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FOREIGN DIRECT INVESTMENT IN INSURANCE SECTOR: TRENDS AND OPPORTUNITIES IN INDIA

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ABSTRACT

The Present paper analyses the trends and growth opportunities of foreign direct investment in insurance sector. The study is based on secondary data which has been collected for the last four years starting from 2010-11 to 2014-15. Further the study explores that the future looks interesting for the life insurance industry with several changes in regulatory framework which will lead to further change in the way the industry conducts its business and engages with its customers. Demographic factors such as growing middle class, young insurable population and growing awareness of the need for protection and retirement planning will support the growth of Indian insurance sector. Lastly the study concludes that attracting foreign direct investment has become an integral part of the economic development strategies for India. FDI has been a booming factor that has bolstered the economic life of India. Over the years FDI flow is increasing. However India has tremendous potential and government will for absorbing greater flow of FDI in the coming years.

KEYWORDS

Foreign Direct Investment, Insurance Regulatory Development Authority, Gross Domestic Product, Foreign Exchange Reserves.

1. INTRODUCTION

A milestone was achieved when the nation decided to privatize the industry along with requisite regulations. The industry functioned under a monopoly for several decades thereafter. However, other problems surfaced such as limited reach and penetration of enterprise and deteriorating servicing standards.

Indian insurance sector was liberalized in 2001. Liberalization has led to the entry of the largest insurance companies in the world, who have taken a strategic view on India being one of the top priority emerging markets. The Insurance industry in India has undergone transformational changes over the last 12 years.FDI in insurance remains a widely debated and heated issue in India's economic and political environment.

The insurance industry of India consists of 52 insurance companies of which 24 are in life insurance business and 28 are non-life insurers. Among the life insurers, Life Insurance Corporation (LIC) is the sole public sector company. Apart from that, among the non-life insurers there are six public sector insurers. In addition to these, there is sole national re-insurer, namely, General Insurance Corporation of India. Other stakeholders in Indian Insurance market include agents (individual and corporate), brokers, surveyors and third party administrators servicing health insurance claims.

Out of 28 non-life insurance companies, five private sector insurers are registered to underwrite policies exclusively in health, personal accident and travel insurance segments. They are Star Health and Allied Insurance Company Ltd, Apollo Munich Health Insurance Company Ltd, Max Bupa Health Insurance Company Ltd, Religare Health Insurance Company Ltd and Cigna TTK Health Insurance Company Ltd. There are two more specialised insurers belonging to public sector, namely, Export Credit Guarantee Corporation of India for Credit Insurance and Agriculture Insurance Company Ltd for crop insurance.

India's life insurance sector is the biggest in the world with about 36 crore policies which are expected to increase at a compound annual growth rate (CAGR) of 12-15 per cent over the next five years. The insurance industry plans to hike penetration levels to five per cent by 2020, and could top the US$ 1 trillion mark in the next seven years.

The total market size of India's insurance sector is projected to touch US$ 350-400 billion by 2020 from US$ 66.4 billion in FY13. The general insurance business in India is currently at Rs 77,000 crore (US$ 12.41 billion) premium per annum industry and is growing at a healthy rate of 17 per cent. Indian insurance companies were expected to spend Rs 117 billion (US$ 1.88 billion) on IT products and services in 2014, an increase of five per cent from 2013, as per Gartner Inc. Also, insurance companies in the country could spend Rs 4.1 billion (US$ 66.11 million) on mobile devices in 2014, a rise of 35 per cent from 2013.

Insurance sector of India needs capital infusion of Rs 50,000 crore (US$ 8.06 billion) to expand, maintain a healthy capital base and improve solvency standards, according to Insurance Regulatory Development Authority (IRDA).

The following are some of the major investments and developments in the Indian insurance sector.

- Life Insurance Corp of India (LIC) has earmarked a total of around Rs 1 trillion (US$ 16.12 billion) for investments in bonds, including non-convertible debentures (NCDs), certificates of deposit (CDs), commercial papers (CPs) and collateralized borrowing and lending obligations (CBLOs), with primary focus on infrastructure and real estate in the year to March 31, 2015.
- Aditya Birla Financial Services Group has signed an agreement to form a health insurance joint venture (JV) with MMI Holdings of South Africa. The two will enter into a formal JV in which the foreign partner will hold a 26 per cent stake.

