# Foreign Direct Investment in Insurance Sector in India: A Critique

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## Abstract

*The Foreign Direct Investment (FDI) is a global phenomenon, high on the agenda of all countries, rich or poor, in the current era of interdependent world order. The 21st century has shrunk the world into a global village where no nation can live in isolation and yet prosper. The need for FDI is not only in the developing or the underdeveloped countries but also in the developed world. Notwithstanding the global nature of FDI, it is undoubtedly the urgent need of developing countries especially the present–day India which is economically challenged. This paper attempts to examine the reasons behind the urgent need to attract more FDI in India especially the proposed 49% in the insurance sector. The other objectives are to study the current status of private insurance sector and analyse the reasons behind the public sector insurance companies dominating the market despite 26% FDI being available to the private sector. The paper also examines the reasons behind varied responses of the political parties to the proposed hike.*

Keywords: FDI, Inflows, Insurance.

## INTRODUCTION

The Foreign Direct Investment (FDI) is a global phenomenon, high on the agenda of all countries, rich or poor, in the current era of interdependent world order. The 21st century has shrunk the world into a global village where no nation can live in isolation and yet prosper. The international organizations like the UN agencies highlight the need to shed protectionism in trade practices by all countries.

As per the United Nations Conference on Trade and Development (UNCTAD), FDI inflows during the year 2011 increased across all major economic groupings viz. developed, developing and transitional economies; in the year 2012, there was a steep fall in the developed world, a small decline in the developing countries but a huge rise in the structurally weak economies. However, in the year 2013, FDI inflows rose again with developing countries maintaining their lead. Hence, the need for FDI is not only in the developing or the underdeveloped countries but also in the developed world. The poor countries may require the FDI mostly for developmental purposes e.g. for building good infrastructure or to address the problems of unemployment etc. The developed world favours it globally to overcome the economic recession it recently faced; the developed world even fears its reoccurrence.

It is heartening to know that some Indian companies provided ample jobs to US citizens both in USA and in India and thus, helped the USA overcome its current economic slowdown. The Government of India has also been trying hard to get increased inflow of FDI in various sectors, including insurance sector, of its economy. The Government now proposes to increase the FDI to the extent of 49% from the existing 26% in insurance industry; it also proposes more FDI in other sectors, including the sensitive Defence and Security sectors.

Notwithstanding the global nature of FDI, it is undoubtedly the urgent need of developing countries especially the present–day India which is economically challenged. It has 4.7% GDP growth (2013-14), 3% urban unemployment (2013, NSSO method), around 10% inflation (2013) and 1.7% current account deficit (2013).To attract FDI, India had earlier tried different routes e.g. investment sought through tax incentives in backward areas, public private partnerships and through establishing special economic zones. It had even allowed 100% FDI in many sectors during the year 2000. However, the FDI inflow in India exhibits a chequered history. Since 2000, there was an increase in the FDI inflows which reached $ 9 billion in the year 2006. It further increased to a record high of $ 46.9 billion in the fiscal year 2011-12; it however dropped to $ 36.9 billion in the year 2012-13.

According to the data available from the UNCTAD Report, FDI inflow in India is 4.3% of its Gross Fixed Capital Formation as compared to global average of 8.3%.Also, FDI stocks in India, as a percentage of GDP, stands at 12.2% in contrast to the ratio for developing countries at 30.4%. It shows that there is urgent need as well as considerable scope to expand FDI in India.

## II. OBJECTIVES OF STUDY

The objectives of research are:

- To study the Concept, Definition and importance of FDI as a global phenomenon.
- To examine the reasons behind the urgent need to attract more FDI in Indiaespecially the proposed 49% in the insurance sector.
- To analyse if the emphasis in soliciting FDI should be on creating greater employment opportunities in sectors like infrastructure, healthcare, insurance, consumer goods etc. or in promoting the economic growth so as to contain the current account deficit.
- To study the current status of private insurance sector and analyse the reasons behind the public sector insurance companies dominating the market despite 26% FDI being available to the private sector.
- To study the reasons behind varied responses of the political parties to the proposed hike. While the Left parties describe it as 'complete sellout to foreign investors', the regional parties term it as an 'anti-people' measure.

## III. CONCEPTUAL FRAMEWORK

### A. DEFINTION AND IMPORTANCE OF FDI

According to IMF, when one individual or business owns 10% or more of a foreign company's capital, it is defined as Foreign Direct Investment. Every financial transaction afterwards is considered as additional direct investment by it. The IMF further describes it as "investment made to acquire lasting interest in enterprises operating outside of the economy of the investor. The FDI relationship consists of a parent enterprise and a foreign affiliate which together form a Multinational corporation (MNC)."

