A STUDY OF THE INDIAN LIFE INSURANCE INDUSTRY

Dissertation submitted in partial fulfilment of the Requirements for the award of the Degree of Master of Philosophy in applied Economics of the Jawaharlal Nehru University, New Delhi

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JULY 1996

I HEREBY AFFIRM THAT THE RESEARCH FOR THIS DISSERTATION TITLED *A STUDY OF THE INDIAN LIFE INSURANCE INDUSTRY* BEING SUBMITTED TO THE JAWAHARLAL NEHRU UNIVERSITY FOR THE AWARD OF THE DEGREE OF MASTER OF PHILOSOPHY WAS CARRIED OUT ENTIRELY BY ME.

D TRIPATI RAO

CERTIFIED THAT THIS DISSERTATION IS A *BONA FIDE* WORK OF D TRIPATI RAO. THIS HAS NOT BEEN CONSIDERED FOR THE AWARD OF ANY OTHER DEGREE BY ANY OTHER UNIVERSITY.

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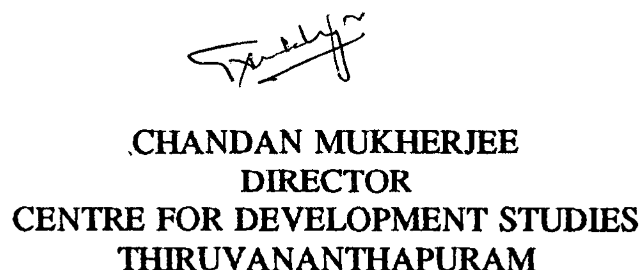

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ACKNOWLEDGEMENT

There is one nature, perfect and penetrative
present in all nature,
one reality which includes all comprising all realities in itself
the one moon is reflected
wherever there is water and all moon in water
are comprised in the one moon.

The end of a long and exciting endeavor, became successful but for the cooperation and support of the `CDS'. By mere submission of it will either belittle or by mere omission of it will do injustice to their genuine efforts. First and foremost to my Teacher (Supervisor), Dr. G Omkarnath who drawn me to the research world. In fact, this exercise which once looked like an Achilles hill, turned in to a saga. The frequent interactions during the weekends, sharp criticisms, valuable suggestions and guidelines led me to this point. Prof. Gulati's comments and suggestions in the initial stages was indeed helpful in the progress of the study.

`Dislearning is more difficult than learning'. And in this direction the lectures by G N Rao, P S George, K K Subramaniam and D Narayana helped in reshaping and reorienting my little understanding of Economics. The comments from Shanta, Puspangadan, Mishra, Indrani Mukherji and Panda helped in polishing my thesis work. This work would not have possible with out the help of officials of LIC Pattom and the staff of National Insurance Academy, Pune. The world bank people were gave a quick response to my request. Also V.Anant send me the useful data which gave the initial thrust.

Miles away from home, my CDS stay would have lost the charm without the company of friends like Pinaki, Sanjith, Suresh, Kurup, Bhaskar, Neetha, Babu, Arbinder, Ashok, charvak, Deepita, Venu, Jayachandran, Binoy, Malika, Uma and Jeena. Our class had its own thermodynamics with usual `push and pulls', `heat and dust' and `oophs and aahs', but the assignment phobia, occasional outings, seminars and especially the prolonged stay in the computer room, could able to keep us under the same roof.

Amit and Gaytri accommodated me whenever I longed for homely touch and love. Srijit Bhai's encouragement and comments on my drafts gave me much needed feedbacks. His patience in going through the whole draft overnight is incredible. Dennis gave a meaning to the neighborhood relationship.

My friend, Sudhakar gave me `solitude of hundred years,' but never made me feel lonely.
Our discussions away from conventional bizarre drifted toward some unresolved questions of values, ethics of life.

Back home Dr.P C Mohapatra was much enthusiastic about my progress and kept on encouraging me. My friends Manoj, Muna and my sister Jaya kept in touch through their letters.

Mummy and Daddy, your love and warmth in the letters and phone calls gave me strength when I was exhausted. My brother, Govinda always bestowed confidence and pushed me ahead.

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CHAPTER I

INTRODUCTION

1.1 The Problem

In India, as else wherein the developing world, there is an active debate on financial sector reforms. The debate is no doubt spurred on the one hand by the success of East Asian Economies in the 80's and the comprehensive macroeconomic reforms that many a developing country have initiated in recent years, on the other. In India, the macroeconomic stabilisation and structural adjustment programmes launched in 1991 have brought into focus the issue of financial sector reforms. While some financial markets such as the capital market, the foreign exchange market and the banking sector have already been subject to various degrees of reforms and restructuring [*Economic Survey* (GOI; 1996)], the insurance sector is as yet relatively untouched by reforms. An official committee[1] has gone into the various aspects of the Insurance Industry. The only step that is effected in the direction of insurance sector reforms is the appointment of an Interim Regulatory Authority (*The Hindu*; 8th May 1996). Meanwhile, there has been no systematic study of the evolution[2], structure and the pattern of growth of the Indian Insurance Industry. The present study, on life insurance industry, is motivated by the need to trace and analyses the

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[1] "Committee on Reforms in the Insurance Sector" appointed in April 1993 by the Government of India, Ministry of Finance under the chairmanship of R N Malhotra submitted its report on 7th January 1994. Hereafter the Committee is referred to as the Malhotra Committee.

[2] Although there have been a few studies viz., Agarwala (1961), Desai (1973), Bajpai (1975), Ray (1982) and Misra (1991) on specific aspects of the industry; apart from the reports of various administrative committees from time to time, viz., Administrative Reforms Committee (1966), Nayudu Committee (1971), Thapar Committee (1974), Ramanthan Committee (1977) and the Era Sezhiyan Committee (1979).

evolution and development of the industry over the past three and a half decades. Our focus on life insurance is due to its relative size and dominance within the industry. It is in the nature of an exploratory, base-line study (given the paucity of literature), that places the performance of the industry in the perspective of the on going debates on the privatisation and globalisation of the insurance sector.

This introductory chapter is divided into five sections. Section 1.1 highlights the problem. Section 1.2 is concerned with some of the important analytical considerations that are germane to the problem under investigation. Section 1.3 gives out the objectives of the study. Section 1.4 discusses the methodology and Section 1.5 notes some of the limitations of the study. The last section, Section 1.6, provides details about the chapter scheme.

1.2 Analytical Considerations

The neo-classical welfare economics posits that in a complete set of markets a competitive equilibrium analogous to the Walarasian Allocation is Pareto-Optimal. For example, the Arrow and Debreu (1954) competitive world, in the absence of externalities, ensures financial contracts (Arrow-Debreu Securities) for all future contingencies. These securities, in essence, are a set of insurance policies with future dimensions attached to each one of it. Implicitly, a set of prices ensures insurance cover against all forms and types of uncertainties and this ensures allocative and productive efficiency. In this environment (Beseley; 1995:2126) points out that the economic agents look for the mechanisms of saving, credit and insurance as complementaries in expanding their productive activities, thus this interactive process gains and sustains trade.

But the above framework stands on the presumption of complete information of both present state and all possible future states of the world to all economic agents with zero monitoring cost. However, the markets, especially the financial markets, are more often than not characterised as imperfect or missing or incomplete. This is due to the inherent problem of asymmetry of information. To be specific, in the context of insurance market asymmetry of information leads to moral hazard and adverse selection. Being incapable of incurring high monitoring costs, the insurer/lender fails to gather sufficient information of the economic agent. Moral hazard arises when the insurer or lender (in case of credit) is unable to discern the undertaken activities of the insured/borrower and fails to foresee the probability of an adverse event. If the insured/borrower knows his/her own risk but the insurer/lender does not, then it affects the realised *ex post* profitability which falls below the *ex ante* profitability of a contract signalling an adverse selection. The insurer may charge the premiums based on its calculated average experience, but it may so happen that the low risk individual being aware of the riskiness of the enterprise may not opt for insurance. And in this process low risk prone individuals end up with less insurance, but paying a low premium. Thus the insurer exposed to high risk falls apart leading to market failure (Stiglitz and Weiss; 1981).

Specifically, the problem is more often noticed in Less Developed Countries (LDCs). There is a limited development of markets for saving, credit and insurance, and the heavy production risks are involved in the major activity of agriculture. Adding to this, the weak social enforcement of property rights, non-reliable collateral, poor reputation of the economic agent and multilateral trading arrangements. Given the unequal asset distribution, the households at least for the case of uncertain and risky productive activities work out shadow prices rather than market prices and thus in the above environment, an equilibrium

even if a competitive one may not be a Pared-Optimum (Bardhan; 1988:43). Therefore, in the above environment the standard neo-classical theory fails to capture the phenomena. The standard notion of efficiency becomes questionable. Perhaps, Greenwald and Stiglitz (1986) rightly point out that LDCs characterised by imperfect information do possess certain externalities which do not allow the market to operate even with constrained efficiency.

However, formal and informal insurance and credit institutions do operate, though under difficult conditions. Such institutions cover only a few aspects of risk like crop, price and health and under exceptional circumstances natural calamities. It is believed that given the imperfections and the volatility or risk in private markets or else informal market leads to inefficiency. Therefore, the state in these economies takes active role, in banking and insurance, by intervening to provide formal insurance to the society.

Insurance also becomes imperative from the social arrangement point as it involves uncertainties and risks. Lundahl (1995:76) points out two reasons for the social insurance arrangements. First, with regard to the life-cycle pattern of incomes and expenditures it was observed that expenditure is more or less evenly distributed in time (allowing for some uncertainties) in contrast to income which is generally unevenly distributed and exhibits a peak during the middle of ones working life. This necessitates a system which can accommodate intertemporal redistribution of incomes to facilitate required income to meet expenditures at different time points of the life-cycle. So it should allow the individual to borrow against future income and then repay and accumulate reserves for the retirement age. As the retirement age cannot be foreseen, even a perfect capital market must be complemented by a system of intergenerational income transfers or an insurance system. Secondly, due to the uncertainty of the vital events (for which insurance is sought for) such

as death. An individual may, for example, encounter a sudden rise in expenditures (seriously ill) and drastic fall in income (losing job). Both reasons are marked by risk. Therefore risk is the foundation stone of insurance. Individual having greater ability to diversify the risk and the capacity (potentiality) to bear the risk offers to share other individual's risk at a premium. This leads to a formal insurance contract which acts as a security ensuring specified indexed returns against a premium. This process which germinates from the existing differences and attitudes of risk bearing capacity of individual generates and sustains trade. An individual faces risk from different sources such as volatility of income, fluctuation in the prices of produced crops and short-fall in demand or supply. Thus any risk-averse individual looks for some kind of insurance protection for smoothing out the convexity in the function of income.

It is observed that in LDCs, both formal and informal sectors play their respective roles simultaneously with their respective advantages and disadvantages. The formal sector counts on the advantages of financial intermediation over space to reap economies of scale whereas the informal sector bases its comparative advantage due to its proximity. Therefore some economists are advocating a combination of the advantages of both the sectors so as to solve the puzzle of missing/imperfect/incomplete markets.

Thus a glance over both theoretical and empirical literature suggests that LDC markets are characterised as missing or imperfect or incomplete markets. And the suspicion is that the mechanisms of saving, credit and insurance seem to operate inefficiently through informal markets, which restrains expansion of trade. The state appears to be committed as it actively intervenes and provides formal credit and insurance mechanisms in these economies. But the policy implications are not clear. Economists have divergent opinions regarding the

state's role on the ground of market failure. Some do view that state should act as an apparatus in providing basic infrastructure facilities to prepare a ground for the efficient allocation of resources through the formal credit and insurance markets. Others feel that hierarchical bureaucracy may also face the same imperfect information problem which the private mechanisms face. These analytical considerations inform broadly our analysis of the Indian Insurance Industry which in its present form is a state monopoly.

1.3 Objectives

Against the backdrop provided in the previous two sections, the present study intends to view the insurance industry in a broad realm i.e., in the macro perspective. More specifically the study examines the growth of life insurance business in India during the period 1957 to 1993/94. The life insurance sector in India is synonymous with Life Insurance Corporation of India (LIC). The study has the following objectives:

(i) To trace the evolution of life insurance in India and its macroeconomic importance;

(ii) To examine the growth of life business in India by the analysis of insurance operations of LIC;

(iii) To examine the investment operations of LIC;

(iv) To analyse the operational efficiency of LIC; and

(v) To assess the likely implications of privatisation and foreign participation in the insurance sector in general and life insurance sector in particular.

1.4 Data and Methodology

The study depends mainly on published literature. This includes Annual Reports of the Life Insurance Corporation of India, Insurance Year Books, Reserve Bank of India Bulletins and Currency and Finance Reports, National Account Statistics published by Central Statistical Organisation and Bombay Stock Exchange Directory. Data regarding world insurance is collected from Insurance Research Letters; World Insurance Report, SIGMA; Swiss Reinsurance Company Report and Life Insurance Fact Books; American Council of Life Insurance Association, UNCTAD Reports. The author also consulted the published and unpublished data collected from National Insurance Academy, Pune and LIC Divisional Office, Trivandrum. Informal discussions with concerned official from LIC were also carried out to understand the technicalities of life insurance business.

The study follows the standard pattern of financial analysis in interpreting annual accounts. The analysis of various trends is carried out using standard econometrics techniques and software packages.

The study is confined to the LIC's life insurance business and does not cover other types of business such as Fire Insurance, Marine Insurance and General Insurance which it was carrying till GIC was nationalised in early 70's and the Capital Redemption Business. Also the LIC has expanded its activities through its subsidiaries such as, the LIC Housing and Finance, LIC Mutual Funds and LIC International, which however falls outside the scope of the present study.

1.5 Limitations of the Study

As pointed out the paucity of literature on life insurance probably stems form the fact that it involves a great deal of technical and actuarial understanding to arrive at any sort of conclusion viz., the inner dynamics of premium determination and investment decision. The former depends on the mortality rates and the actuarial calculations and the later on the market conditions and options available. But given the limited understanding of technical details at present it is not possible to look upon all these in great details. Also a lot of disaggreaged data like policies per person, differential yields from different investment operations are not available. Also given the present fluid situation as to the policy stance, it was not easy to elicit honest opinion on various matters from the insurance officials and functionaries. However, the best possible efforts have been made to incorporate the available data. Given the thin availability of analytical tools on the one hand and the paucity of relevant actuarial data from a state monopoly such as the LIC, it is difficult to set up and test well-defined hypotheses.

1.6 Schemata of the Study

The present chapter, an introductory one, has highlighted the problem, discussed the analytical considerations and specified the objectives and methodology of the study. Chapter II presents a profile of the life insurance industry in India which includes a brief survey of history and puts the life insurance industry in a macro perspective. Chapter III examines the growth of life business in India and goes into the insurance operations of LIC. The other important function of LIC, the investment operations are discussed in Chapter IV. Chapter V analyses the operational efficiency using some indicators specific for the life insurance business. Against these analyses Chapter VI discuess the issues in privatisation and foreign participation in insurance sector in general and life insurance sector in particular. The concluding chapter provides a summary of findings of the study.

CHAPTER II

THE LIFE INSURANCE INDUSTRY IN INDIA: A PROFILE

2.1 Introduction

This chapter presents a brief historical sketch of the life insurance industry in India and its relationship with the general financial development in the macroeconomy. The evolution of insurance industry in India is outlined in Section 2.2 Section 2.3 seeks to place the role of the LIC as a financial institution in the financial development of the economy.

2.2 A Brief Historical Sketch

After surveying the origin of insurance the development of life insurance business during the colonial and the post independence period are discussed.

2.2.1 Origins of Insurance

Darwin's statement "Survival of the fittest" intrinsically contains the insecurity aspect. From the evolution of human kind to the present fast paced world, constant threat to ones life exists, may it be man made or natural. As a result institutions have emerged to make life more secure. However, the concept of insurance[3] is of more recent origin. To be particular, it appeared in the account of an Italian merchant banker in the form of an inverted bottomry bond as an insurance contract in the year 1347 A D. Though modern form of insurance originated in Italy, soon after it spread to other parts of Europe. This is evident

[3] In this modern sense, the *Encyclopedia of Britannica* describes Insurance as "a social device where by a large group of individuals, through a system of equitable contributions, may reduce or eliminate certain measurable risks of economic loss common to all members of the group."

from the marine insurance and insurance over land transit in 14th century Europe. In a matter of time human life came under the purview of insurance. Though the earliest recorded life assurance, in England, dates back to 18th June 1583, yet life assurance in the modern form came into being in 1762 A D with the establishment of "The Society for Equitable Assurance on Lives and Survivourships, London" (Bhave; 1970:6).

In India, the early history of life insurance is rather obscure. Probably protection or insurance to life and property through collective cooperation induced people to volunteer their services. The Aryans had evolved a system of village and community life which stood by ravages of time and sustained the community. Referring to Rigveda F J Maclean in his book "Human side of Insurance" states that the Sanskrit term *Yogakshema* meaning well-being is found in Rigveda and some kind of commercial insurance was practised by Aryan tribes in India nearly three thousand years ago (Kumar; 1991:2). The songs of Vedic Rishis-*Yogakshemam* propagated the idea of welfare state. Also insurance has been named as *Yoakshema* in Atharvaveda (Agarwala; 1961:1). Related to the idea of welfare state, Kautilya's Arthasastra also speaks about the Kings duty as not only to protect and care but ensuring *Yogamshema* (well being) to the people.

In the early social system of India the institutions of joint family, the caste system, village community, temples and charitable institutions used to provide protection to an individual and his dependents in case of unforseen calamities. In the Aryan civilisation the village cooperatives insured against loss of profit in an industry in the early days. Indian history has reliable records of marine traded loans or carriers' contracts which included an element

of insurance. The Hindus of ancient time had a developed form of bottomry contracts[4] similar to that of Babylonians (Agarwala; 1961:1, Bhave; 1970:2, Gopalkrishnan; 1994:4). Existence of this system can be found in Kautilyas' Arthashastra and Yajnvalkya's Dharmashastra and works of Manu (Manu Smiriti). This ancient system continued in India till very recently and it was in existence in Punjab till the middle of the 19th century (Agarwala, 1961:2).

But the growth of industrialisation and urbanisation with progressive civilisation led to disintegration of joint family life and self governing village community. As a consequence, to some extent, individual was left alone to carry his burden on his own shoulders. Perhaps, against these changing environment the modern concept of life insurance entered in India. This necessitates an analysis of the changing scenario during the colonial period.

2.2.2 Development of Insurance During the Colonial Period

The deathnell of Moghul empire gave its way to the British imperialism. Fundamental changes took place in social, economic and commercial activities including expansion in banking and insurance. In the records, the first plan at the government level to form an insurance organisation was inceptioned by Sir John Child the then Governor of Bombay, 1681-90 (Kumar; 1991:4). And the first known insurance company to be established in the Bombay Island by few European merchants was the "Bombay Insurance Society" (Bhave; 1970:20).

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[4] Bottomry Contracts: A system of using a ship as security against a loan to finance a voyage, the lender loses his or her money if the ship sinks.

In the late 18th and early 19th century insurance based on European model, appeared with the establishment of seven marine insurance companies in Calcutta (Gopalkrishnan; 1994:26). The 'Oriental Life Insurance Company' was established in 1818 to serve the widows of European community but later on it accepted to insure Indians. There after some noted English life insurance companies like: the Bombay Mutual (1823), Madras Equitable (1829), Madras Widow (1834), Universal life assurance company (1840), the Christian Mutual in Punjab (1847), Tinnevelly Diocesan Council Widows' Fund of Madras (1849), and The Bengal Christian Family Pension Fund in Calcutta (1852) came up throughout India (Indian Insurance Year Book (IIYB); 1929).

Initially it operated especially in big cities and coastal towns with a limited scale of operation. It started spreading its wings to other parts during the 20th century. However, the growth of both Life (see Table 2.1) and General Insurance was thwarted because of dogmatic and negative attitude towards life insurance, ignorance about insurance, non-reliable mortality tables and poor living conditions, absence of industrialisation and unscientific and disorganised manner in which the predominant production activity of agriculture was carried out. Therefore, most of the newly introduced English insurance companies either reconstructed or liquidated or absorbed due to mismanagement and lack of funds. And till the early 2nd half of the 19th century only a few European companies were operating in India but on a small scale. But sincere efforts were made to write life insurance business scientifically. In these earlier years noted social reformers like Raja Ram Mohan Roy, Rustomji Cowasji and Dwarakanath Tagore were catalysts in the development of life insurance in India.

Table 2.1: Growth of Life Insurance in India

Year	1914	1915	1920	1925	1930	1935	1940	1945	1950	1955
No. of Insurer of which Indian	49 36	 40	 43	 49	 110	 215	 179	215 198	 185	245 149
New Business a.No of Policies b.Sum Assured	 3.20	 2.25	 28 5.16	 43 8.15	 145 27.50	 239 43.50	 206 36.11	 599 136.3	 498 139.5	 831 260.8
Busines in Force a.No of Policies b.Sum Assured					 564 124	 1095 235	 1553 286	 2392 557	 3280 780	 4782 1220
Life Fund	6.36	6.77	8.47	12.57	20.53	35.19	62.41	107.4	181.5	299.7

Source: Indian Insurance Year Book; 1929-30-39-45-55-56
Agarwala (1961): Growth in Life Insurance in India; pp:21-73
Bhave (1970): Saga of Security: Story of Indian Life Insurance; pp:340-351
Note: No of policies are in '000 and Sum Assured are Rupees in crores.

However, the Indian companies were guided by the general Indian Companies Act 1866 which covered all companies including insurance companies, but no specific insurance act was enacted for the smooth functioning of insurance business. For the first time the British Government enacted Insurance Act in 1870 to prevent liquidation of the insurance companies (Kumar; 1991:6). Incidentally at this time the first Indian Insurance company the "Bombay Mutual Life Assurance Society" (1871) was formed and a first attempt was made to treat the Indian lives at normal rate (premiums in par with European lives) in a large scale. During this period, some of the Indian companies established were: General Family Pension Fund (1870), The Hindu Family (1872) in Bengal Presidency, Oriental (1874) and the Hindu Mutual (1891) and the Empire of India (1897) in Bombay Presidency, the Indian Christian and Mangalore, Roman Catholic in 80's in Madras Presidency (IIYB; 1930). At the same time lot of foreign companies were operating in India with handsome business.

After 1870's and by early 20th century the insurance companies were able to come over many difficulties, proved successful and even attracted foreign companies. But mostly elite classes like government servants, advocates, barristers and merchants were brought under insurance coverage. One of the significant feature is that the Indian companies were charging the same premium rates on Indian lives as their foreign counterparts were charging on European lives. This period laid the foundation for the working of life insurance business on scientific lines and a wave of Swedeshism promoted Indian companies by the turn of the century. It has been said that the swedeshi movement of 1905, the non-cooperative movement of 1919 and the civil disobedience movement of 1929 were milestones in the history of Indian insurance as these movements were primarily responsible for generating the spirit of Indianness. Adding to this new spirit, improved conditions of human life and economic expansion changed the attitude towards life insurance, opening new opportunities for life insurance. For the next two decades beginning from the twentieth century a rapid growth was registered. Eight big offices were established such as: the National Indian (1906) and the Hindustan Cooperative (1907) in Bengal Presidency, Bombay Life Assurance (1908), the Western India (1913) and the Industrial and Prudential (1913) in Bombay Presidency, the Asiatic(1913) in Madras Presidency marking a well established insurance enterprise (IIYB; 1930). But these offices were operating with a limited business, accumulating small amount of life funds and mostly issuing endowment policies. Major part of their investment was in government securities earning a decent rate of interest. However, along with these mushrooming of insurance business, some British as well as Indian companies failed miserably. In the mean time to regulate the activities and prevent speculation in life business the British Parliament passed an Act in 1909 and along with this in India too-the Life Insurance Companies Act 1912 and the Provident Fund Act 1912 were passed (Kumar; 1991:9, Agarwala; 1961:25). Though this act was a significant step towards

the advancement of insurance business in India but the discriminatory attitude by the government towards Indian companies in relation to their British counterparts remained the same, leading to a strong pressure for amending the act.

Improvement in over all conditions: spread of education, improved socio-political conditions and standard of Indian lives induced the life insurance enterprise in the subsequent period. Seven big companies were established in the following years of the present century, including New India (1919) and Jupiter (1919) in Bombay Presidency, Lakshmi (1924) in Punjab Presidency and Andhra (1925) in Madras Presidency. In the year 1922, 24 non-Indian life offices transacted business in this country of which 17 were British companies, 4 colonial, 2 constituted in Shanghai and 1 American (Agarwala; 1961:28-29). This period registered rise in volume of total life business, accumulation of huge funds and out of which bulk of the endowment policies were invested in government securities. During the second world war the freedom fighters like Mahatma Gandhi, Lala Lajpat Rai, Pandit Motila Nehru were instrumental in upbringing Indian insurance companies and exerted pressure on the government to repeal the discriminatory Insurance Act. Owing to the pressure the Insurance Companies Act 1912 was amended in 1928. Around this time the Indian life insurance companies felt the need to form national association for the benefit of common cause with the initiatives of Pandit K Santhanam. To protect the interests of the industry an all India organisation "All Indian Life Officer's Association" was formed on 2nd April 1928 (Kumar; 1991:10-11).

