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A RESEARCH PAPER ON FDI IN INSURANCE SECTOR IN INDIA

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ABSTRACT

In order to curb the trend of falling Foreign Direct Investment (FDI) in the country, government recently increased the FDI limit in various sectors, latest being the insurance sector. Government in India had opened up the insurance sector for private participation in 1999, allowing the private companies to have foreign equity up to 26 per cent. But now, Insurance Regulatory & Development Authority (IRDA) has approved an increase in foreign equity capital in the insurance joint ventures upto 49 percent. In the world of increased competition and rapid technological changes, globalization has encouraged more and more multinationals to adopt FDI. In competitive industry, it has become really tough for the Indian insurers to invest the additional capital in the insurance sector. The insurance industry of India consists of 52 insurance companies of which 24 are in life insurance business and 28 are non-life insurers. The continuous inflow of FDI in insurance sector in India clearly shows the faith that overseas investors have in the country's insurance industry. Due to the growing demand of insurance, more and more insurance companies are now emerging in the Indian insurance sector. An increase in FDI in insurance sector would indirectly be a boon for the Indian economy. The objective of this research paper is to analyze the impact of FDI. Is it a boon or bane? As we all know govt is taking initiative to promote FDI in insurance as well as in other sectors. This research paper will draw light on this decision that if FDI in insurance sector good or not and should it be promoted or not.

KEYWORDS

FDI, IRDA, globalization, Insurance sector.

INTRODUCTION

When any nation progresses or say prosper, it is reflected by the pace of its sustained growth and development. In order to grow and develop economically, investments provides the base and pre-requisite. A nation's foreign exchange reserves, exports, government's revenue, financial position, available supply of domestic savings, do contribute to nation development but apart from above factors, magnitude and quality of foreign investment is necessary for the wellbeing of a country. Developed nations, across the whole globe, consider FDI as the safest type of international capital flows out of all the available sources of external finance available to them. During 1990s, FDI inflows rose faster than almost all other indicators of economic activity worldwide. Developing nations like India looks FDI as a source of filling the savings, foreign exchange reserves, revenue, trade deficit, management and technological gaps. There are several factors as to why FDI should be considered as an instrument of international economic integration as it brings a package of assets including capital, technology, managerial skills and capacity and access to foreign markets.

Taking into accounts the above factors, government of India decided to increase the FDI cap in the insurance sector up to 49% from 26%. This step was taken during the monsoon session of the parliament in 2014, when the new government (BJP) in power announced the Finance budget for the year 2013-14.

WHAT IS INSURANCE?

When faced with an unexpected event, you feel a need of security that won't make you beg for money. Any kind of protection or a safety net is welcomed rather than having nothing. Insurance is a promise of compensation for specific potential future losses in exchange for a periodic payment. Insurance is designed to protect the financial well-being of an individual, company or other entity in the case of unexpected loss. Some forms of insurance are required by law, while others are optional. Agreeing to the terms of an insurance policy creates a contract between the insured and the insurer. In exchange for payments from the insured (called premiums), the insurer agrees to pay the policy holder a sum of money upon the occurrence of a specific event. In most cases, the policy holder pays part of the loss (called the deductible), and the insurer pays the rest. Examples include car insurance, health insurance, disability insurance, life insurance, and business insurance.

WHAT IS FOREIGN DIRECT INVESTMENT (FDI)?

Foreign Direct Investment, generally speaking, refers to the capital inflows from abroad that invest 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. Such investments can take place for many reasons, taking advantages of cheaper wages, special investment privileges (e.g. tax exemptions) offered by the country. FDI inflows generally helps the developing countries to have a effective, broad and transparent policy environment for investment issues as well as, builds human and institutional capacities to execute the same.

The International Monetary Fund defines FDI as when one individual or business owns 10% or more of a foreign company's capital. Every financial transaction afterwards is considered by the IMF as an additional direct investment. If an investor owns less than 10%, it is considered as nothing more than an addition to his/her stock portfolio.

With only a 10% ownership, the investor probably doesn't have the controlling interest in the foreign business. However, even with just 10%, the investor usually has significant influence on the company's management, operations and policies. For this reason, most governmental agencies want to keep tabs on who is investing in their country's businesses.