FDI is considered important because it helps in the long-term economic development of a country not only as a source of capital but also through transfer of developed technology together with the best global management practices. Due to the large inflows of capital from the foreign investor, it helps in domestic industrial development of the receiving country thereby increasing its employment opportunities.

### B. FDI SYSTEM IN INDIA

The FDI system in India is a policy framework in the form of Circular on Consolidated FDI Policy which is regularly updated each year to incorporate the changes. The Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce & Industry makes policy pronouncements on FDI through Press Notes/Releases which are notified by the Reserve Bank of India as amendments to Foreign Exchange Management Regulations 2000.

FDI is received in India under two routes: (a) Automatic route: Through it, FDI is allowed in activities which do not require prior approval either of the Government or the Reserve Bank of India. And, (b) Government Route: FDI in activities other than the automatic route requires prior approval of the Government which is considered by Foreign Investment Promotion Board (FIPB), Department of Economic Affairs, Ministry of Finance.

India, in the initial years, mainly adhered to the socialist policies and continued to remain largely a closed economy with emphasis on protectionism and import substitution. Attempts were, however, made in 1966 and 1985 to liberalise the economy but these did not succeed. It was only in 1991 when India was going through a balance of payment crisis that the IMF insisted upon India to undertake a series of structural economic reforms with a view to attain rapid economic growth through integration with the global economy. The reforms of 1991 reduced requirements of industrial licensing, removed restrictions on investment and expansion and permitted easy access to foreign technology and FDI. The Government thus opened its doors to FDI inflows under Foreign Exchange Management Act and adopted a more liberal foreign policy.

FDI has, so far, been permitted in various sectors like Services both financial and non-financial, telecommunications, construction activities, computer hardware and software, housing and real estate, drugs and pharmaceuticals, power, automobile industry, metallurgical industries, petroleum and natural gas. According to FDI statistics of Department of Industrial policy and Promotion (DIPP), the Services sector constitutes the highest FDI equity inflows in India during the last four years with banking, insurance and financial services being one of them.

The overall liberalisation policy yielded the expected results; it brought millions of dollars into the country. In 2001, when India was described as a long-term growth opportunity by Goldman Sachs Brics, there was the FDI inflow in the country to the tune of $ 3-5 billion each year till the year 2006; it rose to $ 30-40 billion each year since the year 2007. The following table shows the amount of FDI inflows in India since 1999.

Table 1: FDI inflows in India since the year 1999

| Period | FDI inflows (US $ billion) |
|---|---|
| 1999-2004 | 19.52 |
| 2004-09 | 114.55 |
| 2009-Sept 2013 | 172.82 |

Source:

Further, during FY 2013-14, India attracted FDI worth US $ 36.40 billion as against US $ 22.42 billion in FY 2012-13.

## C. FDI IN INSURANCE – A HISTORICAL OVERVIEW

Before the year 1956, a large number of insurance companies co-existed in India and the level of competition was high. At that time, allegations of unfair trade practices against the insurers was also high. Therefore, the Government of India decided to nationalize insurance business and an ordinance was passed in January, 1956 that nationalized the insurance sector. Life Insurance Corporation of India (LIC) came into existence in the same year and absorbed 245 Indian and foreign insurance companies.

The LIC had monopoly till late 1990s when the insurance sector was reopened for private participation. Foreign companies were allowed to enter the insurance industry through joint ventures with Indian companies. However, FDI was permitted only to the extent of 26 per cent.

Since liberalization and privatization, the number of insurance companies operating in India increased which further raised the level of competition amongst the insurers. Presently, as joint ventures, there are about two dozen private life insurance companies besides 21 private general insurance companies which include 4 health insurance companies. Table 2 below shows the break-up of insurance companies.(Table 2)

There has been a significant growth in FDI inflows in the last 5 years both in life and non-life insurance sector. The total equity share of foreign investors in life insurance companies has gone up from Rs. 4354.5 crores in 2008-09 to Rs. 6045.91 crores in 2012-13. Similarly, foreign investors' investment in general insurance companies has increased from Rs. 621.72 crores in 2008-08 to Rs. 1586.63 crores in 2012-13.(Table 3)

It is interesting to note that even after an increased participation through FDI, the private sector insurance companies had shown a decline in customer strength. Further, the ratio of premium underwritten in a given year to GDP (insurance penetration) of India remains relatively low at 0.78 per cent for non-life business and 3.17 per cent for life business; quite behind the ratios of the United Kingdom (12.5 per cent), Japan (10.5 per cent), South Korea (10.3 per cent) and the United States (9.2 per cent).

