Foreign direct investment and insurance sector in India

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Abstract: India is third most attractive FDI destination in world. 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 large growth potential. Due to growing demand for insurance, more and more insurance companies are emerging in Indian insurance sector. Foreign direct investment plays an important role in the economic development of the country. However, Foreign Direct Investment (FDI) is released in the insurance industry, and despite many years of debate, the regulations are still not altered and there are still lots of restrictions. Foreign Investors are watching India, ready for a piece of the action in the insurance market, but there are still excess of uncertainties, restrictions and potential socio-economic risks. However, the Government is gradually taking steps to open the sector. 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. The present paper aims to study the pattern of FDI in Insurance Sector and the Government regulation in the said sector. The paper studies current trend in Insurance sector, the challenges and the prospects ahead.

keywords: India, Foreign Investment, FDI, Inflows, Outflows, Insurance Industry.

Objectives of the study

1. To study the effect of foreign direct investment on insurance sector.
2. To analysis the significance of foreign direct investment for Indian economy.
3. To study current trends in insurance sector.
4. To study how foreign direct investment helps in promoting growth.

Introduction

To understand what FDI in insurance means, one must know what FDI actually means, what happens when a country's sector accepts investments from another country. Foreign direct investment (FDI) is a direct investment into production or business in a country by an individual or company of another country, either by buying a company in the target country or by expanding operations of an existing business in that country.

Foreign direct investment (FDI) plays a multidimensional role in the overall development of the host economies. It may generate benefits through bringing in non-debt-creating foreign capital resources, technological upgrading, skill enhancement, new employment, spill-over's and allocate efficiency effects. While FDI is expected to create positive outcomes, it may also generate negative effects on the host economy. The costs to the host economy can arise from the market power of large firms and their associated ability to generate high profits. Much of the existing empirical evidence suggests that the positive effects offset negatives, thus providing net economic benefits for the host economies. While empirical and econometric work on testing various theoretical hypotheses is embedded in the extant literature on FDI, there is lack of information on the plant-level spatial and sectoral spread of FDI-enabled production facilities in

India and their linkages with rural and suburban areas. The majority of the population, both urban and rural, is expected to gain, indirectly and differentially, from FDI. While FDI may benefit the economy at both macroeconomic and microeconomic levels, it is equally important to probe whether people in the rural and suburban areas get affected through such benefits. FDI in relatively labour-intensive sectors including food processing, textiles and readymade garments, leather and leather products, and light machine tools, with plants set up in small cities close to rural and suburban areas, would tend to have relatively high employment-generating potential.

After increasing the FDI cap in the Multi-brand Retail sector, Aviation sector, Power Trading, and Broadcasting sector, the Indian Cabinet Committee on Economic Affairs (CCEA) is so raise the FDI ceiling in the Insurance and Pension sectors of India. The Cabinet Committee on Economic Affairs headed by Prime Minister Narendra Modi has approved the limit of FDI in Insurance sector to 49 percent from the existing 26 percent. 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.

Such an increment in the FDI ceiling in the insurance sector of India will certainly be highly and greatly appreciated by domestic and foreign insurance companies, for the purpose of expanding and enriching their insurance and re-insurance businesses under diverse insurance categories. Here, it may be noted that, the existing limit of foreign direct investment in the insurance sector of India, which was just 26%, now it is 49% is permitted to be made through the Automatic Route with proper license from the Insurance Regulatory and Development Authority (IRDA) of India. It means that a foreign investor cannot acquire more that 49% stake in the private insurance companies anywhere in India. As in all other economic sectors of India, ours prestigious and globally reputed law firm well-based in India, has been providing perfect and swift legal services for secure and profitable foreign direct investment in the insurance sector of India or abroad, for a long successful period.

Described explicitly in the Seventh Schedule of the Constitution of India, Insurance is one of the significant economic sectors of the country, which at present has extensive scope for expansion and development, to be at par with the insurance sectors in developed countries of the world. Progressing fast with an average yearly growth rate of over 30%, the current worth of Indian insurance industry is about $41 billion. Based on these statistical facts, the insurance industry of India has been ranked as the fifth largest and booming insurance market in the whole world. At present, merely two million Indians are covered under any insurance schemes like Medi claim, which is just 0.2% of the total Indian population of one billion. In developed countries like USA, this percentage is about 75%. Hence, there is vast scope for development and refinement in the insurance sector of India in future times. But, at present, only about 52 life insurance and general insurance companies are active in the insurance sector of India. For such purposes, the Insurance Regulatory and Development Authority (IRDA) of India requires a capital infusion amounting to over US $12 billion in the next five years, by domestic and foreign insurance companies.

