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Determinants of Life Insurance Consumption in India

Area to be Determined Till Now.

ABSTRACT

Innumerable economic, demographic, socio cultural, political and other factors determine each economy's consumption of life insurance. The Economic Environment consisting of foreign investment climate, price, inflation and interest rates income, saving and investment parameters may increase or decrease the overall demand of insurance. Similarly demographic environment consisting of education level, household structure, industrialization and urbanization, social environment, political environment of the nation also has a profound impact on the insurance consumption. In the present paper an attempt has been made to assess the impact on life insurance consumption in the light of trend of these factors. Indian insurance industry has good regulatory environment, political stability, changing demographic profile, good economic conditions in its favour.

1. INTRODUCTION

Innumerable, unequivocally, has been the most happening industry in the last decade. Insurance is a mechanism, which apart from providing security also plays a significant role in allocation function, improving capital market and providing worldwide support to the global companies. The growing importance of the insurance industry has led to its internationalization, which involves deregulation and liberalization of the insurance market. Indian life insurance industry has taken a complete 360-degree turn from a liberalized market before 1956 to a nationalized one in 1956 with the single player i.e. Life Insurance Corporation of India (LIC) and again back to a liberalized market, with the entry of private players, in 1999. In fact, opening up of the insurance sector is an integral part of the liberalization process being pursued by many developing countries, including India, because of the various reasons. Firstly, a state monopoly has little incentive to innovate or offer a wide range of products. This can be seen by a lack of certain products from LIC's portfolio, and lack of extensive risk categorization in several GIC products, such as health insurance, prior to the privatization of the industry. Privatization is expected to spur firms to offer several new products, and more complex and extensive risk categorization. Finally, private sector entry into insurance might be simply a fiscal necessity, since large scale funds from long term contractual savings need to be mobilized, especially for investment in infrastructure and the option of not having more (private) players in the insurance sector is too costly. Moreover, the demand for insurance is likely to increase with rising per-capita incomes, rising literacy rates and increase of the service sector, as has been seen from the example of several other developing countries (Ahuja, 1997).

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2. MEANING OF INSURANCE

In this uncertain world, most of us would like to smoothen our lives and consumption patterns by balancing the favorable and unfavorable events. Insurance allows individuals to transfer risks by participating in risk pooling arrangements in which each one sets aside a bit for the rainy day when times are good and draws on the funds in the times of adversity. Insurance is defined as a contract between two parties whereby one party undertakes, in exchange for a fixed sum called premium, to pay the other party called insured, a fixed amount of money on the happening of a certain (pre-decided /insured) event. In financial sense insurance is defined as "A social device in which a group of individuals (insured) transfer risk to another party (insurer) in order to combine loss experience, which permits statistical prediction of losses and provides for payment of losses from funds contributed (premiums) by all members who transferred risk".

3. FACTORS AFFECTING LIFE INSURANCE CONSUMPTION IN INDIA

Innumerable economic, demographic, socio cultural, political and other factors determine each economy's consumption of life insurance as described below:

The Economic Environment

The relative importance of an insurance market to an economy is likely to depend upon economic development, since with a greater rate of economic growth the consumption of insurance products should increase. Early theoretical studies highlighted that the demand for life insurance, as a long-term consumption decision, should be positively related to anticipated income, or permanent rather than current income (Yaari (1965), Hakansson (1969), Fortune (1973), and Lewis (1989)). Many international studies have estimated that the insurance industry in India can grow by over 125 per cent in the next ten years. The Indian economy had the distinction of being one of the two fastest growing economies in the world in the year 2003-04. However; real GDP growth at 6.9 per cent in 2004-05 was comparatively lower than the GDP in the previous year at 8.5 per cent. The decline in GDP in year 2004-05 was due to a sharp slowdown in agriculture. The growth of the services sector at 8.6 per cent in 2004-05 was higher than the average growth of 7.5 per cent during the last five years. The service sector's contribution to GDP growth has been more than 50 per cent since 1997-98. The robust performance of the services sector during 2004-05 was led mainly by 'trade, hotels, transport and communication', which contributed around 60 per cent of the sector's growth. Growth in the finance and insurance sector was further facilitated by increase in bank deposits and surge in insurance business by public and private insurance companies.

