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Inspecting Insurance Companies

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ABSTRACT *In a period of half a century and less, the insurance sector in the country has come a full circle, from being an open competitive market to full nationalization and then back again to a liberalized market, in which private players and public sector companies are on a level of playing field. Out of the significant events occurring in the US and other developed economies, there arise the need for policy makers of India to rethink their economic strategy, as this has been a period of two decades of globalization of finance. The global financial turmoil witnessed today should be considered to safeguard the interest of Indian financial system. At this juncture it becomes imperative to inspect the performance and progression of Indian insurance companies, for which determinants are identified and listed.*

1. REVIEW OF INSURANCE IN INDIA

According to 1995 statistics, India has the highest number of life insurance policies in force and the total investible funds with LIC were almost 8% of GDP. The LIC employs more than one lakh employees who in turn supervise through 200 branches and more than five lakh agents. Yet these numbers believe the fact that life insurance in India is spread very thinly and shallowly and its role as a mobiliser of long –term savings is under developed.LIC largely remains a slow moving, overstaffed behemoth.

The phased globalization of the Indian economy that started in the early 1990s began to have its impact on the monopolistic structure of the Indian Insurance industry. The liberalization of insurance market was among the objectives of the Uruguay round negotiations conducted under the auspices of General Agreement on Trade and Tariff (GATT). However, LIC was put on its toes when in 1993, the Government of India appointed a committee headed by Shri.R.N.Malhotra (Report of Malhotra Committee,1994) to examine the reforms required in the insurance sector. The Government with the committee came out with the following arguments in justification of liberalization:

1. Insurance penetration and density in the country is low.
2. The country needs massive investments in infrastructure and liberalizing insurance and pensions will help mobilization of long term funds.
3. Allowing foreign companies would help them bring a substantial portion of their world wide premium funds into Indian infrastructure and
4. India is a large economy and a big market with ample space for both private and public sector.

2. APPRAISAL OF INSURANCE INDUSTRY IN INDIA

2.1 Opening of Insurance market:

In a period of half a century and less, the insurance sector in the country has come a full circle, from being an open competitive market to full nationalization and then back again to a liberalized market. For almost four decades LIC has been sole player with virtual monopoly in the life insurance sector. In the early 90's the government of India ventured into the policy of liberalization, privatization and globalization. This policy envisaged opening up of the economy along with most of its core sectors to the private entrepreneurs. Along with this the entry of international corporations into various business and services sectors was also planned. This attracted some private and international players in the insurance sector also.

2.2 Liberalization Justified:

The decision to open up the insurance sector witnessed great public debate. There were arguments against opening up of the sector on the basis of the unhappy experiences of the privatization days. The government went ahead to liberalize the insurance sector on grounds of justification that insurance penetration and density in the country is low, country needs massive investments in infrastructure and liberalizing insurance will help in mobilization of long term funds. Allowing foreign companies would help in bringing substantial portion of worldwide premium funds into Indian infrastructure and India is a large economy and a big market with ample space for both private and public sector.

2.3 Re- entry of Private/Foreign Companies:

Consequently by the year 2000-01, 12 private players entered the life insurance sector. The Indian insurance industry has registered impressive growth in the past one decade. Many private players entered the market and most of the companies have entered as joint ventures with participation of a foreign partner holding 26% of the total paid-up equity capital. While four private sector companies had underwritten life business during the financial year 2000-01, the number of private players competing for business during the year 2001-02 alone increased to eleven. The life insurance grew at a very fast pace with new business premium touching Rs.75347.27 crore as at 31st January 2010, similarly the total premium income increased from Rs. 221791 crore in 2008-09. The total assets under management rose to Rs. 931000 crore as at the end of 31st March 2009 (Finance Minister, Pranab Mukerjee, 2010).

2.4 Threats Faced:

The happenings of the world during the year 2008 brought a new experience that also has to be taken into consideration. The crisis which has engulfed the financial sector of the US has far reaching implications both for the international economic order underlying globalization especially the global financial architecture as well as the policy regimes in developing countries. Countries like India were told to emulate the US financial system and integrate with the international financial markets in order to benefit from the globalization of finance.