2. REVIEW OF LITERATURE

Two important indicators of the level of development of the insurance sector in any country are:

(i) level of insurance penetration which is measured as the percentage of insurance premium in gross domestic product (GDP); and (ii) insurance density ratio (wherein insurance density is defined as the per capita expenditure on insurance premium and is directly correlated with per capita GDP). Both insurance penetration and density have increased significantly over the years, especially with the opening up of the insurance industry to the private sector. However, the increase has been marginal as far as the non-life insurance sector is concerned. While the density of life insurance in India grew from US$ 9.1 in 2001 to US$ 47.7 in 2009, the density in the non-life insurance industry for the same period grew from US$ 2.4 to US$ 6.7.

Similarly, penetration in the life insurance sector increased from 2.15 per cent in 2001 to 4.60 per cent in 2009 and very marginally in the non-life insurance sector from 0.56 per cent in 2001 to 0.60 per cent in 2009. Thus, penetration in the non-life insurance sector has remained virtually constant over the years.

A recent study by McKinsey & Company indicates that consumers have an unmet need for long-term savings products and a preference for insurance vis-à-vis other investment products. Consumers rank insurance higher than other investment options because of the ease and convenience in investing, and in obtaining tax benefits and protection cover.

Indian consumers perceive life insurance as a low-risk and high-return investment, this being a perception driven by the awareness of LIC's performance and its record of delivering stable returns over the years. According to the study, India's insurance market has grown over the past six years. Liberalization of the sector has enabled the entry of a number of new players who have contributed to the growth, (over 40 per cent per annum), by enhancing product awareness and promoting consumer education and information. However, the market is still in a nascent stage.

India's insurance penetration is lower than the world average which in 2009 was 7.0 per cent, while for India it was 5.2 per cent. Although, the penetration of Indian insurance is higher than that of some South Asian countries like Pakistan (0.7%), Bangladesh (0.9%) and Sri Lanka (1.4%), it lags behind other Asian countries like Japan (9.9%), South Korea (10.4%) and Singapore (6.8%). However, in the life insurance sector, India's performance in terms of percentage of penetration at 4.6 per cent is comparable with some developed countries and is above the world average of 4.0 per cent. In the non-life insurance sector, India with 0.6 per cent lags behind the world penetration average of 3.0 per cent. (Source: Swiss Re as given in IRDA, 2009–10).

The growing need for financial education for the families to take better financial decision and to increase their economic security has been widely recognized. It is felt that well informed and well educated customers can create economic ripples. They make better financial decisions for themselves and their families, increasing their economic security and well being. Secured families are more involved in their communities as home owners and voters. They are more involved as parents with their children's schools and teachers, enabling better educational and economic outcomes for their children. They contribute to vital, thriving communities, further fostering community economic development. Thus, being financially literate is not only important to the individual household and family, it is also important to communities and societies. (Hogarth, Jeanne M., 2006).

3. OBJECTIVES OF THE STUDY

The main objectives of the study are:

1. To study the trends and growth of FDI in service sector.
2. To analyse the percentage share of FDI in the insurance sector.
3. To identify the determinants and challenges to FDI inflow in insurance sector.

4. METHODOLOGY

The data under the present study has been collected for last four years starting from 2010-11year to 2014-15 (Feb 2015) years. This has been collected from DIPP, Federal Ministry of Commerce and Industry, GOI, IRDA reports and RBI Bulletin and other related published reports. The data has been processed and presented in tables and graphs to study the trends, growth and percentage shares of FDI in insurance sector.

5. ANALYSIS AND INTERPRETATION

There are arguments that support and question FDI rise in the insurance sector. The different benefits are being increasingly identified as a function of introducing FDI reforms in insurance, like, capital for expansion, wider Scope for growth, moving towards global practices, provide customers with competitive and innovative products, more options and better service levels, Infrastructure facilities, boost economic life, job opportunities, increase level of competition, inflation control, availability of new technology, innovative risk management practices.