An exhaustive effort is required to analyse the real reasons behind such dismal performance. There is need to know if it is caused by low per capita income of Indians or it is due to customers' non-awareness of good insurance products and their potential benefits or the real cause is unethical business practices used by the private insurance sector. The current challenge can be met through immediate corrective measures which include the need to reduce the cost of acquiring new customers, improving upon the distribution network for effective spread of awareness, creating customer-oriented insurance products, inculcating the spirit to avoid unethical business practices, a speedy procedure for settlement of claims and developing a mechanism for harmonious redressal of customers complaints.

## IV. NEED FOR INCREASING FDI IN INSURANCE

With 52 insurance companies, the insurance sector in India is one of the largest in the world expressed in terms of volume of money. And yet, the insurance penetration happens to be relatively low. This gap between the market size and market cover is the biggest hurdle of this sector. The total market size of insurance sector has been US $ 66.4 billion as of FY 2013 and is expected to grow to US $ 350-400 billion by 2020.

The insurance sector in India is no doubt growing and is expected to grow further and the imperative need for the purpose is the immense inflow of FDI which shall bring in the needed capital, competition, innovation and efficiency and would also help in improvement in the insurance penetration in hard-to-reach rural areas. The current proposal of the Government to increase the FDI in insurance sector to 49% should be correctly viewed as an urgent need of the sector.

The hike, however, requires an amendment to the Insurance law. The Union Cabinet has officially approved the amendments made in the Insurance Bill in which the FDI limit has been raised from 26 percent to 49 percent and the Insurance Bill is expected to be introduced in the Rajya Sabha in the coming future. The increase, once done, shall hopefully help in bringing best international practices for greater efficiency in the sector.

## V. ARGUMNETS FOR AND AGAINST THE INCREASE IN FDI CAP IN INSURANCE

The increase in FDI limit to 49 per cent shall only be allowed once it gets prior approval of the Foreign Investment Promotion Board (FIPB). Moreover, the Insurance Bill propagates that management control of the insurance companies must remain with Indian players only.

There are both supporters as well as the opponents of the proposed hike. **The proponents of the increase** argue:

- That the current insurance sector is **starved of capital** and is unable to grow. It is estimated that the sector currently requires $ 5 to 6 billion to expand and improve its current penetration level. An increased FDI can only meet this need as the capital market is not capable of doing so.
- Along with more funds, the foreign firms shall bring **better insurance products and also superior technological capabilities** that may help the industry in effectively settling claims, underwriting and other key processes to the satisfaction of its customers. Hence, the FDI increase would, in ultimate analysis, be for the benefit of the policyholders.
- The enhanced FDI would **add depth and competitiveness in the Indian scenario** by providing better products coupled with superior service levels to the customers. A larger inflow of capital and fresh breeze of ideas would also help in training the marketing personnel to adopt ethical practices in a bid to redress customers' grievances and help grow their numbers.
- The **hike in FDI is needed for crucial infrastructural needs.** Only a better infrastructure shall work both ways; it shall help in employment generation in the receiving country and also encourage the foreign investor to pump in more funds.
- A higher FDI limit in the insurance sector would also **facilitate FDI norms in the pension sector.**

The NDA Government apparently seems to sell the proposed hike in the name of national interest. However, organizations like All India Insurance Employees' Association (AIIEA), The North Zone Insurance Employees Association (NZIEA) are opposed to the government's proposal which they feel shall do no good to the country.

Those **opposing the proposed hike** argue:

- That the Government's decision is truly in favour of western countries like United States, France, United Kingdom etc. and that it shall neither benefit the Indian economy nor its insured public. Their argument is that insurance is a medium through which small savings are mobilized for long term investments and hence, allowing foreign capital to have greater access and control over domestic savings would be dangerous and harmful to the Indian economy.
- The opponents do not find the Government's argument convincing that FDI alone can help grow the insurance sector. They argue that private sector companies have Indian promoters who possess not only huge funds to invest but they can also raise more capital from the domestic market, in case of need. Hence, the necessity for increase in FDI is not justified. They further argue that experience of last 10 years show that even with 26% FDI the Indian companies have done better than their counterparts in other countries. For example, while in the US, there are 1000 insurers, the gross premium annually collected is around $

700 billion, whereas in India with only 52 participating firms, the gross premium collected is to the tune of $ 50 billion.

