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Financial Performance Of General Insurance Business In India – A Study Of Select Indicators

KEYWORDS: capital adequacy, assets quality, premium, claim and equities

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ABSTRACT *General insurance business is one of the progressing businesses in India. In the recent decade many private and foreign general insurance companies had entered into this business. The study mainly concentrated on measuring financial performance in terms of capital adequacy and assets quality of public sector general insurance companies. Secondary data was collected for the period of 10 years from 2003-04 to 2012-13. The National General Insurance Company Limited was found to be wanting in capital compared to the other companies. This was due to the fact that while other companies had infused capital periodically, this was not done by this company proportionate to the business generated. Hence an element of risk is found in this aspect. This is also reflected with regard to asset backing of this company which was comparatively less than that of other companies. Quality of assets in terms of equity investments was found to be in similar range for all the companies except for the lower levels of this asset for United India Insurance Company. This is bound to have an impact in the overall profits due to the lower investment income.*

Introduction

Insurance companies perform three distinct functions: i) Risk pooling, diversifying and loss compensation, ii) Risk management; and iii) Resource mobilisation. Insurance contributes to development of the economy through promoting financial stability, facilitating trade and commerce, enabling risk management, loss mitigation, and complementing the government in social security programmes.

General or non-life insurance companies provide safeguard against the financial loss of any property or unforeseen liability. The role of insurance in economic development is as equal to that of banking institutions. A study on the performance of the insurance industry is essential since the financial service provided by insurance industry is important in protecting business and individuals from risks they are exposed to.

Analysis of financial performance of financial service companies differ in many ways from analysis of that of manufacturing companies. Manufacturing companies bring in more capital at the time of establishment and subsequently borrow capital from banks and financial institutions, whereas financial service institutions like banking and insurance companies deal with finance. Their main business activity is getting money from their customers by the way of accepting deposits and premiums. Hence these type of companies do not bring in more capital, but they tend to manage it with the funds obtained from customers and this is a major element in assessing performance.

In order to analyse financial performance of insurance companies a parameter was developed and prescribed as indicators to financial soundness of financial services firms in the Handbook of Financial Sector Assessment by World Bank and IMF[1]. It was applied by many researchers in developed countries as well as by some in India. Among the indicators, analysing capital adequacy and asset quality is considered as important ones.

Statement of problem

Non-life insurance is an important financial service whose main purpose is to mitigate financial losses, due to damage or destruction of property or arising out of unforeseen liabilities. The importance of this service is normally not realised during normal times and appropriate insurance coverage sought, to protect against hazards or perils. Financial efficiency of the insurance companies need to be closely monitored so that they continue to provide the services. Many indicators have been identified which assesses the financial performance. Among these, capital adequacy and asset quality are topping the list.

The public sector general insurance companies had dominated this segment and had been a monopoly service provider till a decade ago. Consequent to the entry of private sector with collaborations with foreign insurers, the nature of the service had been altered. This study was taken up mainly to assess financial performance of non-life segment with regard to the public sector insurance companies.

Objective

The main objective of this paper is to assess the financial performance in terms of capital adequacy and asset quality of public sector general insurance companies in India.

Study Units

There are five public sector general insurance providers of which one company, the GIC which was originally functioning as a holding company of the other four companies, but now is functioning as a reinsurer and hence, have been excluded from the study. The study had taken the four public sector general insurers, The National Insurance Company Limited with its head office in Kolkata, The Oriental Insurance Company Limited, with its head office in New Delhi, The New India Assurance Company Limited, with its head office in Mumbai and The United India Insurance Company Limited, with its head office in Chennai.

Data Collection

The study is based mainly on secondary data, collected from annual reports of the public sector general insurance

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companies in India. Data were also collected from the Handbook on Indian Insurance Statistics, Insurance Hand Book published by IRDA and various journals, magazines and websites.

Tools for Analysis

Since the analysis involved financial data, financial tools, mainly financial ratios were employed for the purpose. Capital adequacy relating to insurance business was evaluated through two ratios namely Net Premium to Capital and Capital to Total Assets. Two ratios have been recommended for assessing asset quality of general insurance companies, one which assesses the quantum of Equities to Total assets and the other the proportion of Real estate and unquoted equities to Total assets. These ratios had been recommended by an IMF study paper prescribed in the Handbook of Financial Sector Assessment by World Bank and IMF for evaluating financial performance of insurance undertakings[1].