Concomitant to these organisational and legislative developments the industry witnessed the growth of life insurance in terms of increase in number of companies and volume of business, particularly for the Indian life insurance companies this phase was a period of

boom and prosperity as they outpaced the non-Indian insurance business in India. Some note worthy companies were: Metropolitan, New Asiatic, Warden and Ruby General. The first Indian Insurance Year Book published in 1914 quotes the figure of the total business force as Rs.22.44 crores which increased to Rs.298 crores in 1938, number of companies transacted business also increased from 44 to 176. Though the investment of the life fund was in government securities, the investment in corporate securities increased. At the same time the life insurance enterprise became widely diversified throughout the country. In response to this enormous growth Indian companies urged for new legislation of Insurance Act to protect the interest of the policy holder ensuring sound business. After lot of deliberations and committees the first comprehensive legislation, The Insurance Act 1938, came into force encompassing both life and non-life branches of insurance to provide state control over insurance business (IIYB; 1939, Kumar; 1991:13). This provided sound guidelines for smooth business and as it was quite effective in the initial period in checking speculative business and large scale liquidation. From time to time: 1939, 1940, 1941, 1949 and 1955 this was amended to overcome remaining shortcomings and Insurance Act 1958 was passed.

In spite of enormous growth the per capita insurance in India was very low compared to other developed countries. The per capita insurance in India was only Rs.1 and eight annas (Re1.50) which increased to Rs.8 in 1944 and Rs. 25 in 1955, where as for USA it was Rs.2000, Canada Rs.1300, Great Britain Rs.600 (Kumar; 1991:16). The growing business brought in malpractices, liquidation of companies, and increase in speculative trading of insurance companies which lead to public distrust and resentment. Though efforts were made to regulate and control the insurance business the business was mainly remain in the hands of some large industrial houses and managerial agencies consequently bringing in

mismanagement and manipulation of life funds and demanded a close scrutiny. In 1946 a bill was introduced based on the recommendation made by Sir Cowsaji Jehangir Committee Report[5]. The bill known as the Insurance Act 1950 was passed by the Indian Parliament, which ensured strict strictures for smooth operation of insurance business to restore public confidence. Yet the genuine efforts were overlooked by the unscrupulous insurance business men. Thus the idea of nationalisattion gave its birth in the background.

2.2.3 The Post-Independence Developments

Prior to independence the Indian National Congress was also in favour of nationalisation of insurance. In this direction in 1938 National Planning Commission was set up under the chairmanship of Pandit Jawharlal Nehru. One of the sub-committee submitted report in 1946 headed by Sir Chunilal Umeneta after examining the working and role of insurance industry in national economy perspective. The sub-committee viewed insurance as a social device and can be effectively under state control though it did not categorically recommended for nationalisation. But the idea took its shape with the introduction of the concept of `mixed economy' after independence which aimed at state control over strategically important activities for economic development. Further, in 1955 the Avadi Congress adopted a resolution for planned development of the economy to establish a socialistic pattern of society and favoured nationalisation of insurance business and be brought under public sector. And in this perspective financing planned development programmes through banks and insurance assumes importance.

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[5] In 1945 a committee was appointed by the government under the chairmanship of Sir Cowasji Jehangir to enquire into the undesirable developments in the management of insurance companies in India and to recommend effective measures to check manipulation of funds, interlocking between banks and insurance companies by financiers having acquired control of the companies and proliferating short-term management policies.

By 1956, 154 Indian insurers, 16 non-Indian insurers and 75 provident societies were carrying on life insurance business in India. But on 19th January 1956, by an unprecedented move the management of life insurance business was taken over by the Central Government and nationalised on 1st September 1956. And by an Act of Parliament, Life Insurance Corporation (LIC) was formed with capital contribution of Rs.5 crore from the Government of India.

The avowed objectives of nationalisation of life insurance business outlined as: (1) to conduct the business with the utmost economy in a trusteeship spirit, (ii) to charge premiums as low as possible consistent with actuarial valuation, (iii) to invest funds to accrue maximum yield vis-a-vis ensuring safety of capital, (iv) to render prompt and efficient service to make insurance widely popular (Malhotra committee Report; 1994:7, Kumar; 1991:47). Thus the nationalisation aimed at overcoming the inefficiency and malpractices involved during the period of private insurance operations, to make life insurance widespread under government control, to restore public confidence and to ensure maximum security to the policy holders' capital.

At the same time nationalisation also aimed at using the funds, available with LIC, for the development purposes of the five year plans. Further, in 1974 as a follow-up to the recommendations suggested by the Administrative Reforms Committee[6], the LIC explicitly outlined its objectives, briefly as follows: (i) to spread the message of life insurance as widely

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[6] The ARC was set up by GOI on 5th January 1966 under the chairmanship of Sri Moraji Desai and under it a Working Group on Life Insurance Administration constituted in August 1967 to examine the organisation and working of the corporation in the light of the requirements of LIC Act and to make suitable recommendations for the improvement of the business, service to policy holders, etc., (Annual Report of LIC; 1968:15).

as possible to provide life insurance to all insurable population[7] engulfing both urban and neglected rural areas and socially and economically backward classes, (ii) to provide maximum security to the policy holder, (iii) to provide prompt and efficient service by promoting a sense of participation, pride and job satisfaction among all the agents and employees of LIC and to devise different products so as to suit different sections of the community in the changing social and economic environment. In a nutshell, it was aimed at bringing all possible sections of the society under life insurance umbrella by availing it cheaply, maintaining it economically and increasing the productivity of the personnel. It will be useful to connect this outline of the evolution of life insurance (see the growth of life insurance in Table 2.1) industry in India to the general financial development of the economy in the post independence period.

2.3 A Macro Perspective

The purpose of this section is to survey the literature on the relation between economic growth and financial development and to place in perspective the role of the LIC as a major financial institution in the process.

2.3.1 Financial Intermediation

Concomitant to development, in an economy, a dichotomy emerges between decision to save and decision to invest, due to non correspondence of asymmetric distribution of savings and distribution of investment expenditures among the economic units (Bhatia and Khatkhate; 1975:133). Consequently the deficit units (investors) will spend more than what they earn. On the other hand the surplus units (savers) earn in excess of what they spend. In the

[7] LIC takes into account the male population in the age group of 20 to 60 years as 'Insurable Population'.

absence of any intermediation, as it happens to be that savers are always not the investors, the savings of surplus units cannot be transferred to deficit units restricting the inter-sectoral flow of funds. Investors would be forced to limit their investment to the availability of funds. And the savers would tend to save in the form of tangible assets like land, jewellery, mansions which are of low value to economic growth (Furness; 1972:11). This leads to a balanced budget position with saving equals investment. This sort of arrangement would result in a relatively low level of investment and saving, and hence relatively low growth of output (Gurley and Shaw; 1960:196).

Deficit units obtain funds from surplus units directly or indirectly. It is direct when they issue claims against them. It is indirect when deficit units issue claims to the intermediaries and obtain finance.[8] In turn, the intermediaries issue secondary securities which are claims against them to surplus units to mobilise their savings. By doing so, they absorb primary securities and transform them into secondary securities of a higher market price. The difference between the rate of return on primary and secondary securities is a reward for their services (Gurley and Shaw; 1960:193).

Channeling savings via financial intermediaries do have certain advantages such as: reduction in transaction and information costs and credit risks, creation of liquidity by short term borrowing and long term lending, overcoming indivisibility or lumpiness of investment projects, diversification of investments and reaping the advantages of economics of scale (Gibson and Tsakaltos; 1994:582-583).

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[8] In a growing monetized economy, for a variety of reasons, its importance declines, and hence indirect finance through financial intermediation increases (Khatkhate and Bhatia; 1975:133).

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To facilitate channelisation of savings requires financial intermediaries, financial instruments and financial assets. A system consisting of these is called financial system. As argued by Patrick, such a system can support and sustain real sectors in the growth process (Patrick; 1966:175). The next section discusses on the need of financial development for economic growth.

2.3.2 Financial development and economic growth

There is a great deal of literature stressing the relationship between financial development and economic growth.[9] Financial development involves a change in the character of existing financial institutions and emergence of a new financial institutions, creation of new types of financial instruments and increase of total stock of financial assets relative to the stock of tangible assets. It is expected to raise saving and investment equilibrium in relation to income of the economy. It is asserted that financial structure accelerates economic growth and improves economic performance to the extent it facilitates channelising funds to sectors with higher social returns (Goldsmith; 1969: 400).

The design and performance of a financial system may stimulate savings and investment in productive use or it may retard savings and divert it to inefficient use (Gurley and Shaw; 1960: 47). Hence, characterisation of financial system in an economy becomes important. It can be demand-following or supply-leading (Pattrick; 1960:198). It is demand-following financial institutions, their financial assets and liabilities, and related financial services are created in response to the demand for their services. When such institutions and services

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[9] For instance, Gurley and Shaw (1960, 1967, 1968), Patrick (1966), Goldsmith (1969) Mckinnon (1973) Shaw (1973), Greenword and Jovanovic (1990), Bencivenga and Smith (1991), and King and Levine (1993).

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are created in advance of their demand, the supply-leading phenomenon characterises the financial system of the economy. Patrick argues that the demand for financial services depends on the growth of real output that results in greater need for intermediation to transfer savings. Thus, demand-following financial system can support and sustain the leading sectors in the process of growth. The supply-leading financial system transfers resources from non-growth sector to growth-oriented sector. It also offers possible avenues to invest and induce real growth by financial means. It is, thus, likely to play an important role in early stages of economic development. As the process of real growth occurs, the supply-leading financial system impetus gradually diminishes and the demand-following becomes dominant. Having discussed the relationship between financial development and economic growth, development and nature of Indian financial system is examined.

2.3.3 The Development of Indian Financial System

At the time of independence the Indian economy was characterised by low growth due to low rates of saving and investment and low capital formation (RBI, 1985:4). Thus emphasis was given to raise the rate of capital formation by stepping up investment. In this context, the First Five Year Plan assigned a greater role to financial system for resource mobilisation (GOI, 1951; 12-16). The existing literature on Indian financial system (Avdhani; 1978, Goldsmith; 1983, Gupta; 1994, Morris; 1985, Rangarajan and Jadhav; 1992) gives ample evidence that there has been a metamorphic transformation of Indian financial systems, which can be comparable to the patterns of developed countries. And financial system pursed was more characteristic of supply-leading (Rangarajan and Jadav; 1992:159).

Financial development can be captured by using some standard ratios. They are:

Finance Ratio (FR) - defined as the ratio of total financial claims issued in an economy to the national income. This ratio indicates the relationship between current flow of financial and real variables.

Financial Intermediation Ratio (FIR) - defined as the ratio of total volume of financial assets in the economy to net capital formation. It reflects the role of financial system in financing investment.

New Issue Ratio (NIR) - defined as the ratio of primary claims issued by the non-financial institutions to the net capital formation in the economy. It indicates the direct resource mobilisation efforts on the part of the non-financial sectors.

Intermediation Ratio (IR) - defined as the proportion of secondary issues to primary issues. It indicates the degree of institutionalisation of borrowing and lending.

These ratios given in Table 2.2. From Table 2.2 tthe upward movement in FR, FIR, NIR and IR reflects the development of Indian financial system during the last three and half decades. The significant rise in FR over the years outlines the growing and important role of financial structure in the economy. So also the rising FIR reflects the increasing role of financial system in moping up funds in the economy for investment purposes. The growth had been higher than that of investment. This confirms the existence of hypothesis of Gurley and Shaw (1960) and Goldsmith (1969) that overtime as economy grows, financial system registers a rapid growth in financial assets relative to national income or wealth.

Table 2.2: Indicators of financial development in Indian economy (Annual Averages)

Indicator	1951/52 to 1955/56	1956/57 to 1960/61	1961/62 to 1965/66	1966/67 to 1969/70	1970/71 to 1974/75	1975/76 to 1979/80	1980/81 to 1984/85	1985/86 to 1989/90
FR	0.04	0.09	0.12	0.13	0.17	0.28	0.34	0.39
FIR	0.63	0.85	0.98	0.93	1.09	1.52	2.28	2.46
NIR	0.46	0.58	0.67	0.63	0.62	0.82	1.37	1.41
IR	0.37	0.47	0.46	0.48	0.77	0.75	0.69	0.75

Source: Flow-of-Funds Accounts of the Indian Economy, RBI Bulletin; Various Issues

Financial claims consists of both primary and secondary issues. The rise in FIR is, hence, a result of a rise in primary claims issued by non financial sector or rise in secondary issues issued by financial sector or rise in both. The increasing NIR indicates the extent of primary claims issued by non financial sectors, implying the increased role of direct financing in the economy. The IR shows an increase in late 60's followed by a decline up to early 80's.

And it has improved along with NIR since then, indicating increased role of financial sector too.

2.3.4 Indian Financial Institutions

Functionally, Indian financial markets broadly consists of money market and capital market. The former deals with short term funds and the later with medium and long term funds. Structurally, both money market and capital market can be classified as Organised sector, runs in the modern lines and regulated by RBI, and Unorganised sector or traditional sector or better known as informal credit market'. The organised money market and capital market comprises of RBI, banks, non banking financial intermediaries (NBFIs) and the stock market. The unorganised sector is made up of indigenous bankers, local money lenders, unregistered chit funds and nidhis and similar other informal institutions. In the

post independence phase, with the growth of banking and other financial institutions, the role of unorganised sector had shrinked and its operations were limited (Gupta;1990; 46–48).

Broadly, the organised sector can be classified as banking and other non banking financial institutions (NBFIs) with RBI as apex bank. Banking includes both commercial (scheduled and non scheduled) and cooperative banks. The NBFIs includes development banks, insurance corporations, provident fund and post offices, and others such as leasing, investment and financial companies. Among these, the development banks and insurance corporations are special term lending institutions and provides medium and long term funds. The importance of these institutions can be assessed from their relative share of resources mobilised (see Table 2.3).

As seen in Table 2.3, it is clear that the share of non-financial sector, though is higher, shows a declining trend with a simultaneous increase in the share of financial sector. Within the financial sector, share of banking has gone down since mid 70's and that of other financial institutions has gone up. This lends support to the hypothesis of Goldsmith (1969: 46-47) that as economic development takes place, banking system looses its share to other financial institutions such as mortgage banks, life insurance companies, investment companies, pension funds and finance companies.

The development of financial structure, with the growth in financial institutions and increase in the available financial instruments, raises the savings in the economy, a prime mover of growth process. One of the major obstacle at the time of independence was the low savings rate. Savings as a proportion of GDP increased from around 12 percent in mid 50's to more

than 20 percent in early 90's (see Table 2.4). Thus there has been a significant step up in the savings ratio of the economy and the financial institutions have played an important role in enabling the economy to achieve this.

Table 2.3: Percentage Share of Financial Flows by Sectors (Annual Averages)

Sectors	1956/57 1960/61	1961/62 1965/66	1966/67 1970/71	1971/72 1975/76	1976/77 1980/81	1981/82 1985/86	1986/87 1990/91
1.All Financial Institutions	32.4	32.4	36.0	43.3	42.6	41.0	41.8
a.Banking	24.5	22.6	24.9	32.1	30.3	28.8	25.7
b.Other Financial Institutions	7.9	9.8	11.1	11.2	12.3	12.2	16.1
2.Non Financial Institutions	67.6	67.6	64.0	56.7	57.4	61.0	59.2
a.Private Corporate Business	14.7	14.1	9.8	10.1	9.5	13.4	13.1
b.Government	53.1	44.3	41.5	35.7	33.7	37.8	39.4
c.Household	8.4	8.6	11.6	8.5	10.3	8.0	8.6
d.Rest of the World	8.6	0.6	1.1	2.4	3.9	0.8	- 1.9
3.Total (1+2)	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1.Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
a.Banking	69.8	69.2	74.1	71.1	70.2	68.8	61.5
b.Other Financial Institutions	30.2	30.8	25.9	28.9	29.8	31.2	38.5

Source: Flow-of-Funds Accounts of the Indian Economy, RBI Bulletin; Various Issues

The development of financial structure, with the growth in financial institutions and innovations of financial instruments, raises the savings in the economy. As a corollary to financial development, savings as a proportion of GDP increased from around 12 percent in mid 50's to more than 20 percent in early 90's (see Table 2.4).

As seen in Table 2.4 a major proportion of savings comes from household sector[10]. The household savings are held in financial and physical assets of which the relative share of the former has increased. Commensurate with the growth of financial institutions and

[10] The household sector consists of individuals, unincorporate business enterprises, farm production units and non profit making organisations.

instruments, range of forms of savings in financial assets also widens. Table 2.4 gives the relative magnitude of different financial assets held by the household sect.

Table 2.4: Percentage distribution of Gross Domestic Savings by type of institution at Current Prices (Annual Averages)

Sector	1956/57 1960/61	1961/62 1965/66	1966/67 1970/71	1971/72 1975/76	1976/77 1980/81	1981/82 1985/86	1986/87 1990/91	1991/92 1993/94
1.Household	73.27	63.21	74.17	71.80	72.56	72.23	81.20	79.49
2.Private Corporate	10.24	13.00	9.14	9.55	7.46	8.86	9.90	15.23
3.Public	16.48	23.79	16.69	18.65	19.98	18.91	8.90	5.28
Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
GDS/GDP	11.90	13.20	14.40	17.30	21.70	19.10	21.40	21.10
1.Household Savings	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
a.Financial Savings	31.28	38.22	24.47	34.52	38.00	49.82	45.17	54.48
b.Physical Savings	68.72	61.78	75.53	65.48	62.00	50.18	54.83	45.52

Source: National Account Statistics (CSO); New Series 1989, 1991, 1993, 1995.
Note: GDP is at market price.

Table 2.5: Percentage distribution of Household Financial Savings at Current Prices (Annual Averages)

Sector	1956/57 1960/61	1961/62 1965/66	1966/67 1970/71	1971/72 1975/76	1976/77 1980/81	1981/82 1985/86	1986/87 1990/91	1991/92 1993/94
1.Currency	24.95	25.64	25.00	16.97	19.69	14.93	15.82	13.65
2.Net Deposits	10.03	23.05	21.52	35.97	37.94	31.12	24.24	24.77
3.Shares & Debentures	14.37	14.65	9.34	3.01	3.73	7.12	11.10	19.92
4.Net Govt Claims	18.00	-1.23	-7.79	0.42	3.97	14.76	14.36	7.82
5.Life Fund	9.88	12.30	14.96	11.72	10.26	9.21	10.21	11.22
6.Provident & Pension Fund	22.77	25.60	36.96	31.91	24.41	22.86	24.27	22.62
Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

Source: National Account Statistics (CSO); Various Issues

As seen in Table 2.5 savings in the form of currency has declined since the early 70s. Savings in the form of net deposits has, though has increased till late 70s, declined in the 80's. The proportion of savings in the form of shares and debentures had registered a spectacular increase since the mid 80s, may be due to spurt in the capital market. The other important form of financial savings of the household sector is contractual savings in the form of life insurance, provident and pension funds. Provident and pension fund share constituted 23 per cent in late 50's which increased to 37 per cent in late 70's and it was 23 per cent in the early 90's. Savings in life insurance fund has remained around 10 percent throughout the period excepting in the 60's. As mentioned, the increase in the household savings is mainly a result of increased financial savings. This had been a consequence of growth of financial system. Of which, banking and insurance played a major role in the mobilisation of savings. The importance of these institutions in the economy can be better understood from their contribution to GDP (see Table 2.6).

Table 2.6: Percentage Share of Banking and Insurance to GDP at Current Prices
(Annual Averages)

Sector	1956/57 1960/61	1961/62 1965/66	1966/67 1970/71	1971/72 1975/76	1976/77 1980/81	1981/82 1985/86	1986/87
1.Banking & Insurance	1.23	1.43	1.87	2.67	3.20	3.82	4.57
a.Banking	0.77	0.94	1.25	1.93	2.46	2.94	3.61
b.Insurance	0.46	0.48	0.63	0.73	0.74	0.87	0.97
c.Life Insurance	0.34	0.36	0.40	0.43	0.45	0.52	0.62

Source: National Account Statistics (CSO); Various Issues

The share of banking and insurance together as a percentage of GDP has shown a continuous rise. With in banking and insurance, share of banking increased from 0.8 percent to 3.6 percent, insurance from 0.5 percent to 0.9 percent and of which life insurance from 0.3 percent to 0.6 percent for the above period

The above discussion brings out the role played by financial sector in mobilisation and financialisation of savings in the economy. However, striking a balance between their economic and social objectives needs to be kept in view while understanding their role. This assumes significance in the wake of financial sector reforms.

The financial sector reforms were initiated on the lines of recommendations of Narasihmam Committee. Malhotra Committee Report too suggested certain series of reforms in insurance industry. Reforms addressed in the case of insurance industry focussed on privatisation and foreign participation. The reforms aim to improve the operational efficiency. and for imparting more competitiveness. However, before evolving more meaningful and effective reforms package concerning insurance sector, it is crucial to understand the societal and economic role of this sector, particularly life insurance. The following chapter examines the role of life insurance in the economy.

CHAPTER III

INSURANCE OPERATIONS

3.1 Introduction

Life insurance business in India, as noted, was nationalized to develop it as a social security cover for all sections of the society and as an important mechanism for channelling the savings of people for national development programmes. Against this backdrop the present chapter analyses the progress of life insurance business in India since its nationalization in 1956. It goes into the operating results of the Life Insurance Corporation (LIC) and their macroeconomic importance. The main objective of this chapter is to capture the pattern and growth of life insurance business in India. Specifically, it deals with the analysis of growth new business, business in force, income and outgo (financial outflow) and life fund i.e., institutionalization of savings. Also included are the analysis of rural business and business by different zones of LIC.

3.2 New Business

In this section the focus will be on new business, individual as well as group. New Business refers to the business contracted during a given year. The analysis will be in terms of constant, 1980/81 prices using the GDP implicit deflator for the life insurance sector computed from National Account Statistics published by the Central Statistical Organization.

New Business in terms of sum assured (individual as well as group policies) grew from about Rs.3300 crores (1980/81 prices) in 1962/63 to about Rs.9300 crores in 1983/84 and further to over Rs.28000 crores in 1992/93 (see Table 3.1). And new business in terms of individual

policies increased from 18 lakhs to 24 lakhs and further to 100 policies over the same period. The number of members in group policies increased from about 74 lakhs in 1983/84 to about 180 lakhs in 1992/93.

Table 3.1: Growth in New Business (at 1980/81 prices)[1]

Year	1962/63	1983/84	1992/93
Sum assured (Rs.crores)			
1.Total	3319	9291	28378
2.Individual	3319	3434	13478
3.Group	-	5857	14899
Number (in lakhs) of			
1.Individual Policies	17.68	23.71	99.68
2.Group Members[2]	-	73.78	180.44

Source: Annual Reports of LIC; Various Issues
Note: (1) Nominal Values have been deflated using the implicit GDP deflator for the life insurance sector. The deflator was computed from CSO (1990, 1992, 1993, 1995). (2) Individuals may be holding more than one individual policy. They may also be members of a group policy simultaneously.

It will be seen that much of the growth in business occurred during the decade beginning 1983/84. Also evident from Table 3.1 is the sharp growth in group business during the 80's. The sharp break in the trends of new business, individual as well as group business, is evident from Figure 3.1.

A regression analysis[11] of the growth rates for two sub-periods clearly brings out the acceleration in the growth of sum assured as well as number of policies during the decade after 1983/84 (see Table 3.2). In both the sub-periods the individual insurance from Indian registered foreign business has shown a decline, as the proportion of new business out of

[11] The growth rates are calculated by using a kinked exponential fit. The results are given in Appendix 3A.