The insurance sector opened up in 2001, with the foreign direct investment ("FDI") limit up to 26 per cent. According to various reports this sector has subsequently witnessed two phases: one that saw high growth between 2001 and 2010 and the other, a dormant period between 2010 and 2012.

However, apart from these periods of rapid and moderate growth, the industry has also seen product and operational innovations, given the increase in competition. As of Financial Year 2013, the total market size of this sector was US$ 66.4 billion and is expected to touch US$ 350-400 billion by 2020.

5.1 TRENDS AND ROUTES OF FDI FLOW IN INDIA

Economic reforms taken by Indian government in 1991 makes the country as one of the prominent performer of global economies by placing the country as the 4th largest and the 2nd fastest growing economy in the world. India also ranks as the 11th largest economy in terms of industrial output and has the 3rd largest pool of scientific and technical manpower. Continued economic liberalization since 1991 and its overall direction remained the same over the years irrespective of the ruling party moved the economy towards a market – based system from a closed economy characterized by extensive regulation, protectionism, public ownership which leads to pervasive corruption and slow growth from 1950s until 1990s.

The actual FDI inflows in India is welcomed under five broad heads: (i) Foreign Investment Promotion Board's (FIPB) discretionary approval route for larger projects, (ii) Reserve Bank of India's (RBI) automatic approval route, (iii) acquisition of shares route (since 1996), (iv) RBI's non – resident Indian (NRI's) scheme, and (v) external commercial borrowings (ADR/GDR) route. An analysis of the last eighteen years of trends in FDI inflows (Chart-3.5 and Chart-3.6) shows that there has been a steady flow of FDI in the country up to 2004, but there is an exponential rise in the FDI inflows from 2005 onwards.

FDI in sectors/activities permitted under automatic route does not require any prior approval either by the Government or RBI. The investors are only required to notify the Regional office concerned of RBI within 30 days of receipt of inward remittances and file the required documents with that office within 30 days of issue of shares to foreign investors.

The FIPB route – represents larger projects which require bulk of inflows and account for government's discretionary approval. Although, the share of FIPB route is declining somewhat as compared to RBI's automatic route and acquisition of existing shares route. Automatic approval route via RBI shows an upward trend of FDI inflows since 1995. This route is meant for smaller sized investment projects.

TABLE 1: FINANCIAL YEAR –WISE FDI INFLOWS (Amount US$ million)

Year	Total FDI Inflow	%age growth over previous year(in US$ terms)
2010-11	34,847	(-) 08%
2011-12	46,556	(+)34%
2012-13	34,298	(-)26%
2013-14	36,046	(+) 05%
2014-15(Apr-Feb 15)	41,223	

Source: RBI's Bulletin April 2015 dt 10-4-2015 (Table No 34-Foreign Investment Inflows

It is found that India was not able to attract substantial amount of FDI inflow from 1991-99. FDI inflows were US$ 144.45 million in 1991 after that the inflows reached to its peak to US$ 3621.34 million in 1997. Subsequently, these inflows touched a low of US $2205.64 million in 1999 but then shot up in 2001. Except in 2003, which shows a slight decline in FDI inflows, FDI has been picking up since 2004 and rose to an appreciable level of US$ 33029.32 million in 2008. The increase in FDI inflows during 2008 is due to increased economic growth and sustained developmental process of the country which restore foreign investor's confidence in Indian economy despite global economic crisis. Table 1 indicates that the FDI inflow increased to US$ 46,556 million during 2012 which shows 34% growth over the previous year 2011. During the year 2013 FDI inflow has been noted US$ 34,298 which shows 26 % decrease in growth over the previous year.