Period of Study

The present study analyses data covering a period of 10 years from 2003-04 to 2012-13.

Review of Literature

Chirag Gosalia[2] (2008) undertook a study on financial performance of Indian Non-Life Insurance Industry for a period of 2003 to 2007 using financial ratios such as claim ratio and combined ratio. Decreasing trend was found in spread between premium underwritten and premium earned by private companies. The study also found that public insurers performed better than private sector insurance companies.

Manjit Singh & Rohit Kumar[3] (2009) found in their study 'Emerging Trends in Financial Performance of General Insurance Industry in India' that the entry of private sector Insurance Companies had undoubtedly contributed to the strengthening of general insurance business by creating a competitive atmosphere.

Shreedevi D and Manimegalai D[4] (2013), compared public and private sector non-life insurance companies in India for a period of nine years from 2002-03 to 2010-11. The study found that insurers are operating under conditions of shrinking premiums, growing customer expectations, tightening regulations, tougher competition, rising operational costs, etc. The study also found that non-life insurance companies in India were still in a budding stage and performance of The New India Assurance Company, among the general insurance companies studied, was considered as satisfactory.

Rabindra Ghimire[5] (2013), used the CARAMEL model to explore the financial efficiency and health of non-life insurance industry in Nepal for the period 2006-2011 and concluded that, the financial health and efficiency of insurance sector was not sufficient in Nepal. Insurance Regulatory Authority of Nepal should pay proper attention to maintain the financial health of the industry and insurers also must be aware of their financial health and need to be more efficient and effective in their management.

No comprehensive study of the financial soundness of non-life sector or general insurance business, especially relating to capital, had been made and this study is an attempt to fill up this cap.

CAPITAL ADEQUACY

In the case of insurance companies analysing capital adequacy in terms of its capital base is considered essential, since the company should be in a position to meet its liability for the business it had accepted or under written. Two aspects which indicate capital adequacy are related to; 1) The extent of business under written in terms of premium collected, for which the insurer would become liable if a claim is raised; and 2) the extent of asset backing, because the insurers need to meet the liabilities as it arises from out of its assets. Hence capital adequacy is considered the first key indicator to the financial soundness of an insurance company.

Capital Adequacy Ratio

The success of the insurance business lies in meeting claims as and when it arises, which means it should possess sufficient capital base to face such an eventuality. Capital is seen as a cushion to protect the insured and promote the stability and efficiency of the financial service and it also indicates whether the insurance company has enough capital to absorb losses arising from claims raised. Capital adequacy ratio of insurance companies is calculated in two different aspects. First, capital adequacy is calculated in terms of net premium to capital. Here, net premium refers to gross premium minus premium paid for reinsurance. Capital is the sum of share capital and reserves. Net premium is an indicator of the business generated and retained by the company, in terms of new policies taken up and continuation of existing policies by renewals for a further period or a year. No benchmark had been prescribed by IRDA, but to ensure safety against insolvency, high capital adequacy ratio is desirable. In other words, a situation when business is generated not serviceable by existing capital base is not desirable. On the contrary, too low a business, insufficient to the level of capital is also not desirable. Hence a ratio of more than 1 and less than 2 may be considered ideal and is adopted in this study.

Table 1 shows capital adequacy ratio in terms of net premium to total capital of public sector general insurance companies for the period from 2003-04 to 2012-13.

Table 1
Capital Adequacy of Public Sector General Insurance Companies for the period from 2003-04 to 2012-13
(Numbers)

Year	National	New	Oriental	United
2003-04	2.1411	0.9102	1.7577	1.1919
2004-05	2.1904	0.8728	1.4967	1.0656
2005-06	2.4893	0.8571	1.4317	0.9308
2006-07	1.9307	0.7533	1.3283	0.8593
2007-08	1.9366	0.6900	1.4194	0.8338
2008-09	2.4990	0.7169	1.5539	0.8853
2009-10	2.4106	0.7686	1.8611	0.9243
2010-11	2.8737	0.8618	2.1748	1.0941
2011-12	3.0628	1.0185	2.1794	1.3386
2012-13	2.9660	1.1089	2.0817	1.4641

Source: Computed from Annual Reports of the respective companies.