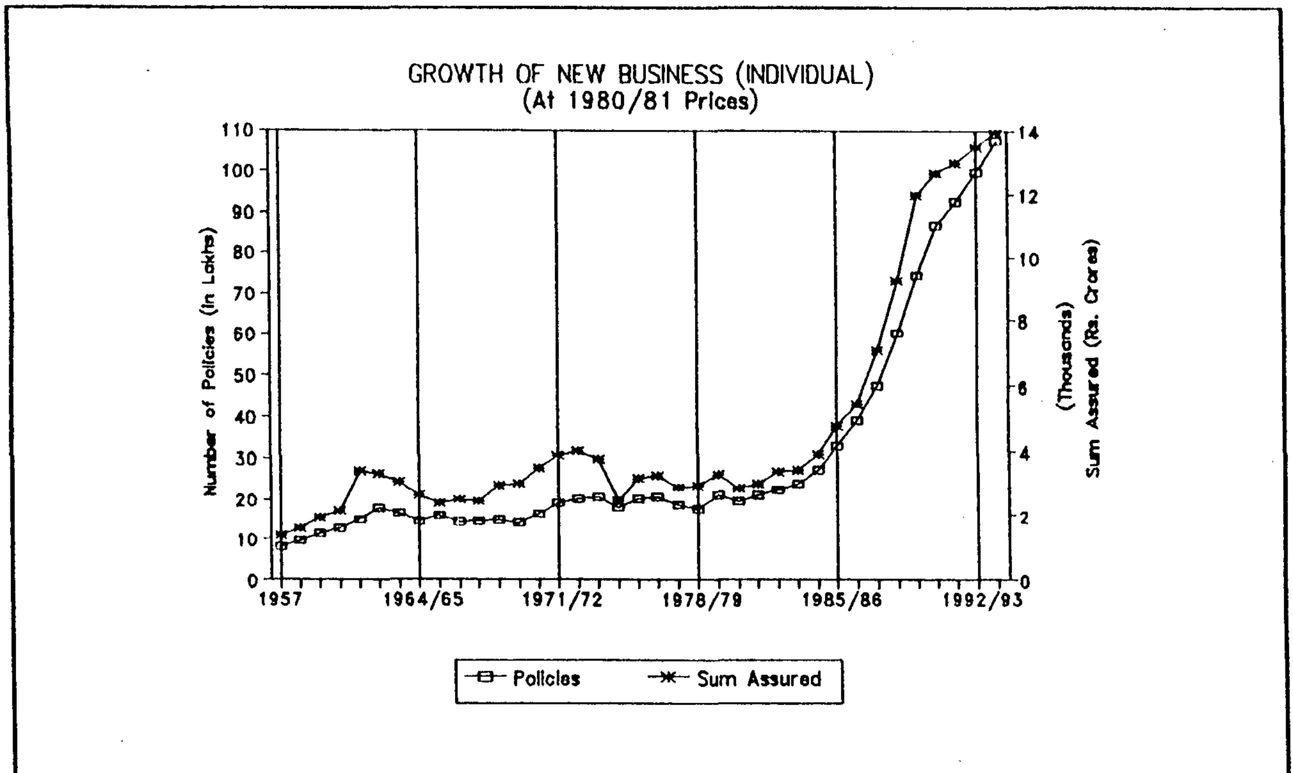

Figure 3.1 A

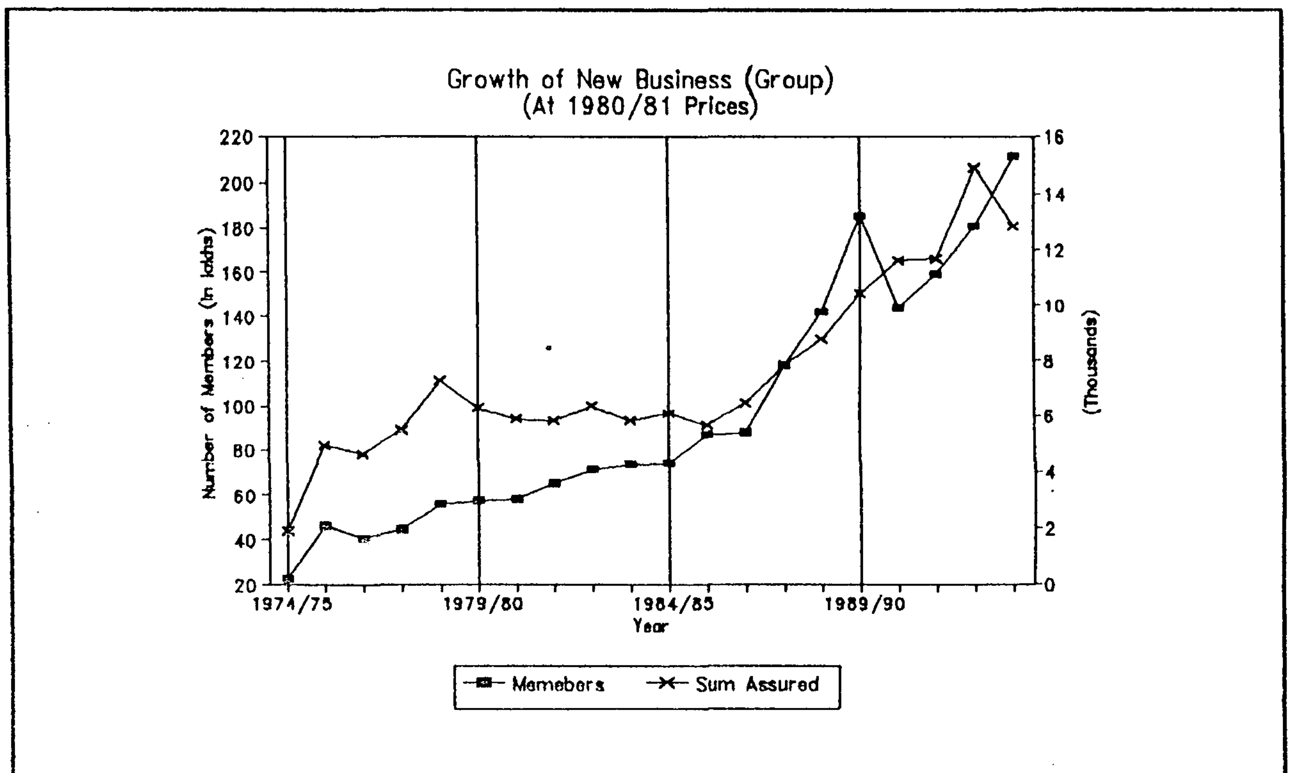

Figure 3.1 B

India to the total new business individual has dropped on an average from 0.35 to 0.15 percent in terms of policies and from 1.05 to 0.42 percent in terms of sum assured.

Table 3.2: Growth Rates[1] of Inflation-Adjusted[2] New Business (in percent per annum)

New Business	Sum Assured	No of Policies	No of Members
Total New Business			
(i)1957 to 1983/84	7.41	-	-
(ii)1983/84 to 1993/94	10.09	-	-
Individual Business[3]			
(i)1957 to 1983/84	2.32	3.16	-
(ii)1983/84 to 1993/94	15.18	16.39	-
Group Business[4]			
(i)1966/67 to 1983/84	37.55	-	17.19
(ii)1983/84 to 1993/94	8.89	-	11.73

Source: Annual Reports of LIC; Various Issues.

Note: (1) The periodwise growth rates are estimated using a Kinked-Exponential Fit of the type Ln(Y)=A+B(D1t+D2k)+C(D2t-D2k)+e; where Y is the dependent variable, t is the time period, k is the kink, B and C are the growth rates for the respective periods and D1 is 1 in the first sub-period and 0 otherwise and D2 is 1 in the second sub-period and 0 otherwise. (2) The inflation-adjusted growth rates are arrived at by deflating the nominal values using implicit GDP deflator for life insurance sector computed from the NAS of CSO. For the years 1957 through 1961 and 1993/94 GNP deflator has been used for lack of data. (3) The individual insurance figures includes Indian registered foreign life insurance business of LIC. (4.a) Separate figures for group insurance became available only after 1966/67 for sum assured and 1974/75 for number of Members; inclusive of group gratuity and group superannuation schemes. (4.b) For the group insurance, averages of simple growth rates are taken as it was found that due to yearly fluctuations the Kinked-Exponential fit found to be unacceptable.

Thus, the decade beginning 1983/84 witnessed a significant growth in new business both in terms of policies and sum assured. Two reasons may be offered for this. First, the growth and development of life insurance business is closely related to the general economic development of a country[12]. In the earlier decades the macro-economic conditions were not

[12] A study by UNCTAD have shown that life insurance business is inextricably interwoven with economic development (UNCTAD Document; 1993). Also, a study by Agarwala (1961) also confirms this hypothesis.

conducive for growth in life business e.g., low GDP growth, low savings rate of the household sector, especially financial savings, and various macro-economic shocks in the form of fluctuation in agricultural production, oil shocks in 70's. Secondly, important organizational and administrative changes in the sub-period II helped to tone up the operations of the corporation. With the growth and expansion of business, it became difficult to cope with a highly centralized functioning of the corporation. The divisional Offices were not entrusted with enough decision making power and branch offices too had limited independent power of selling and servicing functions. Following the recommendations of various committees[13] the corporation started implementing reorganization schemes. And these measures were carried out intensively from 1981/82 and completed in three phases in 1983/84[14]. These measures included autonomy to divisional offices, branch offices being single focal point of sale and service[15], Computerization and staff development.

The sharp growth in group insurance upto early 80's may have been be due to an increase in the renewal of existing members or increase in the coverage of new members. The new members as a proportion of total members covered under new business has declined from 21.85 percent to 17.65 percent in sub-period II, but in terms of sum assured it increased from 38.57 to 52.37 percent. It has also been observed that although there is a substantial

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[13] The Administrative Reforms Commission recommended detailed measures to improve the organizational and administrative set up. And this is followed by Nayude Committee (1971), Thappar Committee (1974), Ramanathan Committee (1977) and the Era Sezhian Committee (1979). The committees dwelt this aspect in depth and suggested measures for organizational changes (see Kumar; 1991 :341-364).

[14] The first phase of reorganization schemes implemented in three divisional offices, Delhi, Bangalore and Cuddaph (Annual Reports of LIC; 1982).

[15] Branch offices were made as accounting units and profit centers.

growth in the coverage of members and sum assured in both the sub-periods, the real growth of individual sum assured is less than that of policies in both the sub-periods and the group sum assured is less in the sub-period II. Thus in the sub-period II group insurance is provided comparatively with low sum assured. And this is due to the increase in different social security schemes which includes central government sponsored and subsidized group insurance schemes specially targeted for the rural and weaker section of the society. Therefore, both individual and group insurance is provided with a lower real sum assured and among these group insurance is provided with much lower sum assured.

3.3 Business in Force

Business in force refers to the total business at the end of the financial year. Broad trends of business in force, individual as well as group, in terms of constant, 1980/81 prices appear in Table 3.3.

Table 3.3: Growth of Business in Force (at 1980/81 prices)[1]

Year	1962/63	1983/84	1992/93
Sum assured (Rs.crores)			
1.Total	14082	30883	82692
2.Individual	14082	23666	66477
3.Group		7217	16215
Number (in lakhs) of			
1.Individual policies	94.93	253.24	566.79
2.Group members	-	76.64	215.23

Source: Annual Reports of LIC; Various Issues

Note: (1) Nominal Values have been deflated using the implicit GDP deflator for the life insurance sector. The deflator has been computed from CSO (1989, 1992, 1995)

Business in force in terms of sum assured (individual as well as group policies) grew from about Rs.14000 crores (at 1980/81 prices) in 1962/63 to about Rs.30900 crores in 1983/94

and further about Rs.82700 in 1992/93. The individual policies in force increased from 95 lakhs in 1962/63 to 253 lakhs in 1983/84 and further to 567 lakhs in 1992/93. The figures reflect the sharp growth in business during the 80's as noted in the previous section. The underlying trend can be seen more vividly in Figure 3.2.

A regression analysis of the growth rates of business in force for two sub-periods is presented in Table 3.4. A clear acceleration in the business in force in the aggregate as well as for individual policies during the 80's evident.

Table 3.4: Growth Rates[1] of Inflation-Adjusted[2] Business in Force

(in percent per annum)

Business in Force	Sum Assured	No of Policies	No of Members
Total Business			
(i)1957 to 1983/84	4.81	-	-
(ii)1983/84 to 1993/94	8.90	-	-
Individual Business[3]			
(i)1957 to 1983/84	3.44	5.18	-
(ii)1983/84 to 1993/94	9.66	7.29	-
Group Business[4]			
(i)1970/71 to 1983/84	32.49	-	32.38
(ii)1983/84 to 1993/94	8.57	-	1.31

Source: Annual Reports of LIC; Various Issues

Note: (1) In growth rate computation the same procedure is followed as in Table 3.1 (2) The same deflator has been used for estimating the real growth rates as in table 3.1. (3.a) Separate figures for group insurance became available from 1970/71 only. (3b) The individual business figures includes Indian registered foreign life insurance business of LIC. (4) For the group insurance, the averages of simple growth rates has been taken.

There is a decline in the percentage share of Indian registered foreign business from 1.29 to 0.16 percent in terms of policies and 2.26 or 0.48 percent in terms of sum assured during the two sub-periods. The new business as a proportion of business in force in terms of individual policies increased from 11.71 to 15.10 percent and in terms of individual sum

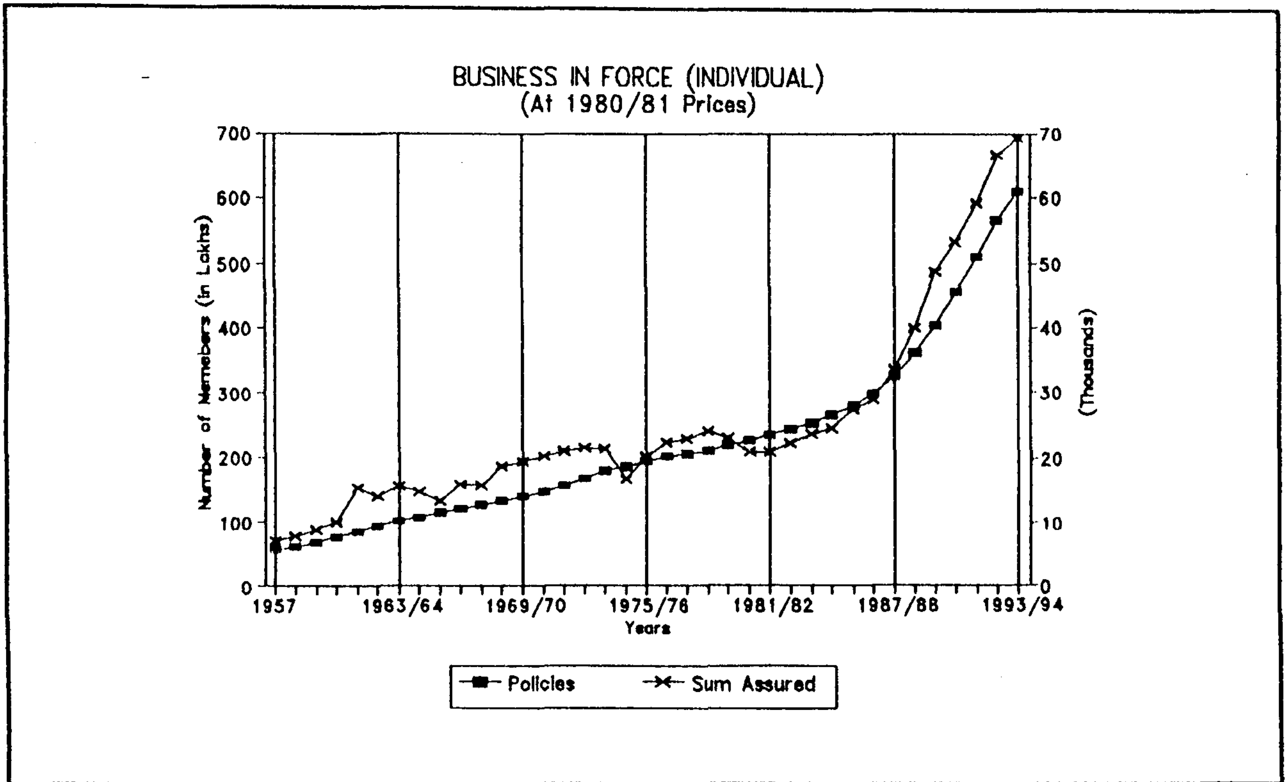

Figure 3.2 A

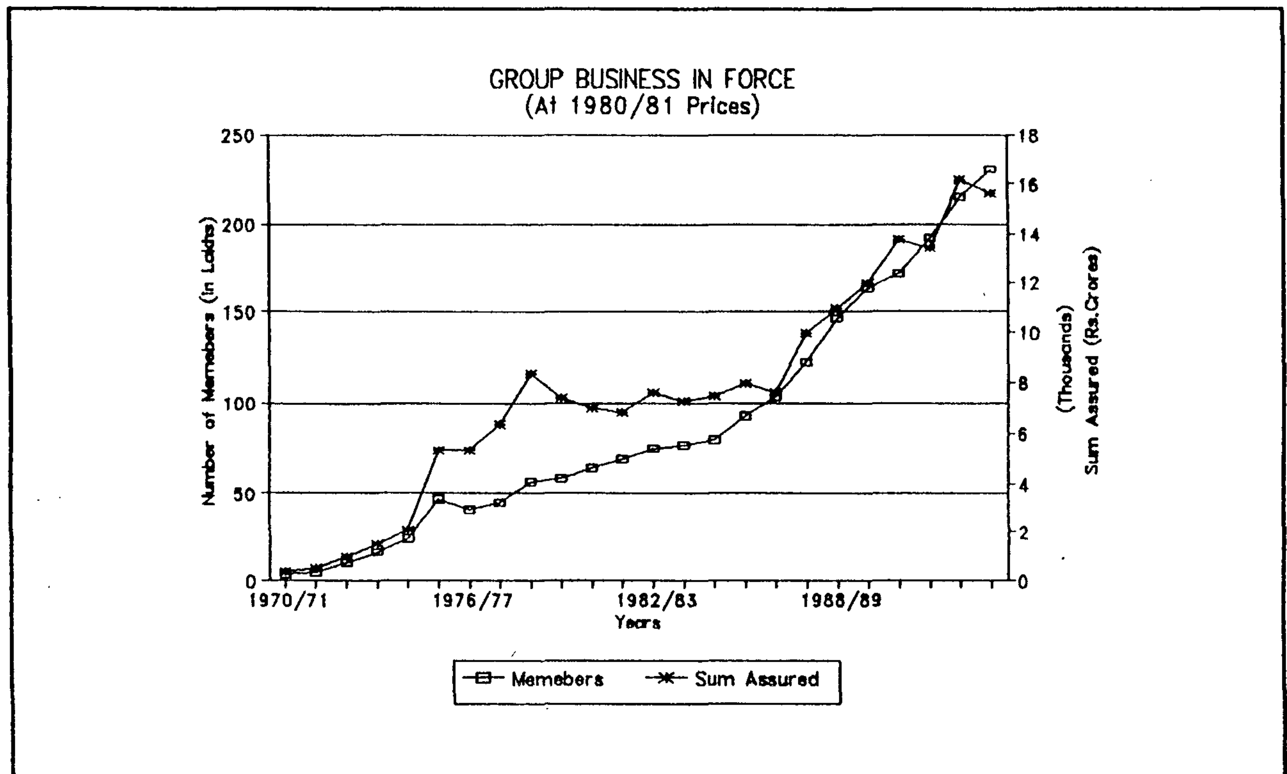

Figure 3.2 B

assured increased from 16.74 percent to 20.16 percent in both the sub-periods. Where as the new group business as a proportion of group business in force in terms of sum assured has shown a marginal decline from 83.40 to 82.87 percent.

Thus, in analyzing growth of business one would notice a significant growth in life insurance business in India since the early 80's. Both the indicators policy number and members have shown an increasing trend. And there had been a spurt in group insurance business between mid 70's and early 80's.

The analysis of new business clearly brings out the point that the growth in policies is slightly more than the real growth in sum assured. But sum assured should rise as a result of growth in both number of policies and average sum assured. If number of policies increases without an increase in sum assured, then the cost of operations is likely to increase. In this respect the average sum assured at constant prices both in terms of individual and group policies declined from Rs.17629 and Rs.10326 in sub-period I to Rs.14505 and Rs.7126 respectively in sub-period II. Thus it seems to be that the corporation spread life insurance business at the expense of higher costs of operations.

3.4 Rural Business

In the pre-nationalization period there was limited development of life insurance in India with rural areas largely neglected. Thus life insurance failed to cater to the vast sections of the society. It could not even reach the organized sector industrial workers until group insurance schemes were introduced. After nationalization, efforts were made to extend the insurance cover to the rural population which as in 1991 stands at 74 percent of total

population and devise an alternative social security mechanism[16]. Disaggregated data is available for individual policies and sum assured for new business only. (see Table 3.5).

Table 3.5: Growth Rates[1] of Inflation Adjusted[2] Rural New Business-Individual[3]

(in per cent per annum)

Rural Business	Growth Rates	
	Sum Assured	Number of Policies
1961 to 1983/84	0.02 (21.75)	1.63 (33.17)
1983/84 to 1993/94	21.15 (33.95)	21.62 (40.83)

Source: LIC Annual Reports; Various Issues

Note: (1) In estimating growth rates the same procedure is followed as in table 3.2. (2) Nominal values have been deflated using the same set of deflator as in Table 3.2 (3) The rural new business-individual figures are available from 1961 only.

The regression analysis of growth rates of two sub-periods clearly shows that, there has been a quantum rise, both in number of policies and sum assured, in the decade beginning from 1983/84. Thus, the share of rural business in total new business in terms of number of policies increased from 33.17 percent in the first sub-period to 40.83 percent in the second sub-period. The corresponding figures for sum assured are 21.75 percent and 33.95 percent. The intensive efforts of the corporation to recruit local people as agents to promote the idea of insurance among the rural population through media campaigns[17] and to involve rural post offices in the collection of premia through saving bank accounts (Annual Reports of LIC; Various Issues) failed to spread the message of life insurance in rural areas in the earlier years. Other reasons for the slow growth of rural business in the sub-period I include

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[16] The then finance minister pursuing the Life Insurance Bill 1956, in Loksabha, stated that in the post nationalization period it would be possible to spread the message of insurance as far and as wide as possible reaching out beyond the mere advanced urban areas into the hitherto neglected rural areas (Committee on Reforms in the Insurance Sector; 1994:51).

[17] In rural areas to spread the insurance awareness Bima Grams (1958) and Bhajan Mandalis were organized. Incidentally Amaravati (Maharastra) is the first district being the Bima Grama in the country.

unfavorable macro-economic conditions, absence of rural infrastructure, especially banking, medical facilities and a lack of properly trained field force, together with lack of awareness among the people of the importance of life cover.

In consonance with the recommendations of Administrative Reforms Committee the corporation devised special schemes and recruited local people and trained them for the procurement of rural business. The corporation introduced Rural Career Agent Scheme in February 1979, which envisages recruitment and training of rural agents (Annual Reports of LIC; 1979:16). Further, in May 1981, the corporation introduced *Jana Raksha* Policy, devised to suit the special needs of rural population. Adding to these measures since the late 70's different group insurance schemes came up to cater the needs of rural population which increased the rural business. Thus, the corporations rural insurance includes individual insurance policies to the affordable sections of the rural population, low premium based group insurance policies, and group insurance policies which are further subsidized by government to subserve the weaker sections of rural population.

3.5 Zonal Business

At the time of nationalization the life business was concentrated in few developed pockets mostly confined to some big cities doing handsome business with a skewed distribution of business across the regions. In this context, nationalization aimed for development and spread of life business throughout the regions irrespective of their demographic features. The nature and progress in this direction can be observed from the zonal business of life business; keeping in view the concentration of rural population of the respective zones. The disaggregated data on the zonal business available only for new business (individual) for the entire study period. The analysis has been made comparing zonal basis life business with

the decadal population including rural population taken as four time points as per the Census of India final population figures. The zonal break up is done as per the LIC's zonal divisions (see Table 3.6).

Table 3.6: Selected Indicators of Zonal Distribution of New Business-Individual

Ratio	Year	West[1]	South[2]	Central[3]	North[4]	East[5]	Total
R/TP[6]	1961	77.26	79.04	86.71	78.38	87.08	82.03
	1971	69.97	76.70	85.25	76.50	85.73	80.09
	1981	66.39	73.20	81.30	72.24	83.40	76.69
	1991	62.72	70.05	79.08	69.67	82.19	74.28
P/1000[7]	1961	5.12	3.79	1.78	4.02	3.66	3.33
	1971	5.27	3.54	1.81	3.06	2.07	2.94
	1981	4.72	3.73	1.70	3.23	1.90	2.85
	1991	14.86	14.73	7.17	9.91	7.10	10.21
PCS[8] (Rs.)	1961	21.77	13.72	7.47	20.07	12.22	13.63
	1971	43.04	22.63	14.75	28.37	14.41	22.17
	1981	69.62	51.10	26.14	60.13	24.89	42.07
	1991	505.13	397.08	253.03	388.76	225.94	332.47
AVS[9] (Rs.)	1961	4248	3624	4187	4991	3990	4098
	1971	8161	6391	8135	9284	6952	7539
	1981	14748	13718	15415	18624	13091	14749
	1991	33993	28097	35302	39224	31828	32548

Source: Annual Reports of LIC for the years 1961-71-81-91.
Census of India-1981, General Population Table
Census of India-1991, General Population Table.