FIGURE 1: FDI INFLOW TRENDS

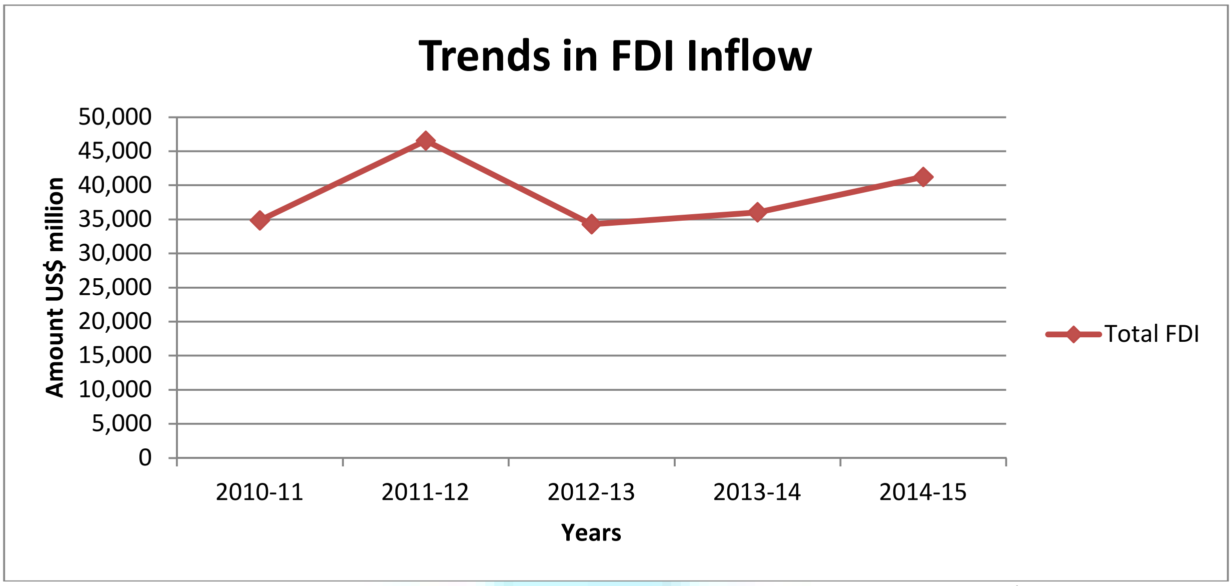


Figure 1 indicates that during 2014 FDI inflow indicated 5 percent growth and up to February 2015 total FDI inflow of US$41,223 million has been noticed. However, the pace of FDI inflows in India has definitely been slower than China, Singapore, Russian Federation, and Brazil. In Insurance sector the FDI is allowed on automatic route in India. According to experts, while India's insurance industry is no doubt growing and is poised to grow further, it is also facing profitability issues on account of distribution and operating models. It pegs the cumulative losses to private life insurers in the excess of Rs 187 billion till March 2012. Slow growth, rising costs and stalled reforms are further hindering the steady growth of this industry.

TABLE 2: TOP FIVE SECTOR ATTRACTING HIGHEST FDI EQUITY INFLOWS [(amount in Rs crores) (US$ in millions)]

Ranks	Sectors	2012-13 (April-March)	2013-14(April-March)	2014-15(April-Feb)	Cumulative inflows(April2000-Feb 2015	%age to total inflows (in terms of US$)
1	Service Sector	26,306 (4,833)	13,294 (2,225)	17,637 (2,881)	203,207 (42,340)	17%
2	Construction Development	7,248 (1,332)	7,508 (1,226)	4,559 (754)	113,116 (24,060)	10%
3	Telecommunications	1,654 (304)	7,987 (1,307)	17,110 (2,853)	83,829 (17,016)	7%
4	Computer Software and Hardware	2,656 (486)	6,896 (1,126)	12,594 (2045)	72,265 (14,862)	6%
5	Drugs and Pharmaceuticals	6,011 (1,123)	7,191 (1,279)	7,840 (1,304)	63,911 (12,901)	5%

Source: DIPP, Year-Wise FDI equity inflows

Note: Service sector includes Financial, Banking and insurance, Non financial/Business, Outsourcing, R&D, Courier, Tech, Testing and Analysis.

The sector-wise analysis determines that service sector (financial and non-financial), has been noted at the top to attract highest %age of FDI to the total inflows i.e., 17 percent. FDI inflow into service sector during the year 2013-14 has been noted US $ 2, 225 million, which was lower than the FDI inflow of 2012-13. The reason behind is the rupee depreciation occurred in India, which created doubt in the minds of foreign investors and resulted in pulling back of investment. European crisis and US crisis were the major reason for the lower investment in service sector in India, which were previously the major investors of this sector. But to the fortune of India in spite being lower investment from the major investors USA and European countries, the investment from other countries like, Mauritius, Singapore, Japan etc. India's service sector has maintained its importance in the Indian economy.