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National – The National Insurance Company Limited; New – The New India Assurance Company Limited; Oriental – The Oriental Insurance Company Limited; United – The United India Insurance Company Limited.

Table 1 shows the capital adequacy ratio in terms of net premium to total capital of public sector general insurance companies. The capital adequacy ratio of The National Insurance Company Ltd., was more than two during most of the years of the study period. During 2006-07 and 2007-08 the capital adequacy ratio was around 1.93 and it was the highest at 3.06 during the year 2011-12. High Capital adequacy ratio indicated lesser capital coverage for the extent of business generated by this company.

Capital adequacy ratio of The New India Assurance Company Ltd., was less than one during the first eight years of the study period and it turned up to more than one, during 2011-12 and 2012-13 during the study period, implying lesser business generated for the level of capital.

Capital adequacy ratio of The Oriental Insurance Company Ltd., was more than one, up to 2009-10 of the study period and it went up to more than two, during the last three years of the study period. Hence this company can be considered to have reasonably kept up its capital adequacy.

Capital adequacy ratio of The United India Insurance Company Ltd., was more than one during first two years and last three years of the study period. During other years it was slightly less than one. It showed that the company had maintained adequacy of capital in tune with its raising business. This company had seen a high growth in business in terms of Net Premium, among the public sector insurance companies during the study period and with reserves and surplus contributing more towards capital growth.

Overall it can be stated that among the four public sector general insurance companies, The United India Insurance Company Ltd., and The Oriental Insurance Company Ltd., had maintained a better adequacy compared to the other public sector insurance companies. For The National Insurance company Ltd., the capital base had been comparatively lower with that of business generated, as indicated by the higher ratios for most of the years. On the other hand, for The New India Assurance Company Ltd., consistently low ratios indicated that the business generated had been comparatively lower.

Capital Adequacy in Terms of Capital to Total Asset

The second measure of capital adequacy is the ratio of capital to total assets. Generally size of a company is measured by its amount or value of sales or by the value assets of the company. Funds generated in any company need to be invested in assets which assure revenue generation for the company. In insurance companies, apart from capital, funds mainly flow in as collection of premium. These funds are invested in various securities both short term and long term and are also held in the form of land and buildings and real estate assets. Hence the ratio of total assets as a proportion to the capital funds is considered as an important indicator of financial soundness. Unlike manufacturing and other trading businesses, the proportion of owned capital in the asset base need not be substantial. A lower ratio however is considered good because, a greater assets base is always good for a company and indicates its strength. However, too low a capital base is also not desirable. Since no standard was fixed for the ratio by any agency like IRDA, the study considered a ratio of around 0.1 as satisfactory and a ratio between 0.1 and 0.2 as good.

Table 2
Ratio of Capital to Total Assets of Public Sector General Insurance Companies for the period from 2003-04 to 2012-13
(Numbers)

Year	National	New	Oriental	United
2003-04	0.1249	0.2279	0.1277	0.1780
2004-05	0.1184	0.2194	0.1437	0.1908
2005-06	0.0804	0.1786	0.1215	0.1738
2006-07	0.1054	0.2197	0.1455	0.2080
2007-08	0.0990	0.2183	0.1249	0.2121
2008-09	0.1124	0.2719	0.1466	0.2786
2009-10	0.0879	0.2017	0.1066	0.2413
2010-11	0.0855	0.1896	0.1023	0.2274
2011-12	0.0996	0.1834	0.1124	0.2189
2012-13	0.1049	0.1878	0.1183	0.2123

Source: Computed from Annual Reports of the respective companies

National – The National Insurance Company Limited; New – The New India Assurance Company ;imited; Oriental – The Oriental Insurance Company Limited; United – The United India Insurance Company Limited.

Table 2 reports capital adequacy ratio in terms of capital to total assets for the selected public sector general insurance companies. Capital adequacy ratio of The National Insurance Company Ltd., ranged from 0.0804 to 0.1249. The results showed fluctuating ratios over the study period. It went up above 0.1 during 2012-13 due to increase in the amount of total capital. The ratio of the company showed that capital adequacy of this company, was less than or around 0.1, during five years and more than 0.1, during the rest of the years which means the company had the required adequacy in terms of assets base during the study period.