Note: (1) West Zone: Gujrat, Maharastra, Goa and Damon-Diu. (2) South Zone: Kerala, Karnataka, Tamil Nadu, Andra Pradesh, Pondichery and Lakhsadweep. (3) Central Zone: Uttar Pradesh, Madhya Pradesh. (4) North Zone: Haryana, Punjab, Delhi, Jammu and Kashmir, Rajasthan, Himachal Pradesh. (5) East Zone: Assam, Bihar, Orissa, West Bengal, Meghalya, Manipur, Tripura, Arunachal Pradesh, Nagaland, Sikkim and Andman and Nicobar Islands. (6) R/TP-Share of Rural Population to Total Population in percent. (7) P/1000-No of Policies per 1000 population. (8) PCS-Per capita Sum Assured in Rupees. (9) AVS-Average Sum Assured Per Policy in Rupees

The zonal comparison of life business shows that the nature of the spread of life insurance business is according to the density of the rural population. As life business indicators viz.,

population per thousand, and per capita sum assured are low in the zones having high rural population concentration. East and Central zones having high concentration of rural population have less policies per thousand population and per capita sum assured as compared to West, North and South zones. Paradoxically, the Central zone having less policies per 1000 population and and low per capita sum assured shows a high average sum assured per policy, which seems to imply that the insurance coverage is confined to a smaller section of the population with a tilt towards well-off sections. Thus it could be said that developed regions have high life insurance coverage than less developed regions. More importantly with the declining share of rural population in each zones life insurance coverage is growing.

3.6 Income and Outgo

Life insurance protection should be available cheaply with affordable premium, a prerequisite for effective mobilization of savings. Hence premium rates are crucial in selling life insurance policies. Whereas premium is determined by mutually influential factors; of which mortality experience, yield on investments and expenses of management are important. The first two factors fall outside insurance operation of policy procuration, thereby making expenses of management and operational cost a crucial factors in influencing directly in the determination of premia. In order to see the extent and nature of influence expenses of management exerts with the expansion of business, the examination of various dimensions involved in the financial flows is needed and for which the analysis of income and outgo (financial outflows) of the corporation is pertinent. Table 3.7 gives the income and outgo in terms of constant, 1980/81 prices.

Table 3.7: Income & Outgo at 1980/81 prices (Rs.Crores)

Year	1962/63	1983/84	1992/93
Income	828.68	1690.28	4569.72
1.Premium Income	672.06	1053.96	2980.95
2.Net Investment Income	136.42	632.04	1551.60
3.Miscellaneous	20.20	4.28	37.17
Outgo	427.26	781.32	2216.08
1.Policy Benefit	219.84	475.02	1336.42
2.Expenses of Management	197.06	235.75	682.58
3.Other Outgo	2.71	40.09	157.74
4.Five Percent Surplus Valuation	7.65	30.46	39.34

Source: Annual Reports of LIC; Various Issues

The income of the corporation broadly consists of premium income, net investment income and miscellaneous income from other sources. The principal source of income is premium collection which is the aggregation of first year premium income from new business, renewal premium income from the existing business in force and single premium[18] and consideration for annuities[19]. Though premium income continues to be the principal source of income, its relative share in the total income dropped from 81.69 percent in the late 50's to 64 percent in 1993/94. And this is due to the rise in the share of net investment income. Net investment income comes from its investment operations which includes interest earned from securities, on loans and mortgages, rents from properties and dividends from shares and debentures of joint stock companies. It's share to the total income increased from 15.95 percent to 35.01 percent for the same period. This rise is due to the steady increase in the realized gross rate of interest of its investment operations from 4.60 percent in the late 50's to over 10 percent in the 80'sand 12 percent in 1993/94 (Annual Reports of LIC; Various

[18] As per the contract premiums are paid only.

[19] A life annuity may be defined as a contract whereby the insurer agrees in consideration of a certain payment(s), to pay the insured a fixed amount regularly for a given period.

Issues). The third source of income, the miscellaneous income[20] continues to be very insignificant part of the total income (see Table 3.8).

Table 3.8: Percentage Distribution of LIC's Income (Annual Averages)

Year	Premium Income	Investment Income	Miscell-aneous	Total Income
1957-61	81.69	15.95	2.36	100.00
1962/63-71/72	77.55	20.31	2.14	100.00
1972/73-81/82	70.37	28.88	0.74	100.00
1982/83-91/92	63.27	35.96	0.77	100.00
1992/93	65.23	33.95	0.81	100.00
1993/94	64.00	35.01	0.99	100.00

Source: Annual Reports of LIC; Various Issues.

Further the premium income may rise due to the rise in any of its one component. But the rise in premium income should be accompanied by the rise in first year premium income so that it will give an indication of rise in premium in income is due to the rise in new business from new policies rather than existing renewal business. This rise in first year premium income is important because most of the expenses incurred at the time of procuring a new policy. In this respect the decomposed analysis of premium income shows that first year premium income[21] continues to remain 19 to 22 percent of total premium income which implies that both premium income and first year premium income have increased at the same pace.

[20] Miscellaneous income includes income from registration and other fees, refundable income tax, outstanding and written back old claims, outstanding, unclaimed and written back deposits and other written back amounts, exchange adjustment due to revision in the currencies value.

[21] The first year premium income as a percentage of total premium income was 19.17 in late 50's, 17.52 in 60's, 15.97 in 70's, 20.66 in 80's, 22.91 in 1992/93 and 21.87 in 1993/94. In the above calculation the total premium income includes first year premium income, renewal premium income, single premiums and annuities but does not include group insurance premiums (Annual Reports of LIC; Various Issues).

The outgo is the financial outflow paid out from the income of the corporation to mitigate the expenditure incurred in terms of policy benefits, expenses of management and other running expenses and five percent valuation surplus[22] to the central government. Depending on the nature of claims the policy benefits may be paid as maturity benefits, death benefits, annuities and surrender benefits and bonuses for the settlement of claims of the policy holders. Claims may arise either due to death or survivance, where the former case arises in respect of both whole life and endowment policies and the later arises in respect of endowment policies only. Apart from death or survivance, policy benefits are also paid to the policy holders who surrender their policy. The surrender arises if a policy holder expresses his unwillingness to pay premiums being unable to do so for one or other reason. In such cases the concerned may surrender his policy and seek settlement of an amount (actuarial valued) provided that the policy holder has already paid the required minimum amount of premium. The expenses of management which are the costs of procuring, maintaining and operating business includes salaries and other benefits to the employees, commission and allowances to the agents, other running expenses. As the total outgo is the expenditure incurred and paid from the total income it is better expressed in relation to income. Table 3.9 gives figures on the total outgo as a percentage of income and the distribution of different components of the outgo.

[22] Valuation Surplus is the excess of life fund over actuarial valued liabilities and out of which 5 percent goes to the Central Government for its contribution of Rs.5 Crore at the time of nationalization.

Table 3.9: Percentage Distribution of Total Outgo (Annual Averages)

Year	Total Outgo/ Total Income	Distribution of Outgo				
		Total Outgo	Policy Benefits	Management Expenses	Other Outgo[1]	Valuation Surplus
1957-61	53.84	100.00	55.60	42.63	0.84	0.93
1962/63-71/72	49.24	100.00	53.98	43.72	0.89	1.41
1972/73-81/82	46.03	100.00	53.87	40.75	3.93	1.45
1982/83-91/92	45.56	100.00	58.14	33.29	6.64	1.93
1992/93	48.49	100.00	60.30	30.80	7.12	1.78
1993/94	43.02	100.00	58.75	32.47	6.97	1.81

Source: Annual Reports of LIC; Various Issues

Note: (1) Since 1981/82 transfer to reserves are included in other outgo as per balance sheet accounts of Annual Reports of LIC.

In the total outgo policy benefits accounted for about 59 percent in 1993/94 and the proportion has varied only marginally over the decades. The other component of the outgo is the expenditure incurred in terms of expenses of management, which declined to a significant extent from about 43 percent in the late 50's to 32 percent in the early 90's. Thus the total outgo arrived at by adding all these components constituted about 54 percent of the total income in the late 50's and 43 percent in 1993/94 . This marks a steady decline in the share of outgo in total income. The policy benefits and expenses of management, being the important constituents of total outgo, need a disaggregated analysis.Table 3.10 shows the different components of policy benefits.

Table 3.10: Percentage Distribution of Policy Benefits (Annual Averages)

Year	Maturity	Death	Annuities	Surrender	Bonus[1]	Total
1957-61	65.35	23.14	1.15	10.26	0.09	100.00
1962/63-71/72	66.70	20.85	0.94	10.49	0.02	100.00
1972/73-81/82	63.85	19.13	1.27	15.76	0.00	100.00
1982/83-91/92	70.72	15.70	2.21	11.37	0.00	100.00
1992/93	68.39	15.49	3.17	12.95	0.00	100.00
1993/94	71.38	16.36	3.29	8.96	0.00	100.00

Source: Annual Reports of LIC; Various Issues
Note: (1) In later years bonuses has been paid along with the claims with maturity and death benefits

The Maturity benefits are the most important component of policy benefits and its share in the total policy benefits has been increasing. Whereas the share of death benefits are declining which may have a positive impact on reducing the premium rates and it also tends to imply that the mortality experience of LIC has shown an improvement. Though the share of benefits paid for the consideration for annuities doubled, still it continues to be small proportion of the total benefits paid. Thus, annuities are not very popular in India. The surrender benefits shown a marginal decline from over 10 percent to about 9 percent of the total outgo. The last component of the outgo is the bonus paid to the policy holders constitutes a very small proportion of the total outgo, as it was 0.09 percent in the late 50's and declined to 0.02 percent in 60's. However, in the later years the bonus has been paid along with maturity benefits and death benefits at the time of settlement of claims.

The second component, the expenses of management arising out of the carrying cost of insurance operation, would be expected to decline with the growing the growing business (see Table 3.11).

Table 3.11: Percentage Distribution of Expenses (Annual Averages)

Year	Distribution of Expenses				Expense Ratio[1]	Renewal Expense Ratio[2]
	Total	Commission and Allowances	Salaries & Other Benefits	Other Expenses		
1957-61	100.00	32.40	49.33	18.27	28.26	13.92
1962/63-71/72	100.00	31.54	54.48	31.98	27.74	14.83
1972-73-81/82	100.00	31.85	56.33	11.82	26.58	15.02
1982/83-91/92	100.00	35.98	48.58	15.44	24.07	8.69
1992/93	100.00	41.36	43.12	15.52	22.89	5.37
1993/94	100.00	44.04	41.30	14.66	21.83	4.95

Source: Annual Reports of LIC 1957-93/94

Note: (1) Expense ratio is the ratio of expenses of management to premium income; a weighted average of new business and renewal expense ratio. (2)Renewal expense ratio is the ratio of renewal expenses to renewal premium income

Over the period both expense ratio has been shown a declining trend. This is due to the decline in the share of expenses incurred in terms of salary and other benefits and other running expenses. Also the adjusted renewal expense ratio[23] declined from 14.24 percent in 1972/73 to 5.29 percent in 1993/94. But, it is argued that the method of calculation for renewal expenses given under the Insurance Rules are redundant and artificially lowers the renewal expense ratio[24].

[23] Adjusted for group insurance and group annuity business on which a lower proportion of 4 percent of the premium is assured as expenses (Annual Report of LIC; 1974:5).

[24] The Committee on the Reforms in the Insurance Sector presents the figures according to the new method of calculation, which is called `Renewal Cost Ratio" as 13.0 percent in 1971/72 and 13.7 percent in 1992/93 (Malhotra Committee Report; 1994:34-35). However, after the informal discussions with some of the insurance officials, it is understood that though the renewal cost ratio is a better indicator than renewal expense ratio, but both method of calculation has got their own limitations and needs actuarial understanding. Therefore, the study does not intend to go further into the cost structure.

The upward movement in yield on investments, the relative decline in outgo to income viz., expenses of management, the decline in death benefits gets reflected in the increase in bonus rates to the with profit[25] policy holders, which is paid to the with profit policies at the time of maturity or earlier death claims. The bonus which is expressed as bonus rate per thousand sum assured increased for whole life and endowment policies from Rs.16 and Rs.14 per thousand sum assured in 1957 to Rs.82.50 and Rs.66 in 1990. And since 1991 the differential bonus rates adopted for different policies according to the year of commencement, which stood at Rs.91, Rs.88, Rs.84 for whole life policies and Rs.74, Rs.71, Rs.67 for endowment polices in 1993/94.

With the growth in business, income increases and outgo correspondingly tends to decrease as the cost of operation gets distributed over the larger business and it is likely that mortality experience of the economy improves over time (also has been noticed in Table 3.10). Also the excess of income over the outgo, which is a surplus, arises because according to the level premium plan which LIC follows, in the initial years the policy holder pays a higher amount of premium than the actual cost of insurance. The reason for this is to compensate for the rise in mortality rate of the individual policy holder in the later years. In the case of the corporation the income is growing and outgo as a proportion of total income is declining (see Table 3.12). This is due to the proportionate decline in the death benefits and expenses of management, as already discussed.

[25] With Profit policies are those which are participated in the distribution of profits.

Table 3.12: Excess Income as a percentage of total income (Annual Averages)

Year	Income I	Outgo O	Excess Income E=I-O	Transfer to Reserves[1] T	Addition to Life Fund A=E-T	Net Adjust N	Net Addition A-N
1957-61	100.00	53.84	46.16	1.49	44.68	-0.59	44.09
1962/63-71/72	100.00	49.24	50.76	1.01	49.75	-0.05	49.70
1972/73-81/82	100.00	46.03	53.97	0.00	53.97	-0.01	53.96
1982/83-91/92	100.00	45.56	54.44	0.00	54.44	0.25	54.69
1992/93	100.00	48.49	51.51	0.00	51.51	0.00	51.51
1993/94	100.00	43.02	56.98	0.00	56.98	0.00	56.98

Source: Annual Reports of LIC; Various Issues
Notes: (1) Since 1981/82 transfer to reserves included in the outgo as per the balance sheet accounts of the Annual Reports of LIC.

3.7 Life Fund

From the above discussion it is clear that the corporation, as any life insurance company, manages two important operations simultaneously: (i) continuous creation of liability and (ii) accumulation of investment income enough to offset these liabilities. The income accrual from both insurance (premium receipts) and investment operations (dividends and interests) is used for meeting the current year's operational cost of life insurance (maturity, death and surrender claims) and expense of management. The remaining surplus viz., the excess of premiums receive over current cost of life insurance, is an accretion to life insurance fund, a liability for endorsing future claims. In this process over time a life office accumulates funds of enormous size. This life fund is nothing but institutionalisation of savings by the life office. In fact the importance of any life office would be determined by the magnitude of life fund at its disposal and its capacity to convert a greater proportion of premium income into life fund. Therefore, growth in life fund is always seen in relation to

growth in premium income i.e., the proportion of premium income that goes into life fund annually.

Both the premium income and annual addition to life fund have grown substantially with the increase in life business of the corporation. The premium income have grown from Rs.672 crores in 1962/63 to Rs.1054 crores in 1983/84 and further to Rs.2981 crores in 1992/93 (at constant, 1980/81 prices). The corresponding figures for annual addition to life fund are Rs.396 crores, Rs. 909 crores and Rs.2354 crores. Consequently, the total accumulated life fund (the stock) has increased from Rs.3207 crores in 1962/83 to Rs.7623 crores in 1983/84 and further to Rs.15301 crores in 1992/93 (at constant, 1980/81 prices). In Table 3.13, a regression analysis has been made which clearly shows that much of the growth has taken place during the sub-period II.

Table 3.13: Growth Rates[1] of Inflation-Adjusted[2] Premium Income and Life Fund

(in Percent)

Year	Growth Rates			Annual Life Fund to Premium Income
	Premium Income	Yearly Life Fund	Accumulated Life Fund	
1957 to 1983/84	3.47	5.63	4.65	68.77
1983/84 to 1993/94	10.36	9.87	6.62	85.44

Source: Annual Reports of LIC; Various Issues

Note: (1) In estimating the growth rates the same procedure is followed as in table 3.2.(2) Nominal values have been deflated using the same set of deflators as in Table 3.1.

Thus annual net addition to life fund to premium income has increased on an average from 68.77 percent to 85.84 percent. In turn a higher proportion of premium income is being converted into institutionalized savings in the form of life fund (see Figure 3.3).

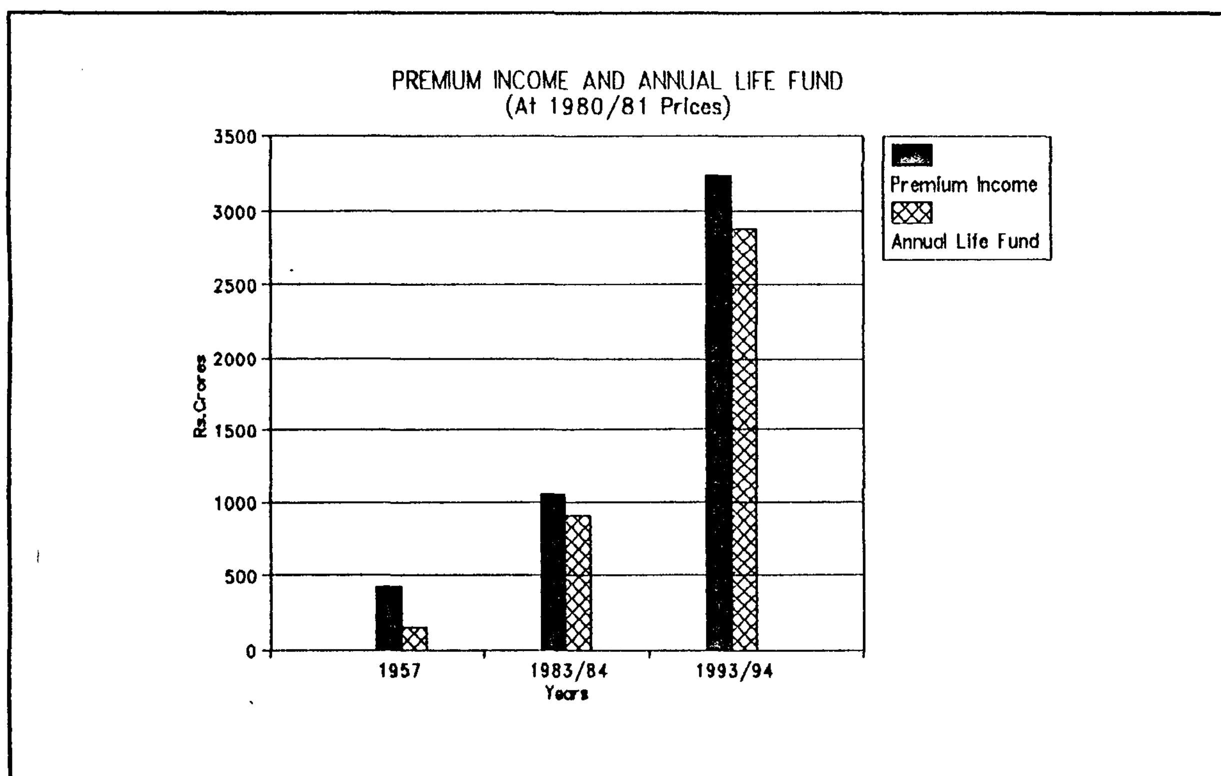

Figure 3.3

3.8 The Macro-Economic Importance of Life Business

While the forgoing analysis indicates substantial growth in the life business, especially since the early 80's, it will be incomplete and partial as it is not related to relevant macro-economic aggregates. In this section, an attempt is made to fill this gap.

In evaluating the macro-economic importance of life business no definite criteria seem to be available. In the limited literature[26] available two criteria are identifiable:

(i) Life Insurance Per Capita, which is life insurance in force per head of population.

(ii) Life Insurance Carrying Capacity, which is defined as the percentage of life insurance in force to national income in a given year.

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[26] For the first time the above criteria were used by Agarwala (1961:103) to measure life insurance standard in India.

To these two criteria we add another one viz., Life Insurance Coverage. This can is defined as follows:

> Life Insurance Coverage, which can be defined as policies per head of population. This will reflect the life insurance coverage in terms of policies in relation to population. It will provide a basis for evaluation whether or not life insurance coverage is growing more rapidly than increase in population.

An analysis based on the above indicators appears in Table 3.14. From Table 3.14 one can infer a steady progress of life business. The life insurance coverage provided increased from 1.68 percent in the late 50's to 9.45 percent in 1993/94. In other words, it implies that life insurance coverage is only 9.45 percent compared to the total population. However, it should be noted that one individual may have more than one policy at a time, in which case life insurance coverage would be much lower than the above figures shows. At the same time for a better comparison the ratio between life insurance policies in force and total insurable population[27] should have been taken. In this respect it is estimated that only 23 percent of the insurable population is covered (Jha; 1995:7). The life insurance percapita shows that per capita individual sum assured in force increased from over Rs.48 in the late 50's to about Rs.2342 and per capita total sum assured increased to over Rs.2880 in 1993/94. The comparison of business in force in terms of sum assured with national income indicates the life insurance carrying capacity of the economy and one can observe both individual and total sum assured in force to national income has increased from over 16 percent in the late 50's to 42 percent respectively in 1993/94.

[27] Insurable population refers to the male population in the age group of 20 to 60 years.

Table 3.14: Macro Comparison of Life Business (Annual Averages)

Macro indicators	1957 to 1961	1962/63 to 1971/72	1972/73 to 1981/82	1982/83 to 1991/92	1992/93	1993/94
A. Life Insurance Coverage (in percent)						
(i) Individual Policies in Force to Total Population[1]	1.68	2.48	3.24	4.30	6.50	9.86
(ii) Total Policies in Force[2] to Total Population	1.68	2.49	3.91	5.84	8.97	9.45
B. Life Insurance Per Capita (in Rs)						
(i) Individual Sum Assured in Force to Total Population	48.49	102.73	246.14	837.74	2042.66	2349.31
(ii) Total Sum Assured[3] in Force to Total Population	48.49	103.31	308.69	1061.54	2540.89	2880.24
C. Life Insurance Carrying Capacity (in percent)						
(i) Individual Sum Assured in Force to National Income[4]	16.17	19.09	20.17	22.86	32.77	33.91
(ii) Total Sum Assured in Force to National Income	16.17	19.18	24.83	29.14	40.46	41.57

Source: Annual Reports of LIC; Various Issues
National Account Statistics; CSO 1995

Note: (1) Total Population figures are taken from the estimated figures of National Account Statistics. (2) Total Policies in force arrived by the addition of individual policies and members of the group insurance. (3) Total sum assured arrived by the addition of individual and group insurance sum assured. (4) National Income is Net National Product at factor cost at current prices.

Like growth in business the growth in premium income and life fund can be compared with standard macro variables which will reflect the contribution of life insurance. The following criteria could be used for macro comparison[28]:

[28] The first three criteria have been used by SIGMA; Swiss Re, Life Insurance Fact Books; American Council of Life Insurance Association.

(i) Life Insurance Penetration is defined as the percentage of life insurance premium income paid during a given year to the volume of gross domestic product.

(ii) Life Insurance Capacity is defined as the percentage of life insurance premiums paid during a given year to the volume of national income.

(iii) Life Insurance Density is the life insurance premiums paid during a given year to the total population in that given year.

(iv) Life Insurance Savings is the percentage of life fund accrued in a given year to the gross domestic saving.

The computed figures based on these criteria are given in Table 3.15.

Table 3.15: Macro Comparison of Premium Income and Life Fund (Annual Averages)

Year	Life Insurance Penetration (in Percent)	Life Insurance Capacity (in Percent)	Life Insurance Density (in Rs)	Life Insurance Savings (in percent)
1957-61	0.66	0.74	2.19	3.02
1962/63-71/72	0.68	0.80	4.28	3.10
1972/73-81/82	0.74	0.89	10.98	2.86
1982/83-91/92	0.84	1.05	38.71	3.37
1992-93	1.14	1.47	91.60	4.48
1993-94	1.24	1.58	109.63	5.47

Source: Annual Reports of LIC; Various Issues
National Account Statistics; CSO 1995

It is very clear from the above analysis that growth in premium income and life fund is more than the growth of the related macro variables in terms of life insurance penetration, life insurance capacity, life insurance density and life insurance savings. But the life insurance premium constitutes barely 1 to 2 percent of GDP and National Income, and the life insurance density which is the life insurance protection per head of population is just little more than Rs.100. Where as life insurance savings constitutes just more than 5 percent in 1993/94.

Apart from contributing to the savings, life Insurance business in its business operation also provides employment opportunities. As an industry, thus, it contributes a reasonable share to the organized sector which shows a steady rising trend (see Table 3.16). The employment provided may be higher than this if one considers the agents engaged in life business.

Table 3.16: Percentage share of LIC's Employment to Total Organized Sector Employment[1] (Annual Averages)

Year	1962/63 to 1971/72	1972/73 to 1981/82	1982/83 to 1991/92	1992/93	1993/94
Percentage of Public Sector Employment	0.53	0.41	0.42	0.59	0.64
Percentage of Total Organised Sector Employment	0.32	0.27	0.29	0.42	0.45

Source: Annual Reports of LIC; Various Issues
Indian Labour Statistics; Ministry of Labour, GOI; Various Issues
Note: (1) The organized sector employment includes both public and private Sector employment

Thus, although life insurance business has shown a steady progress in relation to a range of macroeconomic aggregates. The numerical values of various indicators point to a vast scope for improvement. For example, cross-country comparisons suggest that the life insurance carrying capacity (life insurance in force to national income) of some of the industrially advance countries in 1994 are far above: USA 164 percent, Japan 310 percent, UK 128 percent, Korea 88 percent, Australia 113 percent and Canada 178 percent (Life Insurance Fact Books; 1995). A more detailed discussion has been done in Chapter VI.