Foreign investment climate

Foreign direct investment into India, including equity capital of unincorporated entities, reinvested earnings and intercorporate debt transactions between the related entities, was higher in 2004-05 and amounted to USD 5,536 million as against USD 4,673 million in 2003-04. The improvement in FDI flows reflected the impact of initiatives aimed at creating an enabling environment for FDI and for encouraging infusion of new technologies and

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Every player in the life insurance industry has increased its capital base over the years as demonstrated in the chart given below representing increase in share capital in 2004-05 over the year 2003-04, contribution of foreign promoter, contribution of Indian promoter in absolute and relative terms.

management practices. The Government's proposal to increase the FDI cap in the insurance sector from the present 26 per cent to 49 per cent has not been operationalised, as it requires legislative changes. Over the years paid up capital of the life insurers has increased in the Indian life insurance industry from 1669 crore in 2001-02 to 4352.81 in 2004-05 as shown in table 1. The paid up capital of private players increased dramatically from Rs.1664 cr. in 2001-02 to Rs. 4347.81 cr. in 2004-05.

TABLE 1

PAID UPCAPITAL : LIFE INSURERS

Insurer	LIC	Private Sector	Total (in crores)
2001-02	5.00	1664.00	1669.00
2002-03	5.00	2229.13	2234.13
2003-04	5.00	3238.71	3243.71
2004-05	5.00	4347.81	4352.81

Source : IDCA annual report 2003-04 & 2004-05.

Even with 26 per cent, as India has a favorable market which is growing fast, the foreign insurers are still interested in the market as foreign insurers over the years are increasing their contribution in the increased capital of the companies in absolute terms, keeping their contribution with in the upper ceiling of 26% as shown in the table given below depicting in detail equity share capital of each player. Every player in the life insurance industry has increased its capital base over the years as demonstrated in the chart given below representing increase in share capital in 2004-05 over the year 2003-04, contribution of foreign promoter, contribution of Indian promoter in absolute and relative terms. As depicted in the table 2 equity share capital of all the insurers has increased expect AMP Sanmar and Sahara Life in the year 2004-05 over the year 2003-04. Government is

TABLE 2

EQUITY SHARE CAPITAL OF INSURANCE COMPANIES (IN CRORES)

Name of the Insurer	2003-04 (in crores)	2004-05 (in crores)	% Growth in Total Capital	Foreign promoter (in crores)	India promoter (in crores)	FDI (%)
HDFC Standard Life Insurance Co. Ltd.	255.50	320.00	25.24462	47.52	272.48	14.90
ICICI-Prudential Life Insurance Co.Ltd.	675.00	925.00	37.03704	240.50	684.50	26.00
Max New York Life Insurance Co. Ltd.	346.08	466.08	34.67406	121.18	344.90	26.00
Kodak Mahindra Old Mutual Life Insurance Co. Ltd.	151.26	211.76	39.99736	55.06	156.70	26.00
Birla Sun Life insurance Co. Ltd.	290.00	350.00	20.68966	91.00	259.00	26.00
TATA -AIG life Insurance Co. Ltd.	231.00	321.00	38.96104	83.46	237.54	26.00
SBI Life insurance Co. Ltd.	175.00	350.00	100	84.50	240.00	26.00
ING Vysya Life Insurance Co. Ltd.	245.00	325.00	32.65306	84.50	240.00	26.00
Metlife India Insurance Co. Ltd.	160.00	235.00	46.875	61.10	173.90	26.00
Bajaj Allianz Life Insurance Co. Ltd.	150.07	150.07	0	39.02	111.05	26.00
AMP Sanmar	160.00	217.10	35.6875	56.45	160.65	26.00
AVIVA	242.80	319.80	31.71334	83.15	236.65	26.00
Sahara India	157.00	157.00	0	0.00	157.00	0.00
Total	**3238.71**	**4347.81**	**34.24512**	**1053.93**	**3293.88**	

Source : IRDA annual report 2004-05.

considering the proposal to increase the FDI limit to 49% in the insurance industry, and if the proposal is accepted and implemented it will further increase in insurance penetration, as there will be more investors in the industry.

