Impact of Foreign Direct Investment in Indian Insurance Sector

Pooja, M.Com., NET
Karnal

ABSTRACT

Foreign direct investment does not require any introduction because of the limelight it has attracted in recent days. The growth of the insurance sector in India has been phenomenal. 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. Foreign Direct Investment (FDI) in Insurance Sector in India is a much talked-about subject today. The Insurance Sector in India has undergone transformational changes over the last decade. 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. A lot of international companies have been waiting to enter India and opening up of the sector will give them an entry point. Now the question is whether the entry of international companies in this sector will endanger the existence of insurance business in our country. In this background, an attempt has been made in this paper to study and evaluate the 'FDI Policy' with regard to Indian Insurance Sector in India and its impact thereon.

Keywords: FDI, Indian economy, Insurance Companies, Liberalization, Foreign investment policy

INTRODUCTION

India is no doubt a growth economy and many economists and researchers consider it an attractive country to invest in, particularly in its rapidly growing and changing insurance industry. The insurance industry has undergone a massive change over the last few years and the metamorphosis has been noteworthy. 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. FDI has gained momentum in the economic landscape of world economies in the last three decades. It had outpaced almost all other economic indicators of economic transactions worldwide. It effects the economic growth by stimulating domestic investment, increasing human capital formation and by facilitating the technology transfer in the host countries. The Foreign Direct Investment means "cross border investment made by a resident in one economy in an enterprise in another economy, with the objective of establishing a lasting interest in the invested economy. FDI is also described as, "investment into the business of a country by a company in another country". Mostly the investment is into production by either buying a company in the target country or by expanding operations of an existing business in that country". Such investments can take place for many reasons, including taking advantage of cheaper wages, special investment privileges (e.g. tax exemptions) offered by the country. 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.

Why Countries Seek FDI?

- Domestic capital is inadequate for purpose of economic growth.
- Foreign capital is usually essential, at least as a temporary measure, during the period when the capital market is in the process of development.
- Foreign capital usually brings it with other scarce productive factors like technical knowhow, business expertise and knowledge.

OBJECTIVES OF THE STUDY

- To go through the historical perspective of FDI in insurance sector in India
- To review the policy and regulatory environment in insurance sector in India
- To review the current state of Insurance in India
- To know the pros and cons of FDI in insurance sector in India
- To analyze overall impact of FDI in insurance sector in India

RESEARCH METHODOLOGY

This research is a descriptive study in nature. The relevant data for the paper has been collected from Researcher used the Secondary data:

- Websites of Government
- Various Journals like journal relates with FDI
- Books and magazines related to FDI inflows relate with different sectors.
- Reports and publications of various associations connected with business and industry, Agencies, government etc.
- Historical documents and other sources¬ of published information

FDI IN INSURANCE IN INDIA: A HISTORICAL PERSPECTIVE

Insurance has a deep rooted history in India. This is found mentioned in the writings of Manu (Manusmrithi), Yagnavalkya (Dharmasastra) and Kautilya (Arthasastra). The writings of indian ancient history talk in terms of pooling of resources that could be re-distributed in times of calamities or disasters such as fire, floods, earthquakes, epidemics and famine. This was probably a system of sharing losses of calamities or disasters which we mean modern day insurance. Insurance in India has evolved over time heavily drawing from other countries.

A. Pre Liberalization Period 1818 saw the beginning of life insurance business in India with the organization of the Oriental Life Insurance Company in Calcutta. This Company however failed in 1834. 1870 saw the enactment of the British Insurance Act. In 1928, the Indian Insurance Companies Act was enacted to enable the Government to collect statistical information about both life and non-life business transacted in India by Indian and foreign insurers including provident insurance societies. In 1938, with a view to protecting the interest of the public, the earlier legislation was consolidated and amended by the Insurance Act, 1938 with comprehensive provisions for effective control over the activities of insurers.

B. The Nationalized Period In nationalized period an Ordinance was issued on 19th January, 1956 nationalizing the Life Insurance sector. Life Insurance Corporation came into existence in1956. The LIC had monopoly till the late 90s when the Insurance sector was reopened to the private sector. Due to new economic policy LPG i.e., liberalization, privatization and globalization, the insurance sector was reopened to the private sector. In 1993, the Malhotra Committee was constituted by the government for conducting a study on insurance. On recommendations of the Malhotra Committee report, in 1999, the Insurance Regulatory and Development Authority was constituted as an autonomous body to regulate and develop insurance industry.

C. Post Liberalization Period The IRDA opened up the market in August 2000 with the invitation for application for registrations. The bill allows foreign equity stake in domestic private insurance companies to maximum of 26% of the total paid-up capital and seeks to provide statutory status to the insurance regulator. In December, 2000, the subsidiaries of the General Insurance Corporation of India were restructured as independent companies and at the same time GIC was converted into a national reinsurer. Parliament passed a bill de-linking the four subsidiaries from GIC in July, 2002. The government created a specific 'Board Foreign Investment Promotion Board' to deal with promotion of FDI in India and to be the sole agency to handle matters related to FDI. 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.

POLICY AND REGULATORY ENVIRONMENT

Due to Changes in the regulatory environment substantially impacted the industry dynamics. Apart from macro-economic, social, and demographic growth drivers, the evolving regulatory landscape had a significant impact on the FDI trends in the industry. The regulatory and supervisory policies are being reshaped and reoriented to meet the new challenges and opportunities in this Industry; however the current policy allowed FDI up to 49%.

Key Regulatory Changes are:

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 Desertification

2011: Merger Acquisition Guidelines.