3.9 Conclusion

Commensurate with the overall changes in the economy and the organsiationisational changes that have taken place with the decentralization of functioning of divisional offices and decentralization of policy servicing of branch offices, there has been a significant growth in the life business since the early 80's. The growth has also been due to the increase in rural business and group insurance business since mid 70's. The analysis of zonal business reveals that business is more in the more urbanized zones. The analysis also shows that the average sum assured per policy has declined in real terms. The increase in the rural business might involve higher transaction costs in the absence of adequate infrastructure facilities in rural areas. But the analysis of income and outgo has shown that even with lower sum assured and increase in rural business the LIC has succeeded in converting a growing amount of annual premium income into life insurance fund. The outgo as a proportion of income declined partly due to the decline in the death benefits and expenses of management.

In spite of all these developments life business continues to be low in terms of coverage, contribution to National Income and Savings. This indicates that a lot of potentiality exists for the future development of life business in India.

The analysis of operating results in the present chapter is confined only to insurance operations. The other set of important LIC operation comprise the investment operation which determines premium rates. In the Indian context the LIC plays an important role in resource mobilization and generating loanable funds for national development programs including industrial development. This is taken up in the following chapter.

APPENDIX 3A

A TECHNICAL NOTE

The trend break can be tested by observing the new business, which is nothing but the business written in a financial year. If there is significant change in the new business then it can be said that there is a structural change in life business. The new business consists of both individual and group business. But however growth in individual new business can be observed from number of policies and sum assured and group insurance can be observed from number of members and sum assured. But sum assured is a nominal variable. But sum assured per policy depends on the nature of the policy and individuals can have different sum assured per policy. So the number of policies and number of Members are the real indicators for the trend break test. But in case of group insurance, the data is available from 1974/75 only and also group business is mostly target oriented and at a time a group can be covered. Also as group business consists of centrally subsidized schemes, it won't be appropriate indicator for structural change. Therefore, new business individual which depends on external factors like general macro conditions and also the corporations client servicing, product design influences a lot, it can be taken as the indicator to test trend break.

From the survey of literature it was found that from 1981/82 to 1983/84 major Organization changes have taken place. Also the Figure 3.1 shows there is a significant growth in business from 1983/84. The trend break test for number of members from new business individual (which does not include Indian registered foreign business) confirms this, i.e., 1983/84 shows

a marked change in new business in India. The trend break is estimated using Kinked-Exponential Fit, which is as follows

$$\text{Ln } Y = A + B(D1t+D2k)+C(D2t-D2k)+e$$

where Y is number of policies, B and C are growth rates, t is the time period, k is the kink (in the estimation it is 27) and D1 and D2 are dummy variables. D1 takes the value of 1 for the first period or 0 other wise and D2 takes the value of o for the first period or 1 otherwise.

The estimated trend break equation is

$$\underset{(132.63)}{\text{Ln}(Y) = 14.07} + \underset{(3.52)}{0.02}\,(D1t+D2k) + \underset{(15.50)}{0.15\,(D2t-D2k)}$$

R^2 = 0.99, Adj-R^2 = 0.99, DW =1.67

Note: (1) The figures in the parenthesis are t-statistics at 5 percent significance level..

(2)To correct for autocorrelation AR(1) is used.

(3) For details regarding the functional form see Boyce J; 1987.

From the above equation it is clear that both the coefficients are statistically significantly different from each other. In other words the new business in terms of policies showed a significant growth in the sub-period II i.e., from 1983/84. Therefore, the entire study period taken into two sub-periods.

CHAPTER IV

INVESTMENT OPERATIONS

4.1 Introduction

Along with the insurance operations, which have been studied in the previous chapter, investment constitutes an important part of the operations of the LIC of India. As mentioned, investment operations of the LIC represent an important mechansim for mobilising savings of the people and channelling them to the national development programmes. In this role the LIC is a major financial intermediary and an influential player in the capital market. Because it is also incumbent on the LIC to ensure safe and attractive returns to the policy holders on their savings, important considerations of portfolio management also arise.

The present chapter seeks to examine the trends in investment pattern and tries to evaluate them in the light of portfolio management and the statutory regulations (see Appendix 4A) and controls under which its investment operations are done. This will not only portray the nature and magnitude of investment operations, but also will reflect the LIC's role as an important institutional investor in the guilt-edged market and capital market and will give enough space to address some of the macro-economic issues related to life insurance and their likely implications in the changing liberalised environment.

4.2 Investment Pattern

The financial strength of the corporation can be judged from its assets, life fund and investments. Life insurance fund is a major indicator of the strength of the corporation in

the capital market. It is out of this fund that the investment operations are carried out. Nevertheless, it will be also useful to study the growth of life fund vis-a-vis assets and investments. Table 4.1 presents the broad trends of growth of assets, life fund and investments of the LIC.

Table 4.1: Growth in Assets, Life Fund and Investments (at 1980/81 prices)[1]

Year	1962/63	1983/84	1992/93
A.Assets	3510.75	7961.05	15834.03
B.Life Fund	3206.59	7622.52	15301.13
C.Investments	3029.91	7467.76	14234.49

Source: Annual Reports of LIC; Various Issues

Note: (1) The nominal values have been deflated using implicit deflator for the life insurance sector. For the years 1957 to 1961 and 1993/94 the implicit GDP deflator has been used for lack of data. The deflator has been computed from CSO (1990, 1992, 1993, 1995).

The assets of the corporation grew from Rs.3511 crores in 1962/63 to Rs.7961 crores in 1983/84 and further to Rs.15834 crores in 1992/93 (at 1980/81 prices). The life fund grew from Rs.3207 crores in 1962/63 to Rs.7623 crores in 1983/84 and to Rs.15301 crores in 1992/93. And the corresponding figures of investments are Rs.3030 crores, Rs.7468 crores and Rs.14234 crores. Thus the sub-period II starting from 1983/84 recorded around two fold increase in assets, life fund and investments. From early 80's a consistent rise and similar pattern in all the three variables can be seen from the figure 4.1.

A regression analysis of the growth rates for two sub-periods reflects a clear acceleration in the growth of assets, life fund and investments of the corporation (see Table 4.2).

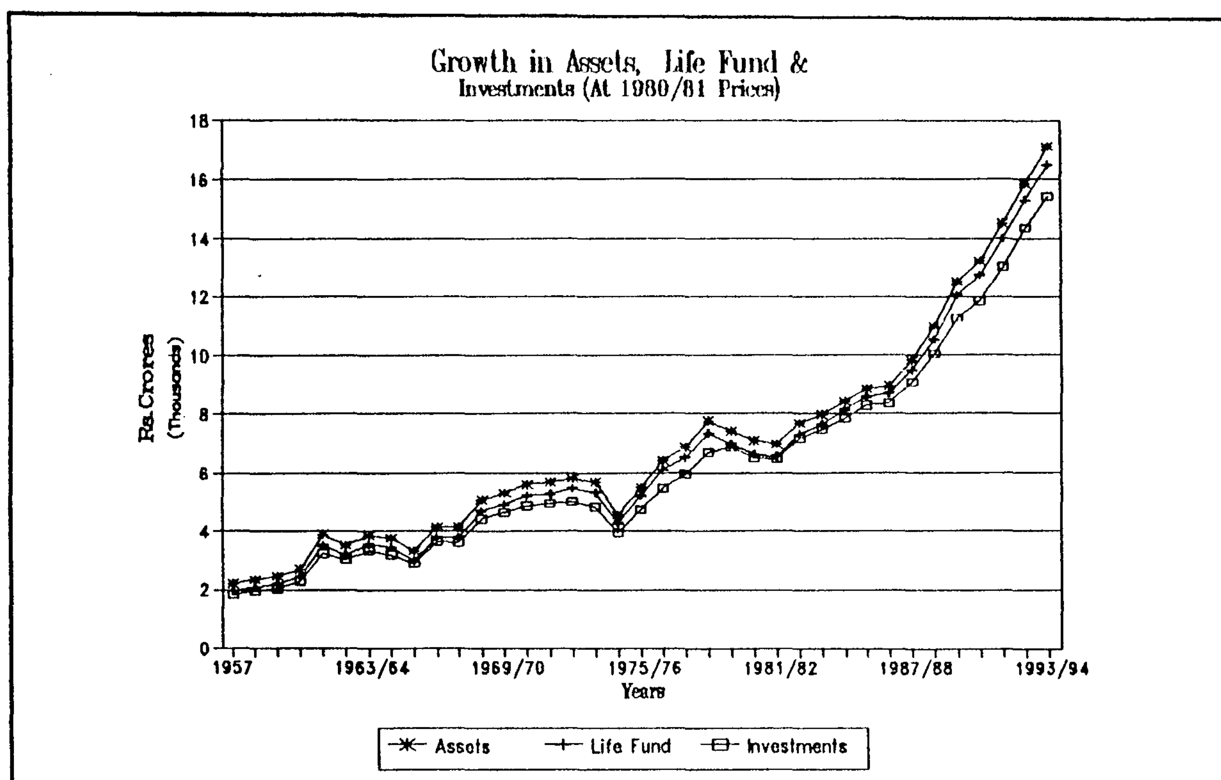

Figure 4.1

Table 4.2: Growth Rates[1] of Inflation-Adjusted[2] Assets, Life Fund and Investments

(in per cent)

Year	Total Assets	Life Fund	Investments
1957 to 1983/84	4.36	4.65	4.77
1983/84 to 1993/94	6.58	6.62	6.38

Source: Annual Reports of LIC; Various Issues

Notes:(1)The periodwise growth rates are estimated using a Kinked-Exponential Fit of the type Ln(Y)=A+B(D1+D2k)+C(D2t-D2k), where Y is the dependent variable, t is the time period, k is the kink, B and C are the growth rates for the resepctive periods and D1 and D2 are the dummy variable where D1 is 1 for the first period and O other wise and D2 is 0 for the first period and 1 other wise. (2)The inflation-adjusted growth rates are arrived at by deflating the nominal values using the same set of deflator as used in Table 4.1.

The accumulated life fund is a liability of the corporation. But since the liability is long term in nature and there is a steady and regular inflow of funds (in the form of premiums, investment income and annuities), a high degree of liquidity is not essential for the day to day operations of the corporation. Therefore much of the funds are held in income earning

financial assets. The available investment options for the corporation include on the one hand build-up of internal reserves with maximum liquidity and zero returns; the low risk and low-yielding governement securities, high risk and high yielding corporate securities, real estate, mortgates and loans on the other. The portfolio represents a wide spectrum of assets in terms of liquidity, increasing risk and returns. In practice, the investments of the corporation consists of government securities, corporate securities, loans, mortgages, real estate (house, land and other immovable property) and other forms e.g., special deposits with the central government[29], contribution to the seed capital of different financial institutions and current assets such as cash and bank balances, outstanding premiums and dues from other insurers, policy holders and agents.

Investments of such magnitude are to be carried out with prudent portfolio choice which analyses the rationale of maximisation of expected earnings for a given rate of risk or conversely minimisation of risk for a given expected rate of return. Even though a substantial chunk of funds of the corporation are preempted for national development programmes, the sheer magnitudes involved demand a prudent portfolio managment. The risks involved in investments can, to a great extent, be minimised by diversifying the portfolio as widely as possible e.g., among different sectors, instruments, industries, companies and regions. Therefore our examination of the investment operations of the LIC includes sector-wise, instruement-wise and industry-wise classification of investments.

[29] The special deposits with central government are treated as central government securities. However, in this analysis it is categorised in `other category'.

4.2.1 Sector-Wise Distribution

Investments along the sectoral dimensions are categorised as investments in public sector, cooperative sector, and private sector. The public sector investments include the securities of the central and state governemnts and other approved securities (municipal, port trust and foreign government securities), government guaranteed shares and debentures, subscription to bonds of and granting loans to state electricity boards and corporations, granting loans to municipalities and zilla parishads for their water supply and sewerage schemes, special deposits with central government and initial capital contributions to LIC Mutual Fund, LIC Housing Finance, Unit Trust of India (UTI). The investments in cooperative sector consists of shares of and loans to different cooperative units. Thus, investment in public and cooperative sector includes investment in social oriented sectors. Whereas private sector investments include loans, mortgages, shares and debentures of private companies, policy holders loans against the surrenders and policies. The growth in sectoral investment is analysed in Table 4.3.

Table 4.3: Growth in Sectoral Investments (at 1980/81 prices)[1]

Year	1962/63	1983/84	1992/93
A.Public	2131.07	5460.63	10817.21
B.Private	553.36	724.48	2120.34
C.Co-operative	90.23	704.12	618.62

Source: Annual Reports of LIC; Various Issues
Note: (1) The nominal values have been deflated using the same defaltor as in Table 4.1.

Is clear from the table that the public sector gets a major chunk of LIC's investible funds. But in recent years a shift towards the private sector is evident. During the decade beginning 1983/84 investments in the private sector registered a threefold increase. The co-operative sector investment declined in absolute terms (at 1980/81 prices). The percentage distribution

of sectoral investments brings out the relative movements of the various components (see Figure 4.2 and Table 4.4)

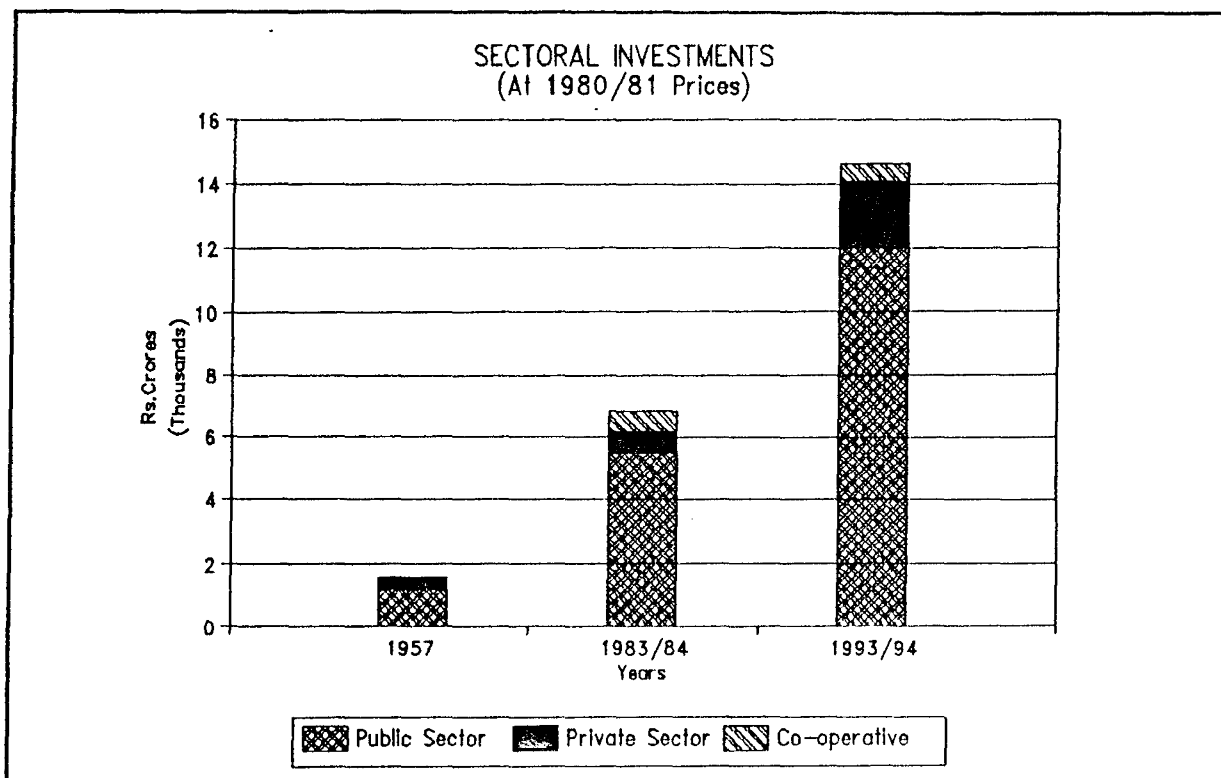

Figure 4.2

Table 4.4: Percentage Distribution of LIC's Investments by Sector (Anuual Averages)

Year	Public Sector	Coop Sector	Private Sector Joint	Private Sector Other	Private Sector Total	Total Invest
1957-61	78.09[1]	-	-	-	21.91	100.00
1962/63-71/72	74.19	7.22	0.60	17.99	18.59	100.00
1972/73-81/82	75.99	11.49	0.45	12.07	12.52	100.00
1982/83-91/92	79.99	8.07	0.57	11.38	11.94	100.00
1992/93	79.80	4.56	0.78	14.86	15.64	100.00
1993/94	82.08	3.88	0.69	13.35	14.04	100.00

Source: Annual Reports of LIC; Various Issues
Note: (1) The figures includes the co-operative sector investment.

Therefore even if the share of private sector declined in the earlier decades, the recent years have seen a noticeable growth. It should be noted that a perfect distinction between public

and private sector is not always easy. For instance, the investment in Industrial Finance Corporations ultimately goes to financing private industries and LIC's housing loans to National Housing Bank and to the state governments are used by employees and private persons for housing purposes. In this sense private sector investment may be underestimated by the above distinction between public and private sectors. From the above analysis it could be said that LIC invests in public sector and thus socially oriented programmes. It is argued that life offices should put their investmens fulfilling socio-economic needs of the country. Blair asserts that investment policy may be slanted in varying degrees towards the socio-economic objectives of the management. If these objectives are for the betterment of society and the economy as a whole such a slant is highly desirable[30]. Also the heavy investment in public sector by the corporation is due to the regulations on its investment operations that the investment in soically oriented sectors should not be less than 75 percent of the controlled fund[31] (see Apendix 4A).

The above analysis has shown an increase investments by LIC in both public and private sector. And within the private sector investment whether or not private corporate sector is getting enough attention would be clear from the instruement-wise analysis of investments.

4.2.2 Instrument-Wise Distribution

An alternative way of looking at the composition of LIC's investments is classification according to the type of instruments in which investments are made. The instruments include government securities, corporate securities, loans and mortgages and real estate. Table 4.5 shows the growth of these various instruments.

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[30] Franklin Blair: Interpreting Life Insurance Company Annual Reports (Bajpai; 1975:206).

[31] Controlled Fund refers to all the funds appertains to life insurance business of an insurer.

Table 4.5: Growth in Instrument-wise Investments (at 1980/81 prices)[1]

Year	1962/63	1983/84	1992/93
A.Govt. Securities	2066.47	3736.82	6921.72
B.Loans & Morgages	258.41	2921.89	4889.09
C.Corp. Securities	557.41	362.00	1685.54
D.Real Estate	128.91	73.03	126.38
E.Others	18.71	374.02	611.76
Total	3029.91	7467.76	14234.49

Source: Annual Report of LIC; Various Issues
Note: (1) Nominal values are deflated using the same defaltor as in table 4.1

The observed growth of investments in instruements clearly brings out that governement securities account for the bulk of investments, followed by loans and mortgages. Also, of late the corporate secuities have gained much impetus. The underlying trends would be clearer from the analysis of relative distribution of investments in various instruments (see Table 4.6 and Figure 4.3).

Table 4.6: Percentage Distribution of LIC's Investments by Instrument (Annual Averages)

Year	Govt Secu	Corp Secu	Loans & Mortgs	Real Estate	Other Inv[1]	Total Assets
1957-1961	71.44	17.91	4.96	5.11	0.58	100.00
1962/63-71/72	60.27	16.51	19.83	3.17	0.23	100.00
1972/73-81/82	52.06	7.42	38.44	1.56	0.52	100.00
1982/83-91/92	49.73	7.70	35.53	0.92	6.12	100.00
1992/93	48.32	11.77	34.13	0.88	4.91	100.00

Source:Annual Report of LIC; Various Issues
Note: (1) The others category includes special deposits with central government, advance subscription and application money for securities and shares, certificate deposits, contribution to the initial capital of UTI, LIC Housing Finance, LIC Mutual Fund and LIC International.

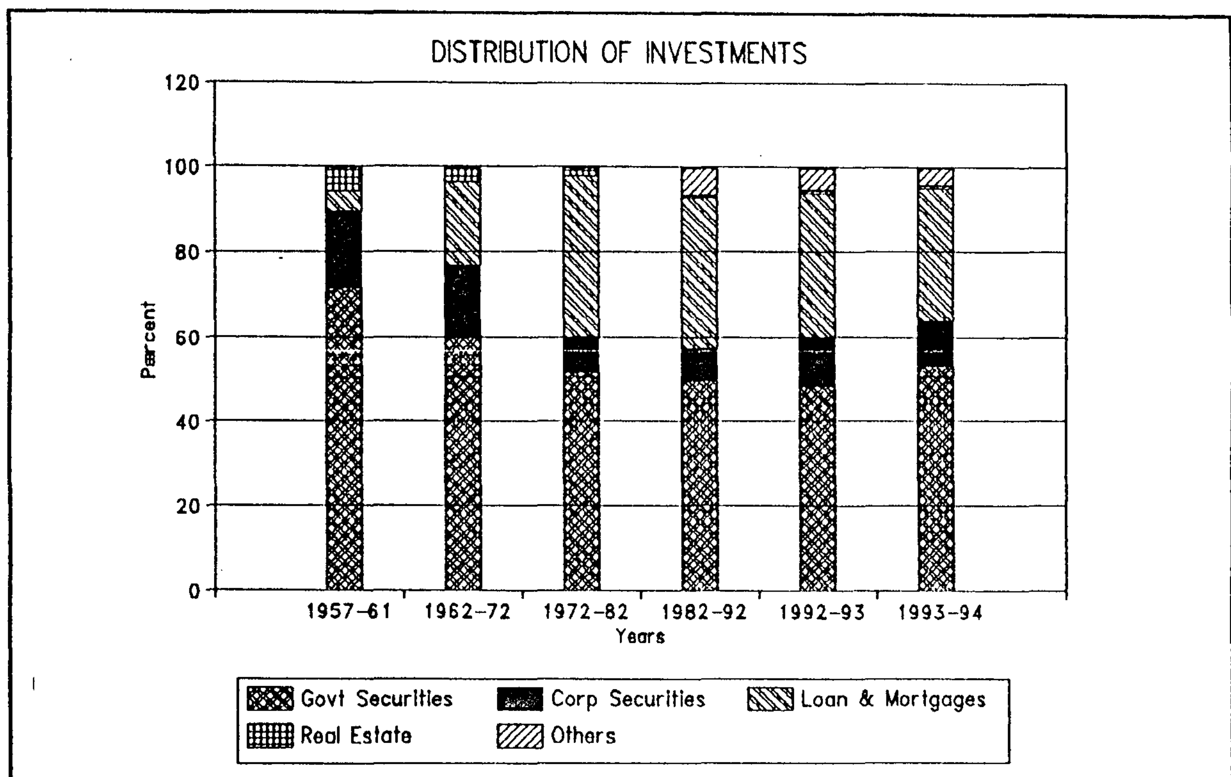

Figure 4.3

The share of government securities in total investment has been declining over the years. The corporate securities investment, which has shown a declining trend untill 70's, revived in recent years. As noted earlier, there has been a phenomenal growth in loans and mortgages; which increased from less than five percent in the late 50's to about 30 percent in 1993/94. Real estate has shown a sharp decline. The other category increased due to the increase in the special deposits with the central government.

Though a major portion of investments is in the form of government securities, there seems to have been a structural shift in recent years towards private sector investments, especially in corporate securities. The activation of the capital market in the late 80's might have induced this shift. Loans and Mortgage[32] investments, which were almost neglible in the

[32] At the time of nationalisation loans and mortgages were almost nill, as many a loan was found to be fraudlent transactions. But with the increase in the urban population and housing demand for loans and mortgages shot up. The corporation implemented a number

initial years, now occupy a major portion of investments, next only to government securities. Given their quantitative importance in the overall portfolio of the LIC, it may be desirable to look more closely into the composition of government and corporate securities.

Government securities are a very broad category including securities of the central and state governments, municipalities, other approved trustee securities and a small amount of foreign government securities. Among these, central government securities occupy a prime place as it was accepted that the corporation will act as an important conduit for financing national development plans[33]. This is clearly reflected from the investments in the central government securities (see Table 4.7).

Within the broad category of government securities, the central government securities continue to be a major category constituting 60 to 70 percent of the total investment. However, the share of state government securities has shown a sharp decline during the 80's. The approved securities, other trustee securities and small amount of foreign government securities together have registered an increasing share.

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of related schemes such as:(i) Mortgage Loans on Immovable Propety (M-I Scheme), (ii)Own Your House Scheme (OYHS), (iii) Individual Employees Housing Scheme (IEHS), (iv) Cooperative Housing Societies formed by Employees of the Corporation (ECHS), (v) Scheme for Public Ltd., Cos, for Construction of Houses for their Employees (PLCHS), (vi) Cooperative Housing Societies formed by Employees of Public Ltd, Cos, (PLECHS) (Annual Report of LIC; 1966:11).

