set at 26%, the investment from the insurance sector to the infrastructure sector was predominantly from the public sector companies. Hence the point of raising the FDI cap in the insurance sector for mobilizing resources does not hold good

ADVANTAGES OF FDI IN 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 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. Currently, FDI represents only Rs.827 core of the Rs.3179 crore capitalizations of private life insurance companies.
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 for some for example in real estate.

CONCLUSION

Despite the current policy and regulatory environment not being 'perfect' for foreign investors, there are clearly moves towards improving the current position and facilitating FDI inflows without having a detrimental impact on various sectors of the economy. '26% insurance FDI limit in India is lowest in world' that's why most of India's 24 insurance companies have lost money in the past decade, hit by restrictions on foreign holding and by regulatory changes. The Cabinet approval of 49 per cent foreign direct investment in insurance is definitely a very positive sign. Nonetheless, it indicates the government recognizes the capital requirements of the insurance industry and is taking steps towards bridging the capital gaps. In addition, it adds the advantage of the widening current account deficit being financed through greater capital account, non-debt, FDI inflows. The benefits of the increased FDI would be seen more in the long term than in the short term. Most prominent insurance companies have a presence in India and will be able to augment their shareholding. This is also a window for Indian promoters to exit the insurance business if they feel it is not a part of their core growth strategy. Broadly, this would tend to create an environment, which consists of shareholders who are willing to invest and to stay committed to the Indian insurance growth story. Many international studies have estimated that the insurance industry in India can grow by over 125 per cent in the next ten years. In fact, India has been identified as one of the fastest growing insurance markets. The current policy is trying to encourage Joint Ventures in insurance industry so as to boost the domestic insurer's growth in this area. However; there is also the risk that some foreign insurers will not be interested in investing unless they have 100% ownership and that the current policy will prevent them from choosing India as an Insurance destination

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