2012: Introduction of Declined Risk pool,

2015: Indian Insurance Companies (Foreign Investment) Rules, 2015 Notified; Foreign Equity Investment Cap of 49 % applicable to All Indian Insurance Companies

Mostly Indian companies entered into a joint venture with the foreign companies to do jointly the business of insurance. 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

THE STATE OF INDIA'S INSURANCE INDUSTRY

The Indian insurance industry seems to be in a state of flux. After a decade of strong growth, the Indian insurance industry is currently facing severe headwinds owing to reasons like:

- Slowing Growth
- Rising Costs
- Reforms being stalled
- Worsening distribution structure
- Heightened customer expectations
- Increasing disasters
- Deepening liberalizations and globalizations

ROLE OF FDI IN INSURANCE SECTOR IN INDIA

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 has evolved as a process of safeguarding the interest of people from loss and uncertainty. It may be described as a social device to reduce or eliminate risk of loss to life and property. Insurance contributes a lot to the general economic growth of the society by provides stability to the functioning of process. The insurance industries develop financial institutions and reduce uncertainties by improving financial resources.

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. The table below shows the breakup of insurance companies.

Table : Showing Companies In Insurance Sector In India

Type of Business	No. of public Sector Companies	No. of Private Sector Companies	Total Companies
Life Insurance	1	20	21
General Insurance	6	14	20
Re-Insurance	8	34	42

Source: Insurance Regulatory & Development Authority Official

Table: IRDA's annual report 2014

	No. of companies	Profitable companies
Life insurers	24	17
Public companies	1	1
Private companies	23	16
Non-life insurers	21	13
Public companies	4	4
Private companies	17	9

(As per IRDA report released in Jan 2014)

India’s current Finance Minister Mr. Jaitley had identified that benefits of insurance in India have not reached a large section of the people as insurance penetration and density are very low and proposed an increase in the foreign direct investment limit in the Budget.

Pros of FDI in Insurance sector

1. Wide range of Insurance products: FDI will promote development of insurance sector by bringing in more products & features in insurance sector, by way of sharing knowledge with foreign investors Private as well as government insurers will benefit from FDI; these companies will offer better and wide range of insurance products, more options and better service levels to customers at larger competitive prices.

2. Helpful for 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.

3. Capital inflow: Foreign investment limit to 49 per cent in the insurance sector has potential to attract up immediate capital inflows of $2 billion and long term inflows of about $10 billion giving a major boost to the segment.

4. Aggression: The industry has been cautious in selling products which are capital intensive, it will be able to become more aggressive.

5. Availability of new Technology: Insurers will not just get capital but also technology and product expertise of the foreign partner who is the domain expert.

6. Entrance of 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. It will introduce more competition in this market which will improve the services of the existing players also.

7. Beneficial for State-Run Companies also: People in the country have more faith on government insurance companies and less on private ones, this hike will benefit the state-run companies more than the private ones.

8. 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. 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.

9. More Job Opportunities: 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.

10. Benefit to customers: - Insurance companies funded by FDI may have lower cost of capital and better operating efficiency thus resulting in cheaper and better cover to end consumers. We have seen in the past as well, competition teaches new strategies, better management and more focus on customer satisfaction. So, this would ultimately benefit the customers.

CONS OF FDI IN INSURANCE SECTOR: The road to FDI is fraught with many roadblocks. Many analysts believe that sector will not get immense benefits from the move.

1. Higher foreign Control: Higher stake holding by foreigners would mean higher foreign control on the insurance sector, thus runs a risk of having some decisions which are not in the best interest of domestic consumers.

2. Profit move : 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.

3. Need of relaxation in rules & regulations:- Different countries have varying rules and regulations in insurance sector, Government may need to relax some rules and regulations in order to encourage FDI which may not always be in best interest of the country.

4. Effect of Cost of capital: 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. It will create a big problem for the insurance companies and all this will made the insurance sector more challenging.

5. Tough Competition: There are already a lot of players in the insurance sector which means that the competition already exists and services are quite good. LIC is one of the best companies in insurance field offering one of the best and quickest settlements to their customers. Not much of competition is desired in this sector.

6**. Need of government concern:** If the government is really worried about the customers, it should make the laws stronger to ensure that the customers do get their deserved and promised benefits from insurance companies.

CONCLUSION

Where almost all the industries in the world trying hard for survival due to the major economic meltdown, Indian insurance industry is one of the sectors that is still observing good growth. FDI will increase competition and basic economic suggests that when the supply increases as compared to demand the prices will come down, thus benefiting the end customers. 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 would increase the number of insurance companies and may also make possible better plans at lower prices. 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.

THE ROAD AHEAD

By 2020, India's insurable population is expected to touch 75 crore. As a result, the importance of life insurance in financial planning is only set to increase. With the new government's stress on reforms, steps taken by IRDA to make insurance more consumer-friendly and India's favorable demographics, the future of India's insurance industry looks good. Despite enormous challenges, future prospectus of insurance sector is very bright. By adopting appropriate strategy along with proper government support and able guidance of IRDA, India will certainly become the new insurance giant in near future. As the insurance sector will expand due to FDI, it will also lead to job creation in the sector. As more capital flows into the insurance sector and the manpower increases resulting from the FDI, it will be easier for insurance companies to tap opportunities in insurance markets. FDI in insurance sector will enable us to achieve our cherished goal of insurance industry and also it will be very much convenient and favorable for our economy but regulations need to be revised to ensure that Insurance Companies are subject to relevant and strict governance.

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