[33] The Finance Minister speaking in Parliament on the LIC Bill on 20th March 1956 stated that, "the investment in ventures established in pursuance of the plan would be governed in the main by the major considerations such as the interests of the policy holders and the interests of the development envisaged in second five year plan and subsequent plans (Kumar; 1991:92).

Table 4.7: Percentage Distribution of LIC's Investment in Government Securities

(Annual Averages)

Year	Central Govt Secu.	State Govt Secu.	Approved[1] & Other Secu.	Total
1957-61	63.51	21.43	15.06	100.00
1962/63-71/72	51.85	27.42	20.73	100.00
1972/73-81/82	53.11	20.23	26.66	100.00
1982/83-91/92	67.94	7.04	25.02	100.00
1992/93	71.33	11.35	17.02	100.00
1993/94	73.48	11.63	14.89	100.00

Source: Annual Reports of LIC; Various Issues

Notes: (1) Approved Securities includes Municipal Securities, Debentures of Port Trust, Bonds of State Electricity Boards and State Financial Corporations, Debentures of State Level Land Development Banks and All India Public Financial Institutions and Foreign Government Securities.

Though the financing of development plans was a major objective, it was not to neglect the investment needs of the private sector[34]. A substantial amount of LIC's funds are at the disposal of the private corporate sector which also give high yeilds for the LIC. But as these investments are comparatively risky than government securities, they generally spread across industries. Thus these investments provide capial to the different types of private industries. The nature of investments also depends on the social needs and preferences.

An examination of the trends in investments in industries it was found that investments are spread across more than 30 private industries with varying magnitude of investments (see Appendix 4B). In tune with the portfolio management, investment is not concentrated in a single industry. It is also observed that with the changing needs and preferences of the industrial sector the allocation has changed. Over time there has been a gradual shift in

[34] In clearing the apprehensions of private sector being neglected, the then Finance Minister on August 25th 1958 spoke, while placing the modified Insurance Act 1938, "though funds will be allocated for financing five year plan projects, private sector would be getting what it used to get".

investments towards Dyes, Chemicals and Pharmaceauticals, Electricity and Electrical Goods, Engineering, Textiles other than Cotton and thus gained special importance as the share of industrial investment in these industries has gone up to a considerable amount. Therefore, one will observe the significant rise in invstment in corporate securities especially during the 80's. Investments in corporate securities comprise equitiy shares, preference shares and debentures and bonds.

Table 4.8: Percentage Distribution of Corporate Securities (Annual Averages)

Year	1957 to 1961	1962/63 to 1971/72	1972/73 to 1981/82	1982/83 to 1991/92	1992/93	1993/94
Equity Shares	51.02	57.69	55.76	33.00	32.32	39.82
Debentures	26.72	25.56	29.00	63.69	67.20	59.79
Preference Shares	22.26	16.75	15.24	3.61	0.48	0.39
Total	100.00	100.00	100.00	100.00	100.00	100.00

Source: Annual Reports of LIC, Various Issues

Table 4.8 points to a gradual shift away from investments in the equity shares and preference shares to debentures of the companies. The investment in preference shares has declined sharply. However, it will be noticed that since the early 80's there has been a slight increase in the share of investment in equity shares. This recent rise in equity shares may be because of the recent relaxation of regulation in reinvesting entire sales proceeds of eqity shares and loans back in the equity sector (see Appendix 4A). The income from the debenture investments are fixed and the invested capital is safe. Therefore, it is clear that the LIC's first objective is to ensure security of the capital as the investment in debentures of the companies holds major portion of the total investment in companies. At the same

time the recent revival in investment in equity capital implies that the LIC is also aiming at higher returns. Though equity capital is risky it generally provides a higher return.

Apart from investing in securities, the LIC also does underwriting business in the primary market. Table 4.9 gives out the average number of primary issues per year and the comparision of its underwriting investments as between different securities.

Table 4.9: Percentage Distribution of LIC's Underwriting Investment (Annual Averages)

Year	No of Primary Issues Per Year	Debentures & Bonds	Preference Shares	Equitiy Shares	Total	Proportion of Corp Secu
1957-61	23	47.63	34.72	17.65	100.00	3.53
1962/63-71/72	92	84.85	8.52	6.33	100.00	15.03
1972/73-81/82	83	95.14	2.08	2.78	100.00	23.10
1982/83-91/92	72	98.75	0.00	1.25	100.00	24.47
1992/93	88	99.27	0.00	0.73	100.00	15.35

Source: Annual Reports of LIC; Various Issues

It will be seen that there is a growing preference for underwriting debentures and bond issues. The non-preference for underwriting equity issues stems partly from the statutory regulations in the LIC's equity holdings (see chapter VI).

4.3 Conclusion

The present chapter has analysed LIC's investment pattern keeping the statutory regulations and controls in the background. Commensurate with the growth of busines its life fund and investments have gone up considerably. The major chunk of its investments have been going into public sector to finance socially oriented sectors consistent with development plan programmes. So the benefits spill over to the macroeconomy at large through the central

government, state governments and statutory corporations and cooperative and housing banks.

However, in recent years there has been a noticeable shift in the flow of funds to the private corporate sector partly because of the favourable developments in the capital market. The LIC is also getting, in a big way, into financial services such as underwriting primary issues of corporate securities. The increased investments in private sector and loans & mortgages also brought about a rise in the net investment income (increase in the gross realised rates of returns as discussed in Chapter III), as observed in the previous chapter. Lack of disaggregated data is a handicap in examining some trends in depth. Also, LIC's investments appear to be broad-based across instruments, sectors and industries in a manner broadly consistent with portfolio management despite the statutory obligations.

In the light of the analysis of LIC's investment operations in the present chapter and that of insurance operations in the previous chapter, the following chapter seeks to evaluate in general and in specific terms the operational efficiency of the corporation.

APPENDIX 4A

In April 22nd 1975, the governement made major modifications in Sec 27 (A) of the LIC Act 1956. With these modifications LIC has to invest each year and at all times keep investing 75 percent out of the accretions to the controlled fund[35] in the following way[36]:

Control Fund:

(a) Socially oriented sector

(1)	In central government securities being not less than	20 per cent
(2)	In loans to National Housing Bank including (1) being not less than	25 per cent
(3)	In central and state government securities including government guaranteed marketable securities and inclusive of (2) being not less than	50 per cent
(4)	In socially oriented sectors including public sector, cooperative sector, house building by policy holders, own your house schemes inclusive of (3) being not less than	75 per cent

(b) Other investments:

(1)	In private sector, approximately	10 per cent
(2)	Loans to policy holder approximately	8 per cent
(3)	Construction and acquisition of immovable property by LIC approximately	2 per cnet
(4)	Funds in pipeline not available for investments approximately	5 per cent

Apart from these above mentioned regulations in accordance with the Sec 27 (A) and 27 (B) of the Insurance Act, LIC cannot invest more than 15 percent its funds in otherwise than approved investments without the approval of the Board of Directors. Where approved investments refers to securities issued by state government or municipalities including debentures, mortgage properties in India approved by central or state governments, preference share of the companies which offered dividends on its ordinary shares for five years. Further LIC shall not invest in equity shares of any one company more than 30 percent of the subscribed equity share capital of the company except with the prior permission of the central government. From 1st April 1989 the government has approved reinvestment of the entire sales proceeds of equity shares and redemption proceeds of debentures, preference shares and loans back in the equity sector.

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35 . Control fund refers to all the funds appertain to life insurance business of an insurer.

36 . The following is adapted from the Report of the Committe on Insurance Sector (GOI); Ministry of Fianance , 1994 pp-45.

APPENDIX 4B

INDUSTRY-WISE DISTRIBUTION OF INVESTMENTS

(in per cent)

Industry	1957	1961	1964/65	1968/69	1972/73	1976/77	1980/81	1984/85	1988/89	1992/93
Aluminium	0.00	3.36	2.61	3.59	4.20	3.74	2.86	2.48	2.59	1.48
Banks	3.81	3.46	3.80	3.48	1.17	0.39	0.31	0.02	0.00	0.01
Cement	5.29	5.67	5.02	5.27	4.76	4.02	3.01	2.98	3.11	1.55
Coal	2.78	2.64	2.29	1.82	1.51	1.28	0.98	0.53	0.11	0.04
Cotton	9.99	8.94	11.46	11.28	10.83	9.28	8.49	9.03	4.72	5.65
Chemicals	1.73	2.03	2.80	3.34	4.71	4.25	7.99	9.03	18.11	14.45
Electricity	11.99	9.52	7.22	7.32	7.82	8.90	6.93	5.12	7.97	12.72
Electrical goods	0.00	3.70	4.68	5.02	4.74	5.06	9.43	8.42	13.42	11.17
Enginiering	10.33	11.31	15.15	18.89	21.31	23.31	22.98	28.25	16.62	19.86
Food	0.00	0.99	0.94	0.89	1.13	1.30	1.12	1.27	0.57	0.25
Insurance	1.96	2.53	1.46	1.16	0.00	0.00	0.00	0.00	0.00	0.00
Investment Trusts	0.73	1.98	1.04	1.22	1.78	2.76	2.90	2.74	1.80	2.91
Iron & Steel	7.93	8.33	6.65	8.25	9.90	8.72	4.35	5.29	3.82	4.59
Jute	6.00	4.24	3.63	2.69	2.37	2.03	1.16	1.18	0.55	0.56
Managing Agents	2.44	1.70	1.10	0.67	0.00	0.00	0.00	0.00	0.00	0.00
Matches	0.00	0.65	0.50	0.40	0.36	0.34	0.28	0.47	0.20	0.11
Mining	0.49	0.65	0.43	0.41	0.48	0.26	0.20	0.12	0.05	1.48
Mineral oil	0.00	7.46	9.29	3.85	1.72	0.45	0.26	0.17	1.02	0.19
Paper & Paper Prdts	4.47	4.30	3.62	3.74	3.65	4.20	3.85	4.04	2.29	2.01
Plantation	1.96	2.21	1.62	1.36	1.19	0.96	0.86	0.88	0.91	0.67
Railways	1.02	0.64	0.41	0.34	0.30	0.20	0.14	0.09	0.03	0.01
Rubber	0.00	2.37	2.04	2.31	2.58	4.17	3.50	3.88	1.50	1.64
Shipping	1.76	0.82	0.48	0.40	0.57	0.78	0.87	0.77	0.31	0.43
Sugar	2.06	4.04	3.70	3.46	3.12	2.79	2.14	1.34	0.76	0.58
Textiles	1.29	1.99	3.35	3.01	2.95	2.92	3.60	5.69	12.45	9.62
Vegetable Oil	0.48	0.66	0.58	0.94	1.21	1.30	1.44	1.11	0.63	0.54
Cooperative Housing	0.43	0.23	0.15	0.11	0.08	0.00	0.00	0.00	0.00	0.00
Miscellaneous	21.06	3.59	3.98	4.96	5.96	5.51	4.64	4.71	7.52	7.46
Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

Source: Annual Report of LIC; Various Issues

CHAPTER V

OPERATIONAL EFFICIENCY

5.1 Introduction

The preceding two chapters have analysed the operating efficiency and investment portfolio of the LIC. The present chapter seeks to evaluate the efficiency, in physical and financial terms, of the LIC. Insurance, being essentially a service industry, would require a distinct set of criteria for evaluating its overall efficiency. In the discussion that follows, the focus will be on following set of physical and financial performance indicators. The physical performance indicators includes the Lapsation, Claims Settlement, Productivity per Employee, Productivity per Agent and Product Range. The financial performance indicators includes the stability ratios, turnover ratios and the profitability ratios.

5.2 Physical Performance

This section discusses the relevant physical performance indicators such as: the lapsation, claims settlement, productivity per employee, productivity per agent and product range.

5.2.1 Lapsation

One of the important indicator of physical performance is the rate of lapsation of policies. Lapsation rate is expressed in terms of lapse ratio, which is the ratio of sum assured lapsed less sum assured revived in the year to the mean business in force during the year. For various reasons the insured sometimes shows his inability to pay the premiums after a short continuation leading to lapsation of the policy. This is a loss for both the insurer and insured. The insurer bears a loss i.e., the cost of procuration of the policy due to the high

initial expenses and for this reason the moment the policy lapses before its full life, it pushes up the expense ratio and gets reflected in the higher premium rate. And the insured forgoes the benefits he would have got had the policy been continued till the maturity period. In the prenationalisation period high lapsation ratio was witnessed, therefore one of the objective of nationalisation was to curb lapsation of policies effectively to avoid inevitable wasteful expenses. The lapse ratio of the corporation has shown an improvement as it came down from 6.22 in the late 50's to 4.83 percent in 1991 (see Table 5.1). But the rising trend in recent years indicates no significant change in lapsation of policies.

However, net lapse ratio would be a better indicator than the afforsaid lapse ratio. Since lapses are the heaviest at the early duration of the policies, lapse ratio calculated without taking into account the distribution of the business according to duration, do not always provide a reliable index of the trend of lapses from year to year. Nevertheless such ratios, reflecting to some extent the economic conditions and other features affecting lapses during the year, are not without statistical significance . Therefore, the best method of studying the phenomenon of lapses to take the new business done during a particular year and follow it during the next few years and see how much of it lapsed in the same calendar year, how much in the next and so on (Annual Reports of LIC; 1959). Both the ratios are given in Table 5.1.

The net lapse ratio gives the survival period of a policy with respect to the year of commencement. This shows a gradual decline from 34.04 percent to 26.32 percent. That means roughly one out of 4 policies that are issued, lapses with in the fourth year of its commencement. Therefore effective steps needs to be taken to curb this.

Table 5.1: Lapse Ratio and Net Lapse Ratio by Mean Duration of LIC

(Annual Averages)

Years	Lapse Ratio[1] (in per cent)	Net Lapse Ratio[2] by Mean Duration[3] (in per cent)
1957-61	6.22	2.64 18.62 8.68 4.10 34.04
1962/63-71/72	6.78	1.48 17.85 9.15 4.85 33.33
1972/73-81/82	4.84	0.69 15.71 8.27 3.36 28.03
1982/83-91/92	4.83	0.50 14.38 8.01 3.44 26.32
1992/93	6.10	0.90 14.50 8.90
1993/94	5.90	1.00 15.60
	6.30	0.60

Source: Annual Reports of LIC; Various Issues

Note: (1) Lapse Ratio is the net lapses to mean life insurance business in force. (2) For net lapse ratio corresponding years refers to year of new business. (3) Mean Duration is the year of lapsation minus the year of commencement

Lapsation of policies is influenced by other external factors and client servicing. In this regard agents plays a crucial role in issuing policies. It is often argued that due to the pressure from development officers and the lure of high commission in the first year from the new policies the agents carry out forceful method of issuation of policies rush hour acting, neglecting the qualitative aspect of policy holder. This get reflected in the unevenness of the business in and around the last month of the year.

The examination of monthly business shows that on an average the new business in the last two months constituted 52.32 percent in the late 50's, 28.89 in 60's, 32.86 percent in 70's, 43.04 percent in 80's and 40.56 in 1993/94 (Annual Reports of LIC; Various Issues). The peak tends to be in last quarter of the financial year, because this happens to settle the income tax accounts and wish to avail of the tax-concession through purchase of insurance policies. Also this happens to be post-harvest period. Nevertheless it can be said that the high commission in the first year is instrumental in this rush by agents.

5.2.2 Claim Settlement

client servicing influences a lot in selling life insurance policies and afterwards. Much of it influences the peoples perception towards life insurance. The claims settlement operation is one of the important aspect of the customer service of any life office. The efficiency of claim settlement operation is looked at in terms of the total number of intimated claims settled during a given year. In other words if the outstanding claims as proportion to the total number claims that are payable during a given year is showing a consistently a declining trend then it is supposed to reflect the efficiency in settling the claims. This is examined in Table 5.2.

Table 5.2: Outstanding Claims as Percentage of Claims Payble[1] during the Year

(Annual Averages)

Year	Death Claims		Maturity Claims		Total Claims	
	By No	By Amount	By No	By Amount	By No	By Amount
1974/75-78/79	28.16	30.21	10.56	8.11	13.31	14.35
1979/80-83/84	26.46	28.46	12.62	10.16	14.22	14.74
1984/85-88/89	16.01	20.41	5.14	4.64	6.08	7.78
1989/90-93/94	8.79	15.66	2.77	2.80	3.29	5.42

Source:Annual Reports of LIC; Various Issues

Note: (1) Claims payable is the claims outstanding at the beginning of the year plus claims intimated during the year

The outstanding claims as a proportion of the claims payable in a given year both by number and amount has declined to a significant extent. The percentage of outstanding maturity claims both in terms of number and amount declined sharply to a little less than 3 percent, where as the outstanding death claims declined to 8.79 percent and 15.66 percent respectively. The operational efficiency lies not only in settling claims but settling claims in the minimum time duration. The analysis of average days taken for settling both maturity and death claims will shed some light on this aspect (see Table 5.3).

Table 5.3: Duration-Wise Percentage Distribution of Settled Claims (Annual Averages)

Time Duration	Average Time Taken for Maturity Claims 1974/5 1978/9	1979/80 1983/84	198/85 1988/9	1989/90 1993/94	Average Days Taken for Death Claims 1974/5 1978/9	1979/80 1983/84	1984/5 1988/9	1989/90 1993/94
Less than 3 months								
By Number	45.92	52.68	58.04	69.24	39.17	39.98	46.48	49.83
By Amount	48.95	54.54	58.16	70.81	38.36	40.47	47.04	45.32
3 to 6 months								
By Number	23.44	21.16	18.95	14.04	16.12	15.68	16.55	17.64
By Amount	21.11	19.70	18.28	13.52	16.16	15.38	16.52	17.75
6 to 12 months								
By Number	13.84	12.05	12.79	8.69	17.89	18.35	16.59	17.78
By Amount	11.70	10.55	12.21	8.28	17.75	18.68	16.74	19.39
1 to 2 Year								
By Number	10.17	8.74	6.91	5.08	16.04	14.85	11.92	9.85
By Amount	10.26	9.69	6.35	4.53	17.04	14.38	11.97	11.92
More than 2 Years								
By Number	6.63	5.37	5.31	2.95	10.78	11.14	8.46	4.90
By Amount	7.98	5.52	5.00	2.86	10.09	11.08	7.73	5.62
Total								
By Number	100	100	100	100	100	100	100	100
By Amount	100	100	100	100	100	100	100	100

Source: Annual Reports of LIC; Various Issues

The above analysis shows that there is a definite improvement in claims settlement operations in terms of average time taken for claim settlement. More number of maturity claims both in terms of numbers and amount are settled in less than 3 months which stood on an average at 69 and 71 percent in early 90's respectively. In case of death claims, improvement has been registered to near about 49 and 45 percent for the above period respectively. And nearly 85 percent of maturity and more than 60 percent of death claims are settled with in 6 months. Therefore with the improvement in the claim settlement operation and average days taken for, the number of complaints per ten thousand mean number of policies in force has come down on an annual average from 1.36 percent in 60's, 0.69 percent in 70's, 0.31 percent in 80's, 0.26 percent in 1992/93 and 0.23 percent in 1993/94 (Annual Reports of LIC; Various Issues).

5.2.3 Productivity per Office and per Employee

At the time of nationalisation the life business was mostly concentrated in urban pockets and in big metropolitan cities with few offices. Thus efforts were being made to spread the business by opening up more number of divisional and branch offices and recruiting employees to bring in both urban as well remote rural areas into its area of operation. Commensurate with the growing business one would notice that offices grown in numbers on an annual average 5.41 and 7.01 percent in the two sub-periods. The average production per office increased from 3.22 thousand to 3.84 thousand policies and Rs. 2.46 crores to Rs. 11.96 crores sum assured in terms of new business for the same. While policies in force per office has declined marginally from 27.02 thousand to 25.03 thousand but per office sum assured increased from Rs 15.31 crores to Rs 55.85 crores (see Table 5.4).

Table 5.4: Performance of Offices[1]

Performance Indicators	1957-83/84	1983/84-93/94
1. Growth Rates[2] of Total No of Offices (percent)	5.41	7.01
2. Average Production per Office		
a. New Business- Individual		
(i) Number of Policies ('000)	3.22	3.84
(ii)Sum Assured (Rs.in Crores)	2.46	11.96
b. Business in Force		
(i) Number of Policies ('000)	27.02	25.03
(ii)Sum Assured (Rs.in Crores)	15.31	55.85

Source: Annual Reports of LIC; Various Issues

Note: (1) Total number offices includes the zonal offices, divisional offices and branch offices. (2) The period wise growth rates are estimated using a Kinked-Exponential Fit of the type $Ln(Y)=A+B(D1t+D2k)+C(D2t-D2k)+e$, Where Y is the dependent variable, t is the time period, k is the kink and B and C are the growth rates for the respective periods and D1 and D2 are the dummy variables. (3) Average production refers to the life insurance business per office. (4) The value figures are nominal and not corrected for inflation.

At the same time the growth in employees, being 1.59 and 6.26 percent, is less than the growth in offices. The average production per employee increased significantly both in

terms of new business and business in force. The new business has gone up on an average from over 236 to 479 in terms of policies and from Rs.22.43 lakhs to Rs.141.71 lakhs in terms of sum assured in the respective sub-periods. At the same time the cost ratio (salaries and other benefits to the DO's to premiums) per DO has shown a slight decline. Thus while there is a marginal decline in expenses, average production has shown improvement over the years.

Table 5.5: Growth and Performance of Employees

Year	1957-83/84	1983/84-93/94
1.Growth Rates[1] of		
Total Employees (in percent)	1.59	6.26
a)Class I Officers	4.76	8.57
b)Development Officers	0.17	9.94
c)Supervisory & Clerical	1.66	5.55
d)Sub-ordinate Staff	1.24	3.45
2.Average Production Per Employee		
(i)New Business-Individual		
a)Number of Policies	32.69	70.01
b)Sum Assured (in lakhs)	2.90	21.14
(ii)Business in Force-Individual		
(a)Number of Policies	290.24	457.82
(b)Sum Assured (in lakhs)	18.62	101.22
3.Average Production Per Development Officer		
(i)New Business-Individual		
a)Number of Policies	236.12	479.31
b)Sum Assured (in lakhs)	22.43	141.71
4.Average Cost[2] Per		
a)Employee (in percent)	14.45	11.38
b)Development Officer(in percent)	21.48	21.32

Source: Annual Reports of LIC; Various Issues

Note: (1) In computing growth rates same procedure is followed as in table 5.1. (2) Average Cost is the ratio of salaries and other benefits paid to employees to premium income (3) The value figures are nominal and not corrected for inflation.

5.2.4 Productivity of Agent

Agents play a crucial role in the progress of life business. More or less the quality of the business ultimately hinges upon the shoulders of the agents. There are agents who takes

it as subsidary profession and others who are specially recruited known as active agents. In the prenationalisation period there existed former type of agents and most of them were causal and benami agents, just to getting high initial commissions, seriously affecting the growth of the business. One of the plank of the nationalisation was to do away with this mushrooming of benami agents by taking appropriate steps such as training and encouraging agents, through higher remuneration to, take up it as main profession. Even panchayats and cooperatives were permitted to take up agency. The changes in the nature and quality of the agents soon gets reflected in the growth of the business along with increase in the productivity of the agents. The detailed analysis on the performance of he agents was given in Table 5.6.

Table 5.6: Performance of Agents

Performance Indicators	1957-83/84	1983/94-93/94
1.Growth Rates[1] of		
a)Total Agents (in percent)	- 1.25	15.96
b)Active Agents (in percent)	4.28	14.82
2.Average Production per Active Agent		
a)New Business-Individual		
(i)Number of Policies	13.23	19.66
(ii)Sum Assured ('000)	12.45	54.40
3.Commissions ('000)	2.96	10.76
4.Average Cost (in percent)	8.62	8.81

Source: Annual Reports of LIC; Various Issues
Note: (1) In computing growth rates same procedure is followed as in Table 5.1. (2) The value figures are nominal and not corrected for inflation.

As the benami agents were removed through careful selection and other appropriate measures one can see a negative growth rate of -1.25 per cent for total agents in the first period and a positive growth rates of 4.28 per cent for active agents. In the sub-period II both total agents and active agents grew at an annual average growth rate of 15.96 and 14.82

percent respectively. Thus the average productivity per agent was on an average about 13 and 20 policies and Rs.12 thousand and Rs.54 thousand in terms of sum assured in the two sub-periods. In other words an individual active agent used to take on an average around 27.59 days to get a policy to be issued in the sub period I now takes only 18.57 days in the sub period II reflecting an improvement. At the same time the cost of the agents i.e., the commissions and bonuses paid to the agents to the premium income remained almost same in both the sub-periods.

5.2.5 Product Range

In a competitive world firms seek product differentiation in order to gain an edge over their rivals in the market. Product differentiation may come about through product variation and advertisement (Chamberlin; 1962:89-92). Product variation results from technical change or a new design or better service.