Capital adequacy ratio in terms of capital to total assets of The New India Assurance Company Ltd., was slightly above 0.2 during five years of the study period and during four years it was below 0.2. For the remaining year 2008-09, the ratio was found abnormal. It indicated that capital adequacy of the company was satisfactory for most of the years during the study period. In other words their assets base could be considered as reasonably good.

Capital adequacy ratio of The Oriental Insurance Company Ltd., was above 0.1 but below 0.2, during all the years of the study period. The ratio showed very low fluctuations during the study period for the company. This showed that capital adequacy ratio of this company was satisfactory over the study period.

Capital adequacy ratio of The United India Insurance Company Ltd., was found fluctuating during the study period ranging between a low of 0.178 to a high of 0.2786. During eight years, capital adequacy ratio of United Insurance Company Ltd., was near or below 0.2. It was during 2008-

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09 and 2009-10 that the ratio was abnormal, meaning lower asset base but subsequently the position started to improve.

Overall, the asset coverage was found satisfactory for The National Insurance General Company Ltd., and The Oriental General Insurance Company Ltd., but was fluctuating for the other two companies.

ASSET QUALITY

While the previous section dealt with the assessment of the quantum of capital and its adequacy to meet liabilities and risks arising out of claims, the quality of the capital fund is more determined as to how this capital is represented in the form of assets. Capital adequacy is the quantity aspect, whereas assessing assets quality is another important aspect in financial analysis and is also considered as an important indicator of financial soundness of a general insurance company. Asset backing becomes essential when claims need to be met, since assets should be sufficiently liquid to meet the liabilities. At the same time, the available assets should also be judiciously invested in such forms so as to earn returns to the company, which would determine the profitability. It is a decision involving a trade-off between liquidity and profitability, the management of which is considered an important indicator to financial soundness. As stated earlier the capital and premium collected, form the inflow of funds which need to be used for meeting claims as and when it arises. This would mean, holding the funds in a highly liquid form, namely cash would be preferable. But insurance companies use the funds for earning returns from investing the same in various assets instead of keeping them idle.

Quality of an asset is characterised by its marketability, implying the quickness with which it can be sold away at a fair price, bereft of any major fluctuation and without suffering any major loss and so on. An investment is made with an intention to earn some returns by way of profits and by gain in value. Of course, all the assets need not satisfy all the criteria of marketability, liquidity, profitability and less risk. Many of these features need to be traded off, like profitability and liquidity, profitability and risk. An assessment of these aspects forms part of the financial soundness.

The proportion of the two set of assets namely the market quoted equities and bonds which are easily marketable and the assets in the form of real estates and unquoted equities which are less liquid is expected to reveal the nature of asset quality.

Two ratios have been recommended, one which assesses the proportion of equities to total assets and the other, the proportion of real estate and unquoted equities to total assets. These ratios are calculated and analysed with regard to the select public sector general insurance companies. Table 3 gives the ratio of equities to total assets for public sector general insurance companies for the years from 2003-04 to 2012-13.

Table 3
Ratio of Equities to Total Assets of Public Sector General Insurance Companies for the period from 2003-04 to 2012-13
(In Percentage)

Year	National	New	Oriental	United
2003-04	51.54	40.93	63.90	36.49
2004-05	44.94	40.88	71.06	38.10
2005-06	54.15	49.28	53.27	46.52
2006-07	51.48	44.06	47.51	42.06
2007-08	57.54	48.96	48.26	46.78
2008-09	44.82	35.39	51.14	29.11
2009-10	55.11	48.34	30.55	34.94
2010-11	53.47	48.34	35.23	33.68
2011-12	50.85	42.83	39.22	28.09
2012-13	42.20	40.57	37.62	29.26

Source: Computed from Annual Reports of the respective companies

National – The National Insurance Company Limited; New – The New India Assurance Company ;imited; Oriental – The Oriental Insurance Company Limited; United – The United India Insurance Company Limited.