ENTRY ROUTE OF FDI IN INDIA

As per RBI, an Indian company may receive Foreign Direct Investment under the two routes as given under:

AUTOMATIC ROUTE: FDI is allowed under the automatic route without prior approval either of the Government or the Reserve Bank of India in all activities/sectors as specified in the consolidated FDI Policy, issued by the Government of India from time to time.

GOVERNMENT ROUTE: FDI in activities not covered under the automatic route requires prior approval of the government which are considered by the Foreign Investment Promotion Board (FIPB), Department of Economic Affairs, and Ministry of Finance. Application can be made in Form FC-IL, which can be downloaded from http://www.dipp.gov.in. Plain paper applications carrying all relevant details are also accepted. No fee is payable.

TYPES

HORIZONTAL FDI arises when a firm duplicates its home country-based activities at the same value chain stage in a host country through FDI.

PLATFORM FDI Foreign direct investment from a source country into a destination country for the purpose of exporting to a third country.

VERTICAL FDI takes place when a firm through FDI moves upstream or downstream in different value chains i.e., when firms perform value-adding activities stage by stage in a vertical fashion in a host country.

METHODS

The foreign direct investor may acquire voting power of an enterprise in an economy through any of the following methods:

- by incorporating a wholly owned subsidiary or company anywhere
- by acquiring shares in an associated enterprise
- through a merger or an acquisition of an unrelated enterprise
- participating in an equity joint venture with another investor or enterprise

FDI IN INSURANCE SECTOR IN INDIA

Insurance has a long history in India. The business of life insurance started in India in the year 1818 with the establishment of the Oriental Life Insurance Company in Calcutta.

Life Insurance was the first to be nationalized in 1956. General Insurance followed suit and was nationalized in 1973. After the report submitted by Malhotra Committee in 1994, Insurance Regulatory Development Act was passed in 1999, which opened up the insurance sector for private participation and also allowing the private companies to have foreign equity up to 26 per cent. The goals of the IRDA are to safeguard the interests of insurance policyholders, as well as to initiate different policy measures to help sustain growth in the Indian insurance sector. Since the advent of the private players in the insurance market it has seen new and innovative steps by the players in this sector. The new players have improved the service quality of the insurance.

A major role played by the insurance sector is to mobilize national savings and channelize them into investments in different sectors of the 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. Insurance Sector contribute to GDP, is quite insignificant. FDI in insurance would increase the penetration of insurance in India. 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.

Now the present government, through The Insurance Laws (Amendment) Bill has raised the ceiling on foreign direct investment (FDI) in insurance to 49 per cent from the current 26 per cent limit. The Cabinet committee on economic affairs headed by Prime Minister Narendra Modi has approved The Insurance Bill, which has been pending since 2008 in the Rajya Sabha. This controversial Insurance Bill, key reform legislation, on 5 march, 2015 cleared the Lok Sabha hurdle easily but the problem of numbers in Rajya Sabha prompted the government to say that it will convene Joint Session if it is defeated in the Upper House. At last on 12 March, 2015 the Insurance Bill is passed by Parliament which is a big reform after a long time for insurance sector. The cabinet has cleared the FDI limit in insurance companies through FIPB route which necessitates the management control with the Indian promoters. This was a long due reform which the Modi government has undertaken and is surely bond to benefit the insurance sector.

The 49 per cent cap would include both FDI and foreign portfolio investments. This change is done to meet the growing capital requirement of insurance companies. Foreign re-insurers will be permitted to open branches only for re-insurance business in India and the provisions of Section 27E, which prohibits an insurer to invest directly or indirectly outside India the funds of policy holder, would apply to such branches.

The proposed 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.

MARKET SIZE

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 percent.