Even though life insurance business in the Indian context is a monopoly of the LIC, product differentiation would still be necessary for somewhat different reasons. It needs to adopt a sophisticated marketing strategy to identify the needs of the customers through the introduction of a variety of new products. One such strategy is market segmentation which aims at devising products to suit the needs of particular sections of the society. Market segmentation usually based on demographic and buyers' characteristics such as attitude, motivation, values and use patterns (Franklin and Woodhead; 1980:159). This helps in determining the types of segmentation and in positioning different products accordingly.

The LIC has devised various schemes in order to spread the message of life insurance and increase sales. The typology of products can be classified in number of ways. On the basis

of duration: whole life policy or endowment policy or term insurance policy[37] and these are further subdivided. On the basis of payment of premium, the policies may be level premium policy or single premium policy or limited premium policy. One policy may cover single life or joint or multiple and policies under group insurance schemes covers number of lives at a time. These polices may be in the nature of with-profit or without-profit depending on whether the insured is entitled to receive share of profit/bonus. The with-profit policy generally carries a high premium rates than without-profit policy.

Apart from these conventional policies the corporation offers from time to time different policies targeting different sections (for details, see the Appendix 5-A). These products include those aimed at covering work force of industrial and organised sector including public sector employees, vulnerable sections including the farming community, armed forces, women work force, pension holders, children, disabled, ailing persons, etc. The incentive structure in the early years were to protect life cover, easy payment and waiving of extra premiums. But after 80's there is a marked shift in the product structure attached with income tax concessions, hedge against inflation, cheap term insurance and endowment plans, protection to children for educational and marriage purposes, construction of house and protection from major ailments.

The group insurance products attach protection for the retirement age with low premiums and easy insurable conditions, loans and pension benefits to the employers of the organised

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[37] Under whole life policy sum assured is paid only on the death or after attaining age of 100 years of the assured. Endowment policy is for a fixed period and the sum assured is payable either at the end of the period or earlier death of the assured. Term insurance policy is a short term policy and sum assured is payable incase of death of the assured with in the period.

sector (see Appendix 5-B). In recent years for protecting the weaker sections of the society, a number of social security group insurance schemes for Landless Agricultural Labourers (LALGI from 15th August) and IRDP beneficiaries (from April 1988)[38] have been devised with central government sponsorship. Also with the central government directive the LIC constituted a separate fund called Social Security Fund of Rs.100 crores in 1988/89 for the benefit of economically weaker sections of the society in the organised sector[39].

But, unless one knows how these have been accepted by the intended beneficiaries, one cannot be sure whether they are successful or not. This can be known, to some extent, from the analysis of plan of assurance. In this respect the distribution of new business according to plan of assurance is analysed in Table 5.7.

From Table 5.7 it can be inferred that the hole life policies not only continued to be a small part of the total new business but also declined in their share. Though endowment policies holds a substantial share, has been showing a declining trend. Contrarily there is a marked shift in peoples preference for other policies which are target oriented products. From the analysis, it may be asserted that the growth in business in post 80's may also be due to the varieties of products LIC was to offer bringing marketing professionalism in its functioning. An important implication of this analysis would be that there is a change in peoples perception in going for life insurance. They no longer view it merely as a death tax, rather

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[38] Upto 31st March 1994 120 lakh and 151.74 lakh lives were covered under the LALGI and IRDP schemes respectively.

[39] There are 23 groups covered under different schemes.
They include: Handloom weavers, Khadi weavers, Brick-klin workers, Bidi workers, Carpenters, Cobblers, Fisherman, Handicraft Artisans, Hammals, Lady Tailors, Leather Workers, Rickshaw Pullers, Safai Karmacharis, Papad Workers, Physically Handicapped Self Employed, Tendu Leaf Collectors, Urban Poor, Forest Workers, Sericulture, Powerloom Workers and Toddy Tapers.

as a source of incentives and are choosy. They take up policies based on the incentive structure behind the product such as: whether the product offers income tax relief, savings element, cheap term insurance, investment linked higher returns or any special element added to it. This would mean that, given the competition from the growing number of other savings institutions, the LIC should come up with effective marketing strategy by designing better target oriented products to better reflect peoples preferences and choices with a higher returns attached with the products. For this, the LIC's investment portfolio should yield higher returns ensuring safety.

Table 5.7: Percentage Distribution of New Business (Individual) According to Plan of Assurance (Annual Averages)

Plan of Assurance	1964/65 to 1968/69	1969/70 to 1973/74	1974/75 to 1979/80	1979/80 to 1983/84	1984/85 to 1988/89	1989/90 to 1993/94
Whole Life (No)	5.39	4.80	2.78	1.65	0.28	0.06
Policies (SA)	8.10	6.72	4.01	2.72	0.56	0.14
Endowment (No)	77.08	70.70	58.07	59.96	63.73	40.28
Policies (SA)	66.16	59.14	44.00	48.26	51.55	33.73
Anticipated (No) Endowment	12.95	16.92	31.71	9.74	0.54	0.00
Policies (SA)	16.50	21.86	41.10	11.69	1.23	0.01
Children's (No)	2.46	3.34	2.63	1.47	0.92	0.33
Policies (SA)	4.66	7.25	5.30	2.90	1.89	0.47
Other (No)	2.12	4.24	4.81	27.81	34.53	59.33
Policies (SA)	4.57	5.03	5.59	34.42	44.77	65.65
Total New (No) Business	100.00	100.00	100.00	100.00	100.00	100.00
Policies (SA)	100.00	100.00	100.00	100.00	100.00	100.00

Source: Annual Reports of LIC, Various Issues

Note: (1) NO refers to Number of Policies. (2) SA refers to Sum Assured. (3) Other includes specific products developed from time to time such as: Salary Saving Schemes, Centenary Policy, Grihalkmi, Money Back, Cash and Cover, Jana Raksha, Jeevan Mitra, Jeevan Sathi and etc.

5.3 Financial Performance

The previous section has examined the physical performances of LIC based on claim settlement operation, time taken for claim settlement, productivity of the personnel and agents, product range and so on. A better physical performance normally implies operation of economics of scale, reduction in premium rates, minimisation of operational expenses with higher percentage of institutionalisation of savings as life fund; which in turn would mean, *ceteris paribus,* higher profits and vice-versa.

The present section seeks to examine the extent to which the relatively better physical performance of the corporation over the years gets reflected in its financial performance. In other words it goes into the question: "Does better growth performance of the corporation translated into higher profitability and better financial position"? But before dealing with this such question it should be made clear that it is plausible that even the realised physical performance does not yield corresponding financial results. The reasons for this may be poor financial management, constraint of markets and government regulations, compulsory social services etc,.

Often there seems to be a conflict between the objectives of public sector enterprises as an economic unit and the political considerations that may enter into the decision making process of the management. Under these considerations the norms applied to asses financial performance of a private business may not apply to LIC since their sources of finance, cost of finance, wage and pricing policies are entirely different from private enterprises. As referred profit or losses are not the result of management capability but of conscious state intervention or because of market imperfections, the use of profitability as an index of efficiency becomes very questionable. Evaluation of public sector in India is

based essentially from the limited information gathered from the balance sheet and profit and loss accounts of the enterprises, where as the role expected of the enterprises may not be confined to financial performance only. Such objectives as provision of employment, emphasis on social security measures, contribution to growth, technical progress and the correction of regional imbalances may often contradict objectives like generating financial surpluses for self stability. This gives us to say that microeconomic profitability does not always reflect the macroeconomic benefits (UNCTAD; 1993).

Despite the widely accepted conceptual difficulties in dealing with financial performance, per se financial profitability is often used as an important criteria for the evaluation of public sector performance. A study of financial performance is important in itself in that "financial health, as one aspect of general economic health, is essential if business is to perform its social function well and play its proper part in the general well being of the economy (Guthman; 1962:4). As Sen argues, the tendency to judge the success or failure of public enterprises based on this criteria might not be fully justified, but it is fairly inescapable in the absence of a different system or well formulated alternative criteria for performance evaluation (Sen; 1983). Thus, financial profitability and good operating efficiency are necessary to enable the public sector to discharge social objectives as well. Thus the evaluation of the corporation from the dimensions of physical as well as financial performance is imperative and constitutes a good starting point for reexamination of its role to evaluate the case for privatisation.

5.3.1 Methodology

An understanding of financial ratios, that reflects the soundness of the internal working of a company, is necessary for the purpose of any sound analysis of financial statements (BSE;

1996:38). The present section follows the usual methodology adopted by the Bombay Stock Exchange Directory in computing special ratios for life insurance corporation. Financial ratios presented in annual basis are expressed in percentages. The financial performance of the corporation is analysed for the period of 1964/65 to 1993/94. The financial ratios used to evaluate financial performance are grouped under three heads:(i) Stability Ratios (ii) Turn Over Ratios and (iii) Profitability Ratios. Since any one ratio taken alone may cloak the strength or weakness of others, the study made use off all the available financial ratios to get the overall picture.

5.3.2 Stability Ratios

The stability ratios comprise the following seven computed ratios:

(i) Reserves to paid up capital

The first ratio is reserves to paid up capital. A higher percentage does indicate a better capacity to maintain dividends and bonus in the difficult years. For the corporation this has been showing a continuous upward trend except in the early 70's where there is a decline.

(ii) Net worth to total assets (or proprietary ratio)

This is the percentage of assets financed by shareholders. This ratio measures the importance of shareholder's equity in relation to borrowed funds and indicates the margin of safety for creditors. This ratio remained around 1 percent except in the initial years when it was more than 3 percent. A lower percentage indicates that a larger portion of funds is supplied by trade and long-term creditors and the shareholder's equity is very small which is obvious for life insurance corporation as the central government's initial contribution is

Rs.5 crores only, where as its huge fund comes through the premiums it collects by selling policies. Thus the lower ratio implies under capitalisation but higher earnings per share.

(iii)The outstanding premiums and balances with agents and other insurers to total assets

This ratio measures the liquidity of the enterprise. The amounts due from other insurers of insurance companies are like trade debtors of non-financial companies. This ratio is very low for the corporation and around 1 percent only. This is a positive indication which implies that at the end of the year lower amount is outstanding, so the liquidity of the corporation is high.

(iv) Increase in insurance funds to net premium

This is the ratio of insurance funds at the end of the year minus insurance funds at the end of the previous year to premiums less reinsurance. Insurance funds represent unearned premiums or reserve for unexpired risks, that is the allocation made out of the premiums received during the year to pay claims arising out of policies for which the period of coverage or risk has not expired as at the date of the balance sheet. Thus the provisions made depend on the nature of the business. This ratio shows the net increase or decrease in the amount carried forward as a percentage of the premium received during the year. A positive ratio indicates that the true profits for the year are likely to be understated and that more is carried forward to provide a cushion against future unfavourable contingencies. This represents a stable position and the higher the percentage greater is the stability. For the corporation this ratio is not only high but also shown an upward trend as it increased from 72 to 86 percent.

(v) Investment to net worth plus insurance funds

Investments on the one hand gives source of income and constitutes major portion of profit to a company and on the other hand in time of need they can be sold off for meeting current liabilities. Therefore, a greater percentage ensures greater stability and indicates higher potential profits. This ratio varied between 53 and 61 percent showing more or less a stable trend.

(vi) Investments in government and other trustee securities to total investment

This ratio shows investments in government and other securities as a percentage of total investment. Government securities ensures security and stability. A high percentage indicates better liquidity and stability. However, a high percentage beyond a point does imply uneconomic utilisation of resources which could be used in other ways of earning a higher income. The corporation has been investing heavily in government and other trustee securities to ensure security. This is increased from 75 to 90 percent between from mid 60's to early 80's, but later declined to 83 percent in early 90's. This does indicate that though the objective of maximum security is fulfilled by ensuring liquidity and stability it might be losing higher income earning capacity from its alternative investment opportunities.

(vii) Investment in equity shares to total investment in companies

This ratio is the proportion of equity shares in the investment portfolios of the companies. Equity capital is risk capital, so a higher percentage indicates a relatively higher risk with higher returns in general. The corporation's investment in equity capital has came down sharply on an average from 58 to 30 percent of the total investment.

(viii) Investment in preference shares to total investment in companies

This ratio shows the proportion of the total investment in the form of preference shares. Investment in preference shares carry higher dividend than the interest paid on government securities or debentures. The corporation's investment in preference shares to total investment in companies declined sharply to 1 percent.

(ix) Investment in debentures to total investment in companies

This ratio shows the proportion of the total investment held in the form of debentures. The income from debenture investment is fixed and the principal is safe. Therefore, a high ratio of investment in debentures to total investment indicates greater stability. This ratio increased from 25 to 68 percent.

Table 5.8: Trends in Stability Ratios[1] (Annual Averages in percent)

Ratio\Year	1964/65 to 1968/69	1969/70 to 1973/74	1974/75 to 1978/79	1979/80 to 1983/84	1984/85 to 1988/89	1989/90 to 1993/94
a) Reserves to Paid Up Capital	738.40	695.20	1381.60	1602.80	2822.80	4902.40
b) Net Worth to Total Assets	3.40	1.80	1.80	1.00	1.00	1.00
c) Outstanding Premiums & Balances to Total Assets	1.40	1.60	1.00	1.00	1.00	1.60
d) Increase in Insurance funds to Net Premium	72.20	71.80	72.80	84.40	85.00	86.60
e) Investment to Net Worth plus Insurance Funds	61.80	61.60	53.80	55.80	61.00	61.40
f) Investment in Govt. & other Trustee Securities to Total Investment	75.60	80.20	86.00	90.40	88.40	83.00
g) Investment in Equity shares to Total Investment in Companies	58.40	56.60	56.80	51.40	30.40	30.80
h) Investment in Preference Shares to Total investment in Companies	16.20	17.00	16.00	11.20	3.20	1.00
i) Investment in Debentures to Total Investment in Companies	25.40	26.40	27.20	37.40	66.20	68.20

Source: Bombay Stock Exchange Directory, Volume 13 (ii); Various Issues

Note: (1) In computing ratios Bombay Stock Exchange Directory avoids two decimal figures, therefore slight differences may come.

5.3.2 Turnover Ratios

For the analysis of turnover, two turn over ratios have been computed:

(i) Operating income to total assets

This ratio measures the relationship between the amount invested in assets and the results accruing in terms of sales and indicates the efficiency in the utilisation of the assets of the company. This ratio may also show whether there is a tendency towards over-investment in assets. For the corporation this ratio on an average varied between 9 to 12 percent, therefore without showing a tendency of over investment in assets.

(ii)Operating income to net worth

This ratio shows the turn over of long term investment in terms of sales. Higher ratio is a more profitable situation, but beyond a certain stage a large turn over is hazardous. This ratio shows a continuous upward trend from 239 percent to 1545 percent for the above period.

Table 5.9: Trends in Turnover Ratios (Annual Averages in percent)

Ratio/Year	1964/65 to 1968/69	1969/70 to 1973/74	1974/75 to 1978/79	1979/80 to 1983/84	1984/85 to 1988/89	1989/90 to 1993/94
1).Operating Income to Total Assets	10.80	9.00	10.00	9.00	10.40	12.40
2).Operating Income to Net Worth	239.20	459.40	572.60	781.00	1274.40	1545.00

Source: Bombay Stock Exchange Directory, Volume 13 (ii); Various Issues
Note: (1) In computing ratios Bombay Stock Exchange Directory avoids two decimal figures, therefore slight differences may come.

5.3.3 Profitability Ratios

To examine the profitablity, following eight profitability ratios have been used:

(i) Claims paid to earned premium

This is claims under policies less reinsurance as a percentage of earned premium income. Earned premiums represents that portion of the premiums which expire during the accounting year. The ratio of claims to earned premiums shows the part of earned premium lost in meeting the claims arising out of maturity, death or surrender for life insurance business. A higher ratio discloses the risk involved in the business. This ratio is high and also shown an upward trend. In case of general insurance companies, because of the yearly nature of underwriting, claims are settled from the earned premiums and thus earned premiums are crucial. Where as for life insurance due its long term nature of claims, not only it will have in its hand the earned premiums for disposal but also the income from its investments.

(ii) Claims paid on death to total claims paid to policy holders:

This ratio shows percentage of premature discontinuity of policies due to the death of the policy holders. A lower ratio reflects a reduction in the cost of premiums. This is more profitable to business. For the corporation this ratio has declined from 22 to 14 percent.

(iii) Net commission to net premium:

Net premium is the premium receivable for the insurance business underwritten during the course of the year. This ratio is the percentage of net commission paid to premiums less reinsurance. A low ratio indicates a more profitable situation. For all these years this ratio is low and has shown a marginal decline from 10 to 9 percent for the corporation.

(iv) Expenses of management to net premium:

Most of the expenses of management are incurred at the time of procuring new policies. This ratio shows the percentage of net premium incurred in terms of the expenses of management. A lower ratio indicates efficient management. This ratio, though declined, has shown fluctuations. It was 27.58 percent in mid 60's but stands at 22.81 percent in the early 90's.

(v) Operating net profit to earned premium:

This ratio shows what percentage of the premium earned is available after meeting all expenses but before taking into account non operating income and expenditure to meet the income-tax liability and to provide a return on the shareholder's investment. This ratio was negative during 70's, around 10 percent in 80's and again declined to below 1 percent. Moreover this ratio also shows yearly fluctuations.

(vi) Net profit to earned premium:

This ratio shows the percentage of earned premium ultimately left to the shareholders. Except for the 70's when this ratio was negative, for all other years this ratio is positive.

(vii) Net profit to net worth:

This ratio measures the investor's rate of return in the form of dividends and profits retained in the business on owner's funds comprising of the paid-up capital and the accumulated profits/loss of the enterprise during past years. This is a key ratio to judge the overall financial performance of the corporation. Except in 70's, when it was negative, this ratio is positive and improved.

Table 5.10: Trends in Profitability Ratios (Annual Averages in percent)

Ratio/Year	1964/65 to 1968/69	1969/70 to 1973/74	1974/75 to 1983/84	1979/80 to 1983/84	1984/85 to 1988/89	1989/90 to 1993/94
1) Claims Paid to Earned Premium	79.60	118.80	135.20	252.00	344.80	313.20
2) Claims Paid on Death to Total Claims Paid to the Policy Holders	22.40	24.40	19.60	19.00	14.80	14.60
3) Net Commission to Net Premium	10.00	8.00	8.80	8.00	8.20	9.60
4) Expenses of Management to Net Premium	27.58	27.82	23.46	23.19	25.20	22.81
5) Operating Net Profit to Earned Premium	2.40	- 8.40	- 1.00	11.20	10.00	0.80
6) Net Profit to Earned Premium	9.00	- 1.75	4.67	16.50	6.25	12.80
7) Net Profit to Net Worth	17.40	- 2.00	8.33	28.00	21.00	38.00
8) Final Net Profit to Total Assets	5.20	- 0.25	1.00	0.50	19.00	0.00

Source: Bombay Stock Exchange Directory; Vol 13 (ii); Various Issues
Note: (1) In computing ratios Bombay Stock Exchange Directory avoids two decimal figures, therefore slight differences may come.

(viii) Final net profit to total assets:

This ratio measures the overall efficiency and profitability of an enterprise and reflects the economic productivity of the total resources employed by the corporation. A higher percentage signifies more economical or profitable use of the resources. On the other hand, a low ratio may reflect over-investment in assets in relation to sales or inefficiency of management. This ratio was mostly 0 to 1 percent for many years. However, being long term in nature, the operating income and profit arising out of it will be very small compared to its huge amount of assets.

5.4 Conclusion

This chapter examined the operating efficiency of LIC in terms of physical and financial performance. With the growth in business it is found that there is a significant improvement in the physical performance of the LIC. All the indicators such as, the outstanding claims to claims payable, and average time taken for settling claims including maturity and death

claims, productivity per offices, employees and agents and lapsation of policies shows consistent improvement over the period, while the operational cost remained almost same implying an improvement in physical performance of LIC.

The financial performance in terms of stability ratio and turnover ratio shows improvement over the period. Both the indicators reflects the safety and ability of LIC as a financial institution. The analysis of various profitability ratios shows that though most of the profitablity indicators have improved over the years and positive, but as compared to the growth of business and physical performance, the financial performance may not be up to the expected level. However, if evaluated against the background that LIC is operating under statutory regulations and government control, operating in a highly cost prone rural business with a consistently positive if not a high profitability, one can safely conclude that the financial performance of LIC is satisfactory. Against these findings the following chapter dwells into the issues in privatisation and foreign participation.

APPENDIX 5A

PRODUCT RANGE

YEAR	PRODUCT	TARGETED Group	SPECIAL Features	PRESENT Status
	GENERAL			
1972	Unit Linked Insurance Scheme		Planned saving & investment in Units & term insurance protection	
1977	Money back		Anticipated Endowment Policy	
1977	Progressive Protection		Automatic increase in sum assured at fixed intervals	
1985	Jeevan Mitra		Double cover endowment plan with profits	
1985	New Jana Raksha Plan		Single premium	
	ORGANISED & INDUSTRIAL SECTOR			
1957	Janata Policy Scheme		Door to door premium Collection & low sum assured	Withdrawn
1957	Salary Saving Scheme	Salaried employees	No extra premium & premiums paid from monthly salary	
1958	Non-medical Scheme	Approved male employees of organised sector	Issue of policies without medical examination under certain plans	
	Vulnerable & Rural Farming Community			
1971	Centenary Policy		Concession for default in payment	Withdrawn
1981	Jana Raksha Policy		Full insurance cover for 3 years	
	FAMILY & CHILDREN			
1975	Grihalaksmi	House wife	Protection to Women	withdrawn
1977	Cash and cover	Family	Early return of policy proceeds	withdrawn
1979	Children's Anticipated Policy	Children	childs life is insured at the age of 12	
1985	Jeevan Sathi	For couples	Double cover joint life plan	
1985	Marriage Plan/ Educational Annuity Plan with profits	Student or young girl	Counter against inflation	
1985	New Children's Differed Assurance Plan	Children	Risk coverage on the life of a child	
1988	Jeevan Dhara & Jeevan Akshay	Pensioner	Income-tax relief	
1989	Jeevan Balya	Children	Income benefit is paid in the death of the father/mother before age 21	
1992	Jeevan Griha		Double & Triple cover endowment plan	
1993	Jeevan Sukanya	Young girls	Risk cover to life assured after marriage	
1993	Jeevan Surabhi		Improved money back plan with increasing term insurance cover	
	POLICY HOLDER			
1988	Bima Niwas Yojana		Construction/purchase of flats	
	PATIENT			
1994	Asha Deep		Death & maturity payment against major ailments	

Source: Annual Reports of LIC 1957-93/94

APPENDIX [illegible]

GROUP INSURANCE SCHEME

(1)Group Term Insurance	Employers or group of persons	Uniform coverage, Outstanding loans to Primary Housing Societies, for Employers in construction of houses and for Professional groups
(2)Group Insurance & Superannuation Schemes		
(a)Deposit Linked Insurance Scheme	Employers	Low premium, Uniform coverage option, Prompt Settlement of Claims
(b)Gratuity Schemes	Employers	Protection against death, Higher benefits to dependents
(c)Superannuation Scheme	Empoyers	Regular incomes by way of pension after retirement
(d)Pension Scheme	Pensioner	Pension throughout the life and incase of death full purchase price is payable
(e)Savings Linked Insurance Scheme	Employers	Higher coverage and savings element with a sound rate of interest
(f)Voluntary Retirement Scheme	Employers	Group Annuity Certain and Group Life Annuity
(g)Social Security Schemes		
(i)Landless Agricultural Labourers Group Insurance Scheme (LALGI)	Landless Agricultural Labourers	Central Government sponsored scheme with a low sum assured (of Rs.2000)
(ii)Group Insurance Scheme for IRDP	IRDP beneficiaries	Insurance coverage to the IRDP borrowers to the extent of Rs.3000 and Rs.6000 for normal and accidental death
(iii)Social Security Fund	Weaker Sections	The premiums are paid by LIC and Central Government on 50/50 basis, Maximum benefit of Rs.5000 and Rs.10000 for normal and accidental death

Source: Annual Reports of LIC 1957-93/94

CHAPTER VI

ISSUES IN PRIVATISATION AND FOREIGN PARTICIPATION

6.1 Introduction

Opening up of the insurance industry to domestic and foreign companies is an issue that is at the center of the current debate on financial sector reforms as part of the current debate on financial sector reforms as part of the stabilisation-cum-strucural adjustment programmes initiated by the Government of India in 1991. An official Committee on Reforms in the Insurance Sector (Malhotra Committee) has strongly recommended the privatisation and globalisation of the Indian Insurance Industry.

Against the backdrop of the analysis of the operations of the Life Insurance Corporation in the previous chapters and the ongoing policy debates this chapter seeks to highlight the issues in privatisation and foreign participation. Section 6.2 gives a broad survey of the World Insurance Industry, section 6.3 survey the theoretical underpinnings of financial sector reforms in general. The following section survey the recommendation of the Malhotra Committee. Section 6.5 critically evaluates the recommendations of Malhotra Committee and concluding section gather the main points of the discussion.