At this juncture happened the first jolt in the US economy, the stock market crash and collapse of the IT boom in the year 2000.This led to the recession in the US in 2001 which caused a global slowdown. Liberalized rules for banks coupled with

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easy liquidity conditions enabled mortgage lending banks to adopt reckless lending strategies, fuelling housing demand. In order to push up their credit business, these mortgage lenders indulged in sub-prime lending, giving housing loans even to those borrowers whose ability to repay the loans were doubtful. These loans were then packaged into securities and were sold off to other financial institutions like the wall street based investment banks and hedge funds, in complex transactions that were made possible by financial deregulation in United States.

The assumption underlying financial deregulation was that financial innovations would enable the mortgage lenders and banks to insulate themselves against loan defaults by spreading the risks associated with these loans. This however was a flawed assumption since spreading of risks through complex derivatives cannot make the risk disappear completely. Eventually a full blown crisis surfaced in the US in 2006 when the housing bubble went burst. Sharp fall in the property prices led to the collapse of hundreds of mortgage lenders engaged in subprime lending, with even the largest mortgage lender in US, countrywide financial heading towards bankruptcy .This had a deepening impact when the list of investment banks and leading insurance companies were marked bankrupted. Among them were Lehman Brothers, the fourth largest investment bank in US, Merill Lynch, Bear Sterns, Fannie Mae, Freddie Mac and the world largest insurance company AIG managed to survive only after the injection of $ 180 billion (Prasenjit Bose, 2008) from the US government. Similar problems were faced by OECD countries, which also witnessed similar real estate bubbles over the past decade.

2.5 Problem Identified & defined:
Out of these significant events occurring in the US and other advanced developed economies, there arise the need for policy makers of India to rethink their economic strategy, as this has been a period of two decades of globalization of finance. The global financial turmoil witnessed today should also be considered to safeguard the interest of Indian financial system.

It is therefore necessary to inspect the business performance of both private and public life insurance companies in the post liberalization era, and also the changes that might have progression.

3. HOW TO INSPECT AN INSURANCE COMPANY?
To study the performance of the insurance companies, the three basic diagnostic tools referred by the Management Guru, Peter Drucker in his book "Essential wisdom of Peter Drucker from the pages of Harvard Business Review" namely Competence, Productivity and Allocation was taken as the base in terms of Performance, Productivity and Investment.

The following are the list of key determinants sourced from the balance sheets and the annual reports of IRDA exclusively for evaluating the insurance companies in India. The determinants identified are listed on the basis of three categories as performance, productivity and investment portfolio as per the objectives of the study.

3.1 Determinants of Performance of Life Insurance Companies – has been evaluated on the basis of the following indices: New Business in India, New Business out of India, Business in force in India, Business in force out of India, New Rural Business, Share of Rural business to Total business, New Business progress under group superannuation schemes, Business inforce under group insurance and superannuation schemes, Growth in active agents, Composition of income, Average sum assured per policy, Ratio of First insurance to Total business in terms of number of policies and Sum assured, Life Insurance Fund, Claims settlement operations, Analysis of utilization of income, Total life insurance premium, Market share of total life insurance premium, First year premium, Market share of first year premium, Market share of Single premium, Renewal premium and Total premium, New policies issued and growth rate, Number of life insurance offices, Lapsation ratio (Number of policies & Sum Assured), Solvency margin of insurers, Status of grievances of life insurers & Ratio of resolved complaints and pending complaints to total complaints.

3.2 Determinants of Productivity of Life Insurance Companies – This has been measured in terms of the following indices: New business per branch, New business per agent, Number of policies per branch, Number of policies per agent, Premium income per agent, Premium income per branch, Ratio of expenses to premium income, Complaints per thousand mean number of policies in force, Percentage of outstanding claims to total claims payable, Members of various agents, Operating Expenses Ratio & Growth rate and Dividend paid & Growth rate.

3.3 Determinants of Investment portfolio of Life Insurance Companies- In order to study the investment portfolio of LIC the following variables were identified and analyzed: Loans advanced for various development activities, Composition of Investments of LIC as per IRDA guidelines, Equity share capital of insurance companies, Investments of insurers and Percentage growth, Proportion of Life fund to total investment fund and Pattern of investments of life insurers.

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