GOVERNMENT INITIATIVE

The Government of India has taken a number of initiatives to boost the insurance industry. Some of them are as follows:

- The Reserve Bank of India (RBI) has allowed banks to become insurance brokers, permitting them to sell policies of different insurance firms subject to certain conditions.
- The select committee of the Rajya Sabha gave its approval, permitting 49 per cent composite foreign equity investment in insurance companies. A broad agreement has also been achieved with the states on most of the issues concerning the implementation of the single goods and services tax (GST), which is scheduled to be rolled out from April 1, 2016.
- The Government of India plans to implement a Rs 1,900 crore (US$ 306.41 million) e-governance project called 'Panch Deep' to automate transactions of the Employees State Insurance Corporation (ESIC), said Mr Bandaru Dattatreya, Union Minister for Labour and Employment with Independent Charge, Government of India. Under the project, enterprise resource planning (ERP) solution would be installed across the country which will give a unique card to the employees and facilitate clearance of third party bills.
- The Government of India plans to launch a new insurance scheme to protect farmers and their incomes against production and price risks.
- Under the Pradhan Mantri Jan Dhan Yojana, it has been decided that even those accounts which had been opened prior to August 28, 2014 and have zero balance will get Rs 100,000 (US$ 1,612.55) insurance cover.

PORTER'S 5 FORCES ANALYSIS

- **THREAT OF NEW ENTRANTS**: The average entrepreneur can't come along and start a large insurance company. The threat of new entrants lies within the insurance industry itself. Some companies have carved out niche areas in which they underwrite insurance. These insurance companies are fearful of being squeezed out by the big players. Another threat for many insurance companies is other financial services companies entering the market. What would it take for a bank or investment bank to start offering insurance products? In some countries, there are only regulations that prevent banks and other financial firms from entering the industry. If those barriers were ever broken down, like they were in the U.S. with the Gramm-Leach-Bliley Act of 1999, you can be sure that the floodgates will open.
- **POWER OF SUPPLIERS:** The suppliers of capital might not pose a big threat, but the threat of suppliers luring away human capital does. If a talented insurance underwriter is working for a smaller insurance company (or one in a niche industry), there is the chance that person will be enticed away by larger companies looking to move into a particular market.
- **POWER OF BUYERS:** The individual doesn't pose much of a threat to the insurance industry. Large corporate clients have a lot more bargaining power with insurance companies. Large corporate clients like airlines and pharmaceutical companies pay millions of dollars a year in premiums. Insurance companies try extremely hard to get high-margin corporate clients.
- **AVAILABILITY OF SUBSTITUTES**: This one is pretty straight forward, for there are plenty of substitutes in the insurance industry. Most large insurance companies offer similar suites of services. Whether it is auto, home, commercial, health or life insurance, chances are there are competitors that can offer similar services. In some areas of insurance, however, the availability of substitute is few and far between. Companies focusing on niche areas usually have a competitive advantage, but this advantage depends entirely on the size of the niche and on whether there are any barriers preventing other firms from entering.

- **COMPETITIVE RIVALRY**: The insurance industry is becoming highly competitive. The difference between one insurance company and another is usually not that great. As a result, insurance has become more like a commodity - an area in which the insurance company with the low cost structure, greater efficiency and better customer service will beat out competitors. Insurance companies also use higher investment returns and a variety of insurance investment products to try to lure in customers. In the long run, we're likely to see more consolidation in the insurance industry. Larger companies prefer to take over or merge with other companies rather than spend the money to market and advertise to people.