- The level of insurance penetration, the opponents maintain, depends upon the economic growth and availability of disposable income in the hands of the common man rather than the quantum of competition between private and public sector. The Indian economy grew from 5.5% in 2000 to 10.1% in 2010 when incidentally this sector was opened up; hence the insurance penetration rate remained on the ascending side. However, there has been de-growth and slowdown in the last four years; it has impacted all sectors of the economy including insurance. There has been a huge drop in domestic savings; and there was also a decline in financial savings rate which resulted in lower collection of premiums even for the foreign companies. Consequently, some of these were forced to exit from India (Sun Life) and few others are in the process of doing so.
- The opponents hold that FDI alone is not the determining factor to judge the performance of this sector. While the private insurance sector has been enjoying the fruits of FDI for the last 10 years, it has not done as good as the state-owned LIC and other public general insurance companies. Hence, more than the FDI, the real determinant of growth of this sector is the credibility factor coupled with its customer-oriented products. It is also proved by the performance of the LIC during the years 2012 and 2013 which was far better than the performance exhibited by the private life insurance sector. Hence, it is important to understand that growth of insurance sector cannot be fostered only through foreign capital.
- The opponents dispute the Government's argument that flow of significant portion of global premium income earned by the foreign partners would be reinvested in infrastructure in India. The contention remains fallacious since there is no evidence to prove the claim on the basis of available experience of the last 10 years.
- The opponents argue that it is a myth to believe that increase in FDI will ultimately benefit the policyholders by bringing in new technology and innovative products. An insurance cover is a means to provide protection to the common man from unforeseeable difficult circumstances. The insured person prefers to take a cover from a company which can provide him protection and can settle his claim quickly when he is in dire need of it. A look at the data published by IRDA shows that the claim settlement ratio of LIC is far better than the private life insurers; it is in fact the best in the world with 97.73 per cent of claim settlement. While the private life insurance players had repudiated around 8% of death claims, it was only 1.12% of LIC.Similarly, the lapse ratio of policies of the private life insurance companies was around 25% in 2012-13 as compared to 5.6% of LIC. The opponents point out that a large number of private companies also indulged in mis-selling of policies and hence, the lapsation ratio was quite high in the private sector. The private players, ironically, made profits through such high lapsation of policies.
- According to the opponents, the public sector life and general insurance companies, of late, have started acquiring advanced levels of technology and thereby, created customer-oriented products in order to continue their hold on huge market share. These companies are once again endeavouring to develop their products keeping in mind the needs of their clients and not merely for profit- making purposes.

## VI. CONCLUSION

There can be an endless debate on the advantages and disadvantages of FDI in any sector of the economy. One must keep in mind that FDI as a global phenomenon has come to stay. The Government, hence, should only be honest in framing and implementing its public policy to advance the real public cause and the opponents should avoid fake alibi for condemning it. In order to consolidate the gains that increased FDI is capable of bringing in the country, the following steps need to be taken: Firstly, the country needs to pay greater attention to its infrastructure building since that alone can help in bringing more FDI. Secondly, India needs to cut unwarranted trade restrictions since too many restrictions put off investors who have better alternatives. Thirdly, there is need to step up regional cooperation through more bilateral pacts rather than remaining in isolation. Fourthly, there should be visible improvement in the art of governance and that it should not remain confined to the domain of Government alone. It should also extend to the private sector which suffers from unethically high valuations, high debts and poor record of governance. And, Lastly, it must be remembered that the FDI goes to countries that are easy to do business; India has a lot to improve in this direction.

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**Table 2: Registered Insurers in India (As on 30th September, 2013)**

| Type of Business | No of Public Sector Companies | No of Private Sector Companies | Total Companies |
|---|---|---|---|
| Life Insurance | 1 | 23 | 24 |
| General Insurance | 6 | 21 | 27 |
| Re insurance | 1 | 0 | 1 |
| **Total** | **8** | **44** | **52** |

**Source: IRDA Annual Report 2012-13**

**Table 3: Total Equity Share of Foreign Investors in Insurance Companies in India**

| Total Equity Share of Life and General Insurance Companies Purchased by Foreign Investors (Rs. Crore) | | | | | |
|---|---|---|---|---|---|
| | **31st March 2009** | **31st March 2010** | **31st March 2011** | **31st March 2012** | **31st March 2013** |
| **Life Insurance** | 4354.5 | 5053.98 | 5723.81 | 6324.27 | 6045.91 |
| **General Insurance** | 621.72 | 896.32 | 1090.08 | 1324.45 | 1586.63 |

**Source: IRDA Annual reports 2008-09, 2009-10, 2010-11, 2011-12 and 2012-13**

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