6.2 World Insurance Industry

The world insurance industry recorded a growth in premium volume (US$ 1803 billion) of around six percent in 1993 over the previous year in real terms. And over the period 1986-93

there had been a similar growth in world's insurance business as a whole, with the life insurance sector recording a growth of over seven percent (see Table 6.1).

Table 6.1: The Structure of World Insurance

Continent	Premium Income (US $ in Billion) Total Insurance Business			Life Business		
	1989	1990	1993	1989	1990	1993
North America	483	514	600	203	222	252
	(39.87)	(37.95)	(33.29)	(31.97)	(31.85)	(24.96)
Europe	375	460	491	182	239	247
	(31.03)	(33.93)	(27.22)	(28.79)	(31.44)	(24.42)
Asia	311	334	628	228	222	482
	(25.70)	(24.64)	(34.84)	(36.02)	(33.83)	(47.42)
Africa	13	14	18	8	9	12
	(1.09)	(1.06)	(0.98)		(1.31)	(1.20)
Latin America	7	10	22	2	2	5
	(0.58)	(0.57)	(1.21)	(0.27)	(0.32)	(0.48)
Oceania	21	24	23	11	12	12
	(1.75)	(1.77)	(1.28)	(1.69)	(1.76)	(1.20)
Unclassifiable			21			
			(1.18)			
World Total	1210	1356	1803	634	707	1010
	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)

Source:SIGMA; Swiss Re, 2/91, 4/92, 5/95

Note: (1) Figures in the parenthesis refer to percentage share in world total.

Asia, America and Europe together contribute more than 90 percent of the total world insurance business in terms of premium income. Life insurance business account for the bulk of the insurance business, 76.8 percent in Asia, 22 percent in Latin America and 40 to 70 percent in other continents. Thus on an average life insurance business was 56.1 percent of the total insurance business (US $ 1010 billion) in the world in 1993. The Asian life market region recorded 5.5 percent real growth and constituted 47.7 percent of world wide premium income in the life sector. The Indian life insurance business with a real growth of 14.6 percent accounted for 0.32 percent of the world share in 1993.

Thus, the insurance industry has shown signs of development consequent to the economic growth including industrial and other activities of world economies. However, the spread and development of insurance industry is very skewedly distributed across the regions. And the world insurance business is dominated by few industrially developed economies. This dominance can be seen from the market share of industrial economies (see Table 6.2).

Table 6.2: World share of Largest Insurance Markets in 1993 (in percent)

Country	Total Insurance		Life Insurance	
	Rank	World Share	Rank	World Share
United States	1	31.31	2	2.82
Japan	2	30.36	1	42.61
Germany	3	6.44	5	4.54
Great Britain	4	6.15	3	7.05
France	5	5.27	4	5.67
South Korea	6	2.12	6	2.95
China	25	0.30	26	0.16
India	23	0.26	20	0.32

Source: SIGMA; Swiss Re, 5/95
Notes:(1)India and China's data has been given for comparative purposes.

From the table one would notice that more than 80 percent of the total and life insurance market shared by only top 6 industrial economies such as United States, Japan, Germany, Great Britain, France and South Korea. Similarly, though the Asian region accounts for 34.8 percent of the total insurance business in 1993, among the Asian countries Japan alone contributes 30.36 percent. The developing countries hold a very insignificant share in the international insurance market. The developing countries (LDCs) share in the total insurance business in the world is only 3.94 percent in 1988 and 4.56 percent in 1990 and share in the life insurance business is 3.68 percent in 1988 and 4.79 percent in 1990. China and India, the potential markets, together account for less than 1 percent. Therefore, it is clear that the industrial advanced regions dominates the world insurance market both in life and non-life insurance business.

The reasons for the skewed development of insurance business are multiple in nature. First, the insurance business is highly sensitive to the general socio-economic conditions of the region/country concerned. This probably explains why the insurance industry tends to be regulated one. And there seems to be a positive correlation between the economic development of a country and the amount of people spend on insurance.

Second, the demand for insurance is influenced by the general price level, prices of insurance services, the aversion to risk and the specific social and political features of a country (UNCTAD; 1993:2-5). The life insurance density and life insurance penetration (as defined in chapter III) of a cross sectional country analysis shows that the developed countries (DCs) having better life insurance business compared to the developing countries. For example, life insurance density for DCs in 1990 in US $ is as follows: Japan 2252.49, Great Britain 1775.15, United States 1928.66 and in case of some of the LDCs: India 5.60, Malayasia 32.68, China 0.53 and Indonesia 1.34 (SIGMA; Swiss Re, 4/92). Thus the DCs have a high amount of life insurance per head compared to the developing countries. Though India's position is far behind compared to the DCs but fares reasonably well compared to other DCs with a real growth higher than both DCs and LDCs.

Third, other than general socio-economic conditions, the business more or less depends on the way insurance operations carried out. In other words the condition under which the insurance market operates such as: the market structure, inadequate capital, investment regulations, the evaluation of underwriting loses and unsatisfactory claim settlement operations. In this respect the LDCs insurance markets, where both state and private insurers operate, feature monopolistic or oligopolistic or collusive oligopolies (cartels). Also

in the DCs where the private insurers operates feature highly centralised (or monopolised) insurance markets.

However, most of these DCs insurance market more or less reached to a saturation point. For instance in United States the number of policies in force was 39.4 crores where as the population was around 25 crores in 1989. In Japan for a 12.45 crore population 18 crore policies were in force in 1992. Around 81 percent and 93.7 percent of the households have some kind of life insurance (Jha; 1995:5-7). Thus this may indicate that the private insurers of DCs may look for other markets to ensure growth of their insurance business. And the target may be the Asian insurance markets, being in the initial stages they are considered as the fastest growing in the world. Next to Japan, South Korea and Taiwan the foreign insurers are vying for South East Asia specially China and India due to their enormous size and potentiality.

It is against this over all scenario one should weigh the pros and cons of privatisation and allowing foreign participation in the Indian insurance industry and more specifically in the life insurance sector. In Indian context, unlike the DCs which are characterised by not only economic growth but also over all socio economic development, the role of insurance industry should be evaluated very judiciously. The vast majority of population both organised sector and unorganised sector still to be brought into the social security by providing some kind of safety nets. Whereas even though the relative poverty in the Western countries is very low, they have taken sufficient care in developing alternative form of social security systems and a sizeable amount of funds flows into social sectors like health and education. But in the present Indian situation where the life insurance is playing a significant role as

an alternative given the inadequate social security protection, needs a careful scrutiny before privatisation question comes into picture.

6.3 Privatisation and Foreign participation

In the recent years many LDCs had to go for macroeconomic reforms involving stabilisation and structural adjustment programmes. In this context financial sector reforms specially the banking sector, which typically either owned by the state or heavily regulated in these economies as attracted attention in policy debates. The recently concluded Uruguay Round under the GATT advocated the removal of restrictions and non-tariff trade barriers, so that there will be free flow of international services to LDCs, in strengthening domestic capacity and improving efficiency and competitiveness in the ultimate enhancing economic growth. However, in insurance sector in LDCs, privatisation is not necessarily a response to lack of profitability. In fact well established strong state owned/controlled insurance companies contributed substantial amount of finance to the governments through taxes, dividends and investment in the government bonds and securities and allocating funds to the social oriented priority sectors for instance Argentina, Benin, Zaire and India.

Therefore the argument for privatising insurance industry really hinges on operational efficiency. This is based on the belief that in a competitive environment private firms will be able to minimise costs and offer competitive prices (in this case premium rates) for their products. This vision of resource use efficiency in the financial sector does not recognise some of the structural specificities of developing economies. For example, there is the real problem of missing markets, e.g., rural credit and insurance market. Secondly, given the very skewed distribution of assets in both agriculture and industry, the market by itself may be unable to allocate resources optimally across all sectors. For example, in the case of

insurance the governments may direct the insurance agencies to devise schemes specifically tailored for weaker sections to extend the cover up social security to these sections. Such schemes may not be otherwise commercially viable. Consequently such lines of business, marked by high transaction costs may push up costs and therefore premium rates.

Therefore, there is certain problems are inherent in privatisation. The very nature of scarcity of capital which resulted in state owned firms is due to short supply of domestic private funds. In the absence well developed financial market and infrastructure such as stock markets reduces the raising capital through equities for instance, Guinea and Pakistan. The private firms often show reluctance in the given unstable political and economic environment as insurance becomes less attractive and risky. Also in these countries state found to be unwilling to free completely the insurance industry considering its strategic importance for capital formation and resource mobilisation.

Also privatisation may not necessarily yield efficiency. The efficiency depends much on the nature of market and not solely on nature of ownership. Even if a public monopoly transferred to private monopoly efficiency may not increase in the absence of competitive environment (where there will be a drive for providing better service to hold the market share). Of course, the competitive environment must ensure cost efficient management service. And further to ensure transparency and strong competitive environment it necessitates enough back up from the state in the regulatory role. A regulatory and legal frame work which can supervise to prevent to the maximum the liquidation of firms, speculative trading and restrictive business practices, cartel formation by monopoly firms, may be the essential ingredients of a privatisation package.

It is against these grounds many a LDCs have already deregulated their insurance sector in the context of SAP. These recent trends includes countries like Argentina (1990), Pakistan (1990), Czechoslovakia (1992) and those who already allowed operation of private insurers further deregulated their reinsurance business including countries like Brazil and Peru (1991). For LDCs, whose insurance sector has progressed and well established the opening of market and relaxing internal restrictions would be both feasible and stimulates the effects of competition on innovation and efficiency.

In India, the Malhotra committee has recommended privatisation of insurance industry and to allow foreign participation in life insurance. This is in keeping with the spirit prevalent in other developing countries of Eastern Europe (for instance Czechoslovakia privatised in 1992) and Latin America. This is aimed at bringing about greater efficiency by increasing productivity and reducing transaction costs. Competition is believed to bring forth a wider choice of products at lower prices, besides larger coverage of population, better customer service, better information technology and better returns to the policy holders, leading to the increase in the awareness and spread of insurance.

6.4 The Malhotra Committee Report

In consonance with the financial reforms in the context of wider SAP, the GOI appointed a Committee on Reforms in the Insurance Sector (popularly known as Malhotra Committee) in April 1993 and it submitted its report in January 1994. The terms of reference of the committee briefly were:

(i) to examine the structure and to assess the strengths and weaknesses of the insurance industry in terms of the objectives of efficient, viable and mobilisation of resources for development.

(ii) to make recommendations for changes in the structure and the general framework of policy of the insurance industry fulfilling the above mentioned objectives consistent with structural changes in the economy and financial sector.

(iii) to make specific suggestions LIC and GIC to help in the functioning of these organisations in the changing economic environment.

(iv) review and make recommendations on the role and functioning of the surveyors, intermediaries and other ancillaries of the insurance sector.

(iv) to make recommendations on other related matters relevant for the health and long term development of the insurance sector.

Although the Malhotra Committee touches both general and life insurance business; the study discusses some of the recommendations those which falls in the scope of this study and relates to life insurance business are addressed in the following:

(a) Investment Regulations: Keeping in view the present developments in the capital market; the transparency and prudence with which it is working, and the increasingly stiff competition from other saving institutions, and given the governments approach to reduce the fiscal deficit, the Malhotra Committee recommends to slice down the mandated investments from the present level. Therefore, the committee recommends certain modifications in confirmation to the broad pattern laid down in Sec 27 of Insurance Act as:

(i) Investment in central government securities with in prudential norms should remain as such not less than 20 percent and the special deposits with the government should continue to be considered as investment in central government securities.

(ii) State government securities and government guaranteed securities inclusive of central government securities should be not less than 40 percent as compared to existing not less than 50 percent.

(iii) In socially oriented sectors including above should not be less than 50 percent compared to existing not less than 75 percent.

And to reach these desired modification levels LICs mandated investment of fresh accretions should come down from the present level of 75 percent to 40 percent in two annual stages till it confirms Sec 27 of Insurance Act of investments. However, no changes should be made to the present level of investments in otherwise than approved investment which shall not exceed 15 percent. And in order to reach the recommended level of 50 percent, the profits arising out of sale of equities should be excluded from the ambit of accretion to the controlled fund for a period upto four years. Also the investment of any insurer should not exceed at any time more than five percent of the subscribed equity share of any company. And the LIC should achieve this over a reasonable number of years.

(b) Rural Insurance: In relation to the rural insurance, the committee recommends that life insurance to the relatively weaker sections of society including working women, has to be tackled more effectively by bringing improvement in coverage including increase in cheap term insurance coverage, through adopting marketing strategy. For covering untapped rural areas, institutions including panchayats, voluntary organisations, mahila mandals and cooperatives should be sought for. To ensure rural business the new entrants into the life insurance business should be required to write a specified proportion of their business in a rural areas including writing small policies, failing which penalties are to be imposed by Insurance Regulatory Authority (IRA). The sponsored relief oriented welfare schemes

without having element of insurance should be transferred from LIC to concerned government authorities.

(c) Pension Funds: With regard to the pension funds schemes, it should be fully exempted from tax, private pension funds set up by employees should be allowed to pay pension to their members under the careful scrutiny of IRA and unit-linked pension plans should be popularised.

(d) Supervision and Regulation: On the formation of LIC in 1956 and GIC and its subsidiaries in 1973, most of the regulatory functions were transferred from Controller of Insurance (COI) to LIC and GIC, though COI, a statutory body attached to ministry of finance, continues to be the supervisory and regulatory authority for the insurance industry. Therefore in the wake of privatisation and liberalisation, the COI should be empowered as prescribed in the Insurance Act, to create a level playing field for all insurers, as an interim measure. It also recommends the creation of Insurance Regulatory Authority (IRA), a multimember statutory body, on the similar lines of Security and Exchange Board of India (SEBI), having full functional autonomy and operational flexibility. The IRA should be empowered with supervisory powers covering all aspects of insurers in conducting transparent and smooth business with utmost economy so as to protect the customers interests. In brief, its role should be as an initiator, conductor, regulator, supervisor, controller, detector and mediator of insurance industry. And to keep it as an autonomous body, the committee proposes that 0.05 percent of yearly premium income of insurance companies can be levied to finance its establishment and activities.

(e) Informational Technology: Information technology with imaginative and prudent use can be valuable aid for efficient customer service, effective management and meaningful regulation. Therefore, for an intensive business of ever expanding nature demands to handle lumpsum data. Thus, the LIC should update existing information support and develop strong R & D departments to increase technical proficiency.

(f) Restructuring: The delegation of policy servicing responsibilities to the branch level has been helped a lot, still delegation of authority to zonal and divisional offices and the system. Therefore, the committee recommends that to convert zonal offices into de-facto head offices for all operational purposes and thus limiting the functions of the central office to policy formulation, review and evaluation, product development, pricing and actuarial valuation, investments, personnel policies, systems development and accounts of the corporation. The divisional offices should act as a effective supervisor of branch offices. It is important to strengthen the role of branches further as the single point of services and contact for customers (sell). Comprehensive computerisation in LIC for handling business at all levels and the development of an effective management information system is the need of the hour. It also views that the delay in decisions taken is due to the rigidity arising out of the state ownership. Therefore, LIC's ownership pattern should be changed as to take it out of the complete state ownership.

The committee suggests that for a corporation of the size of LIC, capital of Rs.5 crores is not enough and it should be raised to Rs.200 crore with the government holding 50 percent, thereof and the remainder being held by the public at large, including company employees for whom a suitable proportion may be reserved. No shareholder other than the promoter should hold more than one percent of the share capital.

(g) Liberalisation: The state monopoly of the insurance sector should be broken by opening it up for competition. This is on the ground that competition would lead to use of untapped potential and expand the lines of business to provide better choice to the consumers in terms of better products, variety of products, reduction of prices, efficient customer service. And also it feels that the nationalised industry financially strong enough and have large infrastructure to face up competition. In this direction, to clear the apprehensions of privatisation in safeguarding the money of policyholders, it outlined certain measures to be taken: (i) number of single insurers should be allowed to transact both life and general business, (ii) the private insurers should be under firm regulations through IRA, (iii) the insurance company auditors should have an obligation to report to IRA. In order to ensure that companies have enough financial strength the committee sets a minimum criteria that a new entrant should have a minimum paid up capital of Rs.100 crore except incase of a state level cooperative institutions taking up life business. Where the promoters holding in private insurance company should not exceed 40 percent of the total and less than 26 percent. No person other than promoter should be allowed to hold more than one percent of the equity.

6.5 An Evaluation of the Malhotra Committee Report

The recommendations of the Malhotra Committee Report need a careful scrutiny. First, the present economic liberalisation programme aims at reducing the borrowings of governments and other public sector undertakings such as electricity and transport. These should now be directed to raise their resources primarily from the market. However, in the absence of borrowing from the government and other agencies, there may be limited avenues for productive use of the growing investible funds at the disposal of the LIC. Thus there may be effective constraints on the absorption of funds (Diwan; 1994:7). During the

prenationalisation period heavy speculative activity of the companies in the absence of a regulatory framework led to the liquidation of insurance companies. The operation of insurance companies may therefore demand a more transparent and transparent and direct role in the economic development of the country and in the interest of the policy holder from the insurance industry.

In the wake of liberalisation and a rat race of competition rural business may loose its attention. The private insurers may find it difficult, at least, in the initial stages to penetrate in the rural areas and also it may not be profitable for them to write small policies involving high transaction costs and risks. Though the committee views for the compulsion of rural business, it did not discuss clear cut modalities; nor did it explicitly mentioned what constitutes the rural business or how much percentage of the total business should come from the rural business. In the then prevailing conditions the LIC, to certain extent, did its job of spreading life business in the rural areas. However, the corporation is required to come out with a more effective marketing strategy as rightly pointed out by the committee.

The success of any programme of privatisation certainly depends on the transparency in insurance operations and an effective regulatory authority. Therefore, privatisation generally followed by strong supervisory and regulatory authority to monitor the activity of the insurers. The committee favours the setting up of an Insurance Regulatory Authority with an independent source of financing. The union government has since constituted an interim regulatory authority as a watchdog panel. Although it is a welcome step, in the presence of multiple authorities such as: Controller of Insurance, Insurance Division of the Ministry of Finance, the Comptroller and Auditor General of India (only for GIC) and the Central Vigilance Commission, it is very difficult to understand the scope and jurisdiction of each

of these authorities. Skepticism prevails as to the sanctity of the functioning of IRA. With an independent source of financing the IRA may turn out to be a pressure group or lobby of influential trade leaders and collecting the levied premiums from the increasing number of insurers may turn into Achilles hill (Nigam; 1996:25). The Committee seems to neglect the whole range of issues like the recent experience of USA of fraudulent activities of private insurers by misreporting the reserve accounts and falls reporting to regulators and the solvency margins. The IRA cannot function effectively unless clear-cut modalities are worked out and the issues of safety norms are addressed. Similarly, the existing outdated laws, rules and regulations such as: the accounting formats (presenting the necessary information), the actuarial valuation method, calculation of outstanding premiums, calculation of expense and renewal expense ratio, reserves for unexpired risks need to be completely reviewed (Diwan; 1994:3). Such measures would be essential for a level playing field for all the companies.

However, there is no doubt about the need for restructuring the insurance industry. For example, although a greater decentralisation of services was stressed in the early 80's, which to an extent helped push up the business, still may gaps exist. The divisional offices should actively perform their task of supervisory role of branch offices. But one of the recommendations of the Committee is that the divisional offices should be given operational autonomy and they should be made de-facto authorities. Rather than assigning de-facto role, it may be proper in giving more freedom. The LIC should pursue the restructuring vigorously to keep pace with the competition or else it has to succumb to the privatisation and private insurers. The committee also recommends an increase in the share capital which is desirable given the size of the LIC the fund should be larger in the interest of its financial stability.

Lastly, the committee strongly favours liberalisation on the plea that LIC could not able tap the potential market. But in dealing with this particular aspect it seems to overlook the corporation's effort in that direction and its role in fulfilling social obligations. About privatisation, it is not necessarily going to increase competition or efficiency with a mere change in ownership; rather it may depend on the restructuring the ownership. the regulatory mechanism, market structure and a whole lot of other considerations. But to admit, the people may get a wider choice. In the Indian context, at least the life insurance business needs a further restructuring of its internal organisation and effective marketing strategy rather than going in for privatisation at least for some time to come.

However, a lot of Skepticism surrounds there expectations. The Skepticism concerning the possible retrenchment of staff following computerisation, insecurity about the payment guaranteed on death or maturity and tax benefits. The new entrants may concentrate on the more lucrative areas neglecting low income strata and rural areas and the advertisement may actually push up prices. Also, the sanctity of the role of the Insurance Regulatory Authority is questioned without any independent source of financing its establishment and activities and in the presence of other parallel multiple authorities.

CHAPTER VII

SUMMARY OF FINDINGS

The present study has made a modest attempt to understand the evolution and development of life insurance business in India over a period of three and half decades. The focus was on the growth and performance of the Life Insurance Corporation of India which is synonymous with life business in India until now. In the absence of any comprehensive and systematic study on the subject, the present exercise may be viewed as an exploratory one, providing a base-line for further enquiry.

Commensurate with the overall changes in the economy and the organsiationisational changes that have taken place within the LIC, there has been a significant growth in the life business since the early 80's. The growth of life business has been accompanied among others, by the growth in urbanisation. Growth in rural business and group insurance business, especially since the mid-70's, have marked the overall performance of the LIC. These implies that the corporation has succeded in extending the insurance cover to the larger section of the population at a lower average sum assured in real terms. In the absence of such social orientation, the operational cost of the corporation would have been lower.

Significantly, in spite of the higher transaction costs that may be involved in the increase in rural business. The corporation has been able to reduce financial out-flow as a proportion of its income. This decline in out-flow has also been facilitated by general decline in the share of death benefits. The rise in income is not only due to the increase in premium

income, but also due to a significant increase in investment income. Consequently, the corporation could convert a progressively rising share of its income into life fund.

In spite of the commendable growth and performance of life insurance business, a vast potential still exits. Such macro indicators as population coverage, per capita premium, contribution to employment and GDP are still very low as compared to developed countries, although they compare reasonably well with others.

Given that the corporation's investment operations are subject to statutory regulations, the corporation invests heavily in socially-oriented sectors, the benefits of which spill over the entire economy. Since the mid-80's, the corporation appears to have been breaking out of its conservative stance in portfolio management. Over the years, the portfolio has been quite diversified accross sectors, instruments and individual industries. Thus the life insurance corporation has played a crucial role in supplying funds to the central and state governments by investing in government securities under the investment regulations. Also, it has contributed substantially to the financing of socially-oriented sectors like State Electricity Boards, Municipalities and Zilla Parishads, Cooperative Societies and Housing and Urban Corporations, besides investing in corporate securities and underwriting of primary issues.

In terms of the physical performance indicators such as, claim settlement, productivity of personnel and agents, lapse rate and product range the LIC has shown significant improvement. It has devised a number of products to cater to specific target-groups with the incentives of low sum assured, tax exemption and retirement benefits. Our analysis also shows that people's preferences have changed from looking life insurance as a `death tax'

to a product which not only insure their lives but also yields a reasonable return on their savings. In this respect, however, the LIC has to come out with more innovative products to compete with alternative saving institutions and instrurements, e.g., mutual funds and nidhis, appearing in the market in recent year.

An analyis of world insurance industry is essential to assess and evaluate the implications of privatisation and foreign participation in the insurance sector in general and life insurance sector in particular. The financial sector reforms in a wider context of SAP aim at privatising the insurance sector also. In this respect, the Malhotra committee has recommended privatisation of insurance industry and to allow foreign participation in life insurance. This is in keeping with the spirit prevalent in other developing countries of Eastern Europe (for instance the erstwhile Czechoslovakia privatised its insurance in 1992) and Latin America. This is aimed at bringing about greater efficiency by increasing productivity and reducing transaction costs. Competition is believed to bring forth a wider choice of products at lower prices, besides larger coverage of population, better customer service, better information technology and better returns to the policy holders, leading to the increase in the awareness and spread of insurance. Also these arguments are based on the view that privatisation programmes will succed in this process. But the theoretical arguements put forward do not seem to be founded on an understanding of the market structures and other specificities of the LDCs. Thus, a lot of scepticism surrounds there expectations. There is also scepticism concerning the possible retrenchment of staff following computerisation, security about the payment guaranteed on death or maturity and tax benefits. In the absence of proper regulatory authority the new entrants may concentrate more on lucrative areas neglecting the needs of the low income strata and rural areas and the likely advertisement costs may actually push up prices (premia). Also, the effectiveness of the proposed Insurance

Regulatory Authority is doubtful without any independent source of financing its establishment and activities and given the presence, of other multiple authorities.

Therefore, given the specificity of Indian context and the social obligations of the insurance industry, especially life insurance business, the immediate efforts of policy must to ensure restructuring and improving the operational efficiency of a reasonably well-established Life Insurance Corporation. The issue of private sector and foreign participation must be approached cautiously and slowly. Any haste in this direction might result in the kind of undesirable events that marked the pre-nationalisation period.

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