BENEFITS OF INCREASED FDI LIMIT IN INSURANCE SECTOR

- **INCREASED INSURANCE PENETRATION**: With the population of more than 100 crores, India requires insurance more than any other nation. However, the insurance penetration in the country is only around 3 percent of our gross domestic product with respect to over-all premiums underwritten annually. This is far less as compared to Japan which has an insurance penetration of more than 10 percent. Increased FDI limit will strengthen the existing companies and will also allow the new players to come in, thereby enabling more people to buy life cover.
- **LEVEL PLAYING FIELD:** With the increase in foreign direct investment to 49 percent, the insurance companies will get the level playing field. So far the state owned Life Corporation of India controls around 70 percent of the life insurance market.
- **INCREASED CAPITAL INFLOW**: Most of the private sector insurance companies have been making considerable losses. The increased FDI limit has brought some much needed relief to these firms as the inflow of more than 10,000 crore is expected in the near term.
- **EMPLOYMENT:** With more money coming in, the insurance companies will be able to create more jobs to meet their targets of venturing into under insured markets through improved infrastructure, better operations and more manpower.
- **FAVORABLE TO THE PENSION SECTOR:** If the pension bill is passed in the parliament then the foreign direct investment in the pension funds will also be raised to 49 percent. This is because the Pension Fund Regulatory Development Bill links the FDI limit in the pension sector to the insurance sector.
- **CONSUMER FRIENDLY:** The end beneficiary of this amendment will be common men. With more players in this sector, there is bound to be stringent competition leading to competitive quotes, improved services and better claim settlement ratio. FDI in Insurance will introduce more competition in this market which will improve the services of the existing players also.
- **INSURANCE PRODUCTS:** Private as well as government insurers will benefit from the proposed hike of FDI; these companies will offer better and wide range of insurance products to customers at larger competitive prices.
- **SMALLER COMPANIES:** FDI will help smaller insurance companies to break-even faster and help monetize (convert into currency) the holdings of the promoters of the older life insurance companies.
- **TECHNOLOGY:** Insurers will not just get capital but also technology and product expertise of the foreign partner who is the domain expert.
- **NEW PLAYERS:** We can expect about 100 life and non-life insurance companies to serve a market of our size. Increasing FDI could see 25-30 new insurers entering the market.

DRAWBACKS OF INCREASED FDI

- Higher stake holding by foreigners would mean higher foreign control on the insurance company, thus runs a risk of having some decisions which are not in the best interest of domestic consumers.
- Foreign Direct Investment is money put in to our country by financial institutions or individuals of another country, and thus some or most of the profit made would at some point move outside our country and invested or spent in another country or home country.
- Different countries have different regulations in insurance sector; Government may need to relax some regulations in order to encourage FDI which may not always be in best interest of the country.
- Non FDI funded domestic insurance companies may have higher cost of capital and they would need to find ways of competing with lower premium offered by FDI funded insurance companies.
- There are already a lot of players in the insurance field which means that the competition already exists and services are quite good. LIC is one of the best companies in insurance sector offering one of the best and quickest settlements to the customers. Not much of competition is desired in this field.
- If the government is worried about the customers, it should make the laws stronger to ensure that the customers do get their deserved and promised benefits.

CONCLUSION

India is one of the most attractive foreign direct investment destinations in the world. The Indian insurance companies offer a comprehensive range of insurance plans. Due to the growing demand for insurance, more and more insurance companies are now emerging in the Indian insurance sector. But there are always pros and cons of each decision. Increase in cap in insurance sector will definitely boost up the Indian Economy due to enlarge scope of foreign players in the Indian Market. The insurance sector in India is still under developed as compared to developed countries, and despite private players now allowed to enter this sector, we only have a small number of providers. FDI will increase competition with increased number of insurance companies and basis economics would suggest that when the supply increases as compared to demand the prices will come down, thus benefiting the end customers. This will also help in increasing the employment level in India. But careful consideration is required to ensure that the investment stays for long term and does not get withdrawn, leaving the companies and their domestic customers in a miserable position, and not all profits are moved outside the country but some reinvested or spent in our country. Regulations need to be revisited to ensure that Insurance Companies are subject to relevant and strict governance. Likewise, the deficiencies in current pension schemes should offer significant opportunities to private providers. With the majority of the population still residing in rural areas, the development of rural insurance will be critical in driving overall insurance market development over the longer term.

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Looking forward an appropriate consideration.

With sincere regards

Thanking you profoundly

Academically yours

Sd/-
Co-ordinator

DISCLAIMER

ABOUT THE JOURNAL

In this age of Commerce, Economics, Computer, I.T. & Management and cut throat competition, a group of intellectuals felt the need to have some platform, where young and budding managers and academicians could express their views and discuss the problems among their peers. This journal was conceived with this noble intention in view. This journal has been introduced to give an opportunity for expressing refined and innovative ideas in this field. It is our humble endeavour to provide a springboard to the upcoming specialists and give a chance to know about the latest in the sphere of research and knowledge. We have taken a small step and we hope that with the active co-operation of like-minded scholars, we shall be able to serve the society with our humble efforts.

Our Other Journals