There is significant growth in FDI in life insurance sector of the India. Because of liberalized policy of FDI leads to investment in this sector. Overall FDI was only Rs. 2821.63 crore in 2007-08 now it is increased to Rs. 6532.26 crore in 2011-12. It shows that there is significant growth of FDI in insurance sector.

Services sector puts the economy on a proper glide path. It is among the main drivers of sustained economic growth and development by contributing significant share in GDP. There is a continuous increasing trend of FDI inflows in services sector with a steep rise in the inflows from 2005 onwards. Service sector received FDI inflows of US$ 42,340 million during the period 2000-2015 (Table2.).

TABLE 3: FDI FLOWS IN INDIA, INSURANCE SECTOR (Rs in crores)

Year	Total FDI in India	Total inflow of FDI in Insurance Sector	%age of FDI inflows in Insurance sector over total FDI
2010-11	147532.43	6818.89	4.622
2011-12	201668.75	7648.72	3.793
2012-13	155505.65	7632.54	4.908
2013-14	190210.68	7985.44	4.198

(Source- IRDA 2010 to 2014 Annual Reports)

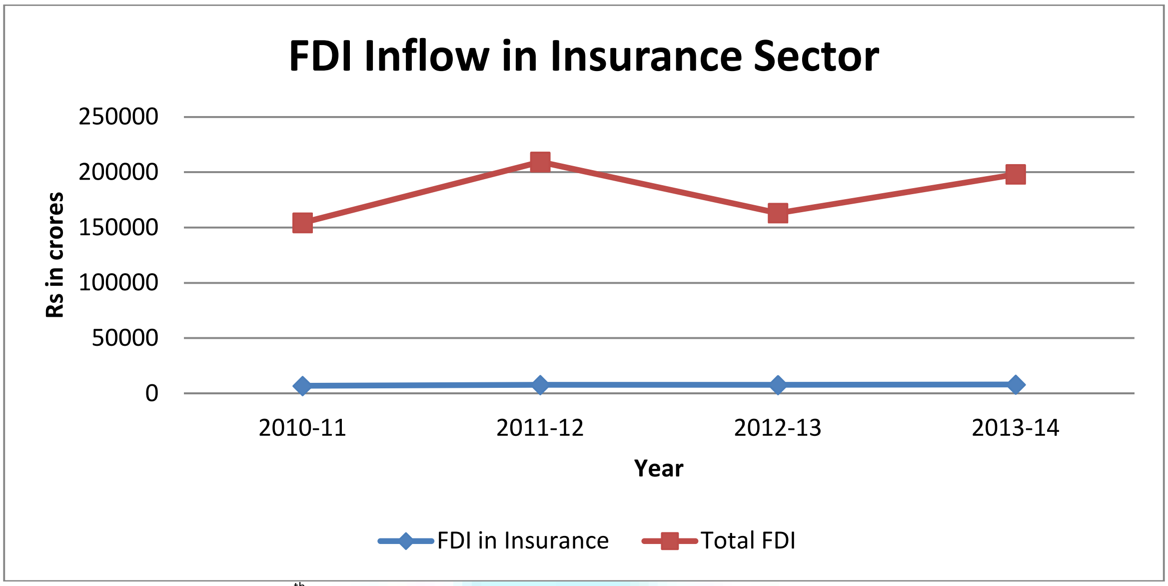
The FDI inflows are not constant, they are fluctuated in most of the years, particularly in the year 2004-05 the flow was very less by Rs 69454.32 crores.

As per Table 3, the insurance sector registered the highest inflow of FDI in the year 2012-13 by Rs 7632.54 crores, which equals to 4.908 per cent and in the Life Insurance sector it is Rs 6401.12 crores, which equals to 80.12 per cent over the flows to Insurance sector.