The stock market has reacted positively to the news and the shares of Reliance Capital and Max India gained more than 4.5% in intra-day trade today. The higher FDI cap will immensely help the insurance sector which is extremely short on investments. India's current FM 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.

Table 1: Fdi in insurance in different countries

Country	% of FDI in insurance
Japan	100
China	50
India	49
Indonesia	80
Vietnam	100
Malaysia	51
South Korea	100

The FDI limit for insurance in India is among the lowest globally. China, Indonesia and Malaysia have an FDI limit of 50%, 80% and 51% respectively. Japan, South Korea, Vietnam, Hong Kong and Taiwan allow 100% FDI. In this context, the Union Budget moves to increase the FDI limit in insurance are a welcome move, which aims that the global investors to bring in the much required foreign capital to meet the industry needs.

BENEFITS OF INCREASED FDI IN INSURANCE SECTOR.

1. 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.
2. 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: Immediate capital inflows of $2 billion and long term inflows of about $10 billion can be expected.
4. Aggression: The industry has been cautious in selling products which are capital intensive, it will be able to become more aggressive.
5. Technology: Insurers will not just get capital but also technology and product expertise of the foreign partner who is the domain expert.
6. 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.

7. State-Run Companies: 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. 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.
10. 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.
11. 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. This could go up to 40,000 crore in the medium to long term, depending on how things pan out.
12. 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.
13. 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.

Views against about increased FDI in insurance

•The World Economic Forum Financial Development Report 2012 tells the success story of LIC. It shows that given the low level of income, insurance penetration in India is good. India has achieved a life insurance penetration of 3.61 per cent as against 3.56 per cent of the United States.

•The LIC, the four general insurance companies in the public sector and GIC of India are doing an excellent job despite competition from private insurance companies. In 2011-12, LIC registered a market share of 71.36 per cent in premium income.

•The average annual premium for a policy issued by the private insurers is about Rs.60, 000, compared to Rs.9,000 for a policy issued by the LIC. If the LIC is weakened, it may be forced to behave like a clone of the private insurers.

•In a developing country like India, the government needs to retain some control over domestic savings instead of allowing foreign investors to enjoy control over Indian savings. The Parliamentary Standing Committee came to the same conclusion. It recommended that the cap on FDI be retained at 26 per cent.

•Insurance industry is one in which even with a small amount of investment, lakhs of crores of public money can be garnered. It is believed that the FDI hike will allow foreign capital with small investments to gain greater access and control over large domestic savings.

•Financial experts say that domestic savings, and not FDI, are crucial for any country's economic development. In India, LIC has provided Rs.7, 04,151 crore to the 11th Five-Year Plan (2007-2012).

•India's life insurance sector was nationalized in 1956 after a series of failures and scandals in the private insurance companies. The risk of the entry of profit-seeking foreign companies, rationalizing the savings and interests of the people is real.

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. However, it remains to be seen how this sector impacts the unbanked sections of India, in the years to come.

CONCLUSION:

There are always pros and cons of each decision, FDI will increase competition and basis economics would suggest 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. Regulations need to be revisited to ensure that Insurance Companies are subject to relevant and strict governance.

FUTURE PROSPECTS:

Increasing the FDI ceiling will make the Indian Insurance sector more vibrant and dynamic in the intermediate and long term. Increased competition coupled with wider variety of products will result into a healthy Industry. Insurance companies and other players have to gear-up and plan now to reap the future benefits

The Indian insurance industry has always been an attractive market for global insurers to expand their business in the country, mainly due to demography profile and untapped business opportunities. This may help the insurer to expand their footprint to support Government's objective of financial inclusion, through insurance inclusion in the country. However, there is a need that the Government should simplify the KYC norms and demat accounts to a single unit across all financial products, which will benefit the insurance inclusion in the country. It is also feasible to provide a separate cap of `50,000 for life and health insurance, under 80C deductions, which will help all the stakeholders.

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