Table 3 shows that the ratio of equities to total assets of The National Insurance Company Ltd., was found reasonably high throughout the study period. The ratio ranged from a low of 42.20 per cent to a high of 57.54 per cent.

Assets quality of The New India Assurance Company Ltd., ranged between a low of 35.39 per cent and a high of 49.28 per cent and was found fluctuating over the study period.

The ratio of equities to total assets of The Oriental Insurance Company Ltd., ranged between a low of 30.55 per cent and a high of 71.06 per cent. It was found very high for the first two years of the study period. The ratio was gradually decreasing during the following years and stood at 37.62 per cent in 2012-13. Basically the proportion of equities had been continuously decreasing which should have had an adverse impact on the earnings of the company.

The ratio of equities to total assets of The United India Insurance Company Ltd., ranged from a low of 29.11 per cent to a high of 46.78 per cent over the study period. The ratio had shown high fluctuations during the period of the study.

Overall, of the four companies, The National Insurance Company Ltd., and The New India Assurance Company Ltd., had comparatively higher level of investments in market securities, which should have helped the companies in showing better returns.

Table 4
Ratio of Real Estate and Unquoted Equities to Total Assets of Public Sector General Insurance Companies for the period from 2003-04 to 2012-13
(In Percentage)

Year	National	New	Oriental	United
2003-04	7.16	4.42	1.83	2.87
2004-05	6.23	6.74	2.27	3.35
2005-06	6.26	6.74	2.83	5.02
2006-07	7.49	6.45	4.49	2.66
2007-08	7.56	5.96	4.96	2.84
2008-09	13.19	12.03	12.72	4.57

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2009-10	10.83	9.42	0.13	2.60
2010-11	6.41	7.31	0.12	2.12
2011-12	1.14	8.82	0.12	5.67
2012-13	0.08	8.52	0.10	4.84

Source: Computed from Annual Reports of the respective companies

National – The National Insurance Company Limited; New – The New India Assurance Company ;imited; Oriental – The Oriental Insurance Company Limited; United – The United India Insurance Company Limited.

Table 4 shows the assets quality in terms of real estates and unquoted equities to total assets. It was found that the ratios of The National General Insurance Company Ltd., ranged from 0.08 per cent to 13.19 per cent. It showed heavy fluctuations during the study period. But the ratio was found to be at low levels of below 10%, except for in 2008-09 and 2009-2010.

Assets quality ratio in terms of real estates and unquoted equities to total assets of The New India Assurance Company Ltd., ranged from 4.42 per cent to 12.03 per cent over the study period. The ratio was fluctuating, but range bound over the study period. The ratio was found low during the study period except for a spurt in 2008-09.

Assets quality ratio of The Oriental General Insurance Company Ltd., ranged from a low 0.10 per cent to a high of 12.72 per cent. The ratio had been low up to 2007-08 with a spurt in 2008-09 but subsequently got reduced drastically.

Assets quality ratio in terms of real estates and unquoted equities to total assets of The United India Insurance Company Ltd., had ranged between a low of 2.12 per cent and a high of 5.67 per cent during the study period. The ratio was found to be low without much of fluctuations. Compared to the other study institutions this company had been in a better position in regard with lesser fluctuations.

Considering the fact that these assets are comparatively of low quality, the low ratios reveal that, basically the management had been very cautious in taking up these high risk investments.

Conclusions

In terms of capital adequacy among the public sector general insurance companies, The National General Insurance Company Ltd., was found to be wanting in capital compared to the other companies. This was due to the fact that while other companies had infused capital periodically, this was not done by this company proportionate to the business generated. Hence an element of high risk is found in this aspect. This is also reflected with regard to asset backing of this company which was comparatively less than that of other companies. However, since the stability of the institutions have been intact, this otherwise presents an acceptable position. Quality of assets in terms of equity investments was found to be in similar range for all the companies except for the lower levels of these assets for The United India Insurance Company Ltd. This is bound to have an impact in the form of lower investment income. This aspect has to be further studied. But none of the companies studied had committed themselves in low quality investments like real estate and unquoted equities. But it is also to be borne in mind that the investment policy of the insurance companies is more regulated and the discretion for individual companies is very limited. However, if these have not impacted the overall return of the companies this otherwise presents an acceptable position.

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