Hence, the inflows of FDI is very minimal in the Insurance sector as part of FDI flows in India, but within the insurance sector, flows to Life Insurance segment is very high comparatively.

Figure 3 shows the highest FDI flows of Rs 201668.75 crores, in the year 2011-12 in the Indian economy.

FIGURE 3: FDI INFLOW IN INSURANCE SECTOR



According to the latest FDI circular effective 12th May 2015, The FDI limit in insurance increased to 49 per cent from current level of 26 per cent. The 49 per cent cap would include FDI, foreign portfolio investments with automatic rout up to 26 percent and government rout beyond 26 percent and up to 49 percent. The hike in foreign investment limit to 49 per cent in the insurance sector has potential to attract up to USD 7-8 billion (about Rs 50,000 crore) from overseas investors, giving a major boost to the segment. In India FDI inflow in service sector in recent years puts the economy on a proper gliding path by contributing 55% to GDP.

5.2 DETERMINANTS OF FDI INFLOW

The major detriments of FDI inflow observed in the Indian context are large market size, economic growth, political stability, expected higher return on investment, high level of foreign exchange reserves, lower cost of transaction, ensuring ease of doing business, openness, government regulations, tax policies and firm specific advantages, competition capabilities, managerial skills and practice etc. are some of the crucial points for industrial organization to survive which make FDI inflow to the country attractive destination.

5.3 CHALLENGES

- **Resource challenge**: India is known to have huge amounts of resources. There is manpower and significant availability of fixed and working capital. At the same time, there are some underexploited or unexploited resources. The resources are well available in the rural as well as the urban areas. The focus is to increase infrastructure 10 years down the line, for which the requirement will be an amount of about US$ 150 billion. This is the first step to overcome challenges facing larger FDI.
- **Equity challenge**: India is definitely developing in a much faster pace now than before but in spite of that it can be identified that developments have taken place unevenly. This means that while the more urban areas have been tapped, the poorer sections are inadequately exploited. To get the complete picture of growth, it is essential to make sure that the rural section has more or less the same amount of development as the urbanized ones.
- **Political Challenge**: The support of the political structure has to be there towards the investing countries abroad. This can be worked out when foreign investors put forward their persuasion for increasing FDI capital in various sectors like banking, and insurance. So, there has to be a common ground between the Parliament and the foreign countries investing in India. This would increase the reforms in the FDI area of the country.
- **Federal Challenge**: Very important among the major challenges facing larger FDI is the need to speed up the implementation of policies, rules, and regulations. The vital part is to keep the implementation of policies in all the states of India at par. Thus, asking for equal speed in policy implementation among the states in India is important

5.4 OPPORTUNITIES

- India's insurable population is anticipated to touch 75 crore in 2020, with life expectancy reaching 74 years. Furthermore, life insurance is projected to comprise 35 per cent of total savings by the end of this decade, as against 26 per cent in 2009-10.
- The future looks interesting for the life insurance industry with several changes in regulatory framework which will lead to further change in the way the industry conducts its business and engages with its customers.
- Demographic factors such as growing middle class, young insurable population and growing awareness of the need for protection and retirement planning will support the growth of Indian life insurance

6. CONCLUSION

The study concludes that, FDI is as an engine of capital, technology, managerial skills, technological progress & capacity, access to foreign markets and in maintaining economic growth and development for developing countries, where as for developed countries it is considered as a tool for accessing the market of emerging economies. The study clearly observed from the data that foreign investors showed keen interest in different sectors because of liberalised regime pursued, launch of make in India scheme and ensuring ease of doing business and growth of Indian economy. FDI has helped the Indian economy grow and the government continues to encourage more investments of this sort. Attracting foreign direct investment has become an integral part of the economic development strategies for India. Foreign direct investment has been a booming factor that has bolstered the economic life of India. Over the years FDI flow is increasing. The study further observed that India has tremendous potential for absorbing greater flow of FDI in the coming years. Finally, the study also pointed out that, when discussing Foreign Direct Investment it is important to keep in mind that we are talking of investment. Hence, unless FDI has a net contribution of its own there is no reason why it should be distinguished from the general level of investment in the economy.

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