Price

Price is a critically important determinant of insurance demand and supply. The prices that insurance companies charge are influenced by their cost structures, by the competitiveness of the particular line of insurance, by inflation rate in the economy, by the interest rate structure in the economy and by government tax and other policy. Unfortunately, no completely satisfactory national measures of price exist. Proxies are used, but the fact remains that the price elasticity of life insurance is not well understood. Babble (1985), for the US economy, found prices to be negatively related to new sales, with the elasticity ranging from - 0.32 to – 0.92, depending on the policy type and the price index used.

Inflation and Interest Rates

Greene (1954), Fortune (1973), Browne and Kim (1993), and Beck and Webb (2003) examined the impact of the expected inflation rate on life insurance demand. Since a rising inflation rate leads to a devaluation of the future benefits from purchasing life insurance, inflationary expectations would seem to dampen insurance demand. The findings from these studies indicate that inflation is indeed statistically significant and negatively related to life insurance. Inflation rates are also expected to have an influence on life insurance consumption. It is impossible to discuss inflation without also discussing interest rates, for inflation expectations drive interest rates. Inflation has been found to be negatively associated with life insurance consumption (Outrevilie 1996). In times of high inflation and significant economic volatility, consumers sought shorter term, more liquid investments and avoid longer term, fixed commitments. Traditional cash value insurance products have been perceived as long term, fixed commitments and therefore demand for them often shrinks during volatile times, additionally, consumers perceive that inflation erodes life insurance values. The recent trend of inflation in India, which is now well above the 5 per cent tolerance threshold may reinforce these fears.

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Income

The level of country's income has been found to be the most important factor in explaining the level of national life insurance consumption. The higher a country's income, other things being equal, the more it spends on all types of insurance. Also, at the microeconomic level, the higher a household's income, the greater will be the probability of life insurance consumption (Lewis, 1989). GDP per capita average annual growth rate had been 1.7% during the period (1960-1990) and 4.0% during the period (1990-2003). India's per capita income (average income of an Indian) has risen at the fastest rate in the country's history over the past 10 years. Over the past decade, India has witnessed a high rate of GDP growth (average of 6.2% a year) and a declining rate of population growth (from 2.1% to 1.7%). The result is the highest ever growth in income levels of India.

Saving and Investment

Gross Domestic Saving (GDS), as a proportion of GDP at current market prices, increased from 26.1 per

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cent in 2002- 03 to 28.1 per cent in 2003-04, reflecting improvement across all the sectors. The household sector continued to be the major contributor to gross domestic saving at 24.3 per cent in 2003-04 as compared with 23.3 per cent in 2002-03. 'Deposits' continue to dominate financial saving of households with its share increasing to 41.6 per cent in 2003-04 from 40.9 per cent in 2002-03. However, percentage of deposits as a saving instrument declined to 39.4 in the tear 2005-06 as shown in table 3. Some of the other major components of financial savings were contractual savings, mainly life insurance funds. Life insurance funds as a component of financial saving had the highest percentage in the year 2002-03 i.e. 15.5% and subsequently declined to 12.8% and 12.4% in the year 2003-04 and 2005-06 respectively. It shows that insurance sector has to compete with other financial saving instruments available in the market I the form of bank deposits, total financial savings of the economy.

The Demographic Environment

Changes in demographics also affect the insurance consumption of a nation. In India, according to United Nations Data fact sheet, current population is 1087 million and expected to grow to 1628 million by 2050. 36% of the population is less than 15 year of age and 4% of the population is greater than 65 year of age, which implies 417 million lives are still insurable. The rural and urban population also affects demand of insurance product. Increasing life expectancy translates into a greater demand for saving based life insurance products as well as for long term care

TABLE 3

FINANCIAL SAVINGS OF THE HOUSEHOLD SECTOR (GROSS)

Year	Financial Saving (Gross)	a) Currency	b) Deposit	c) Shares & Debentures	d) Claims on Govt.	e) Insurance Funds	i) Life Insurance Funds
2004-05	100.0	9.2	39.4	1.1	24.0	13.2	12.4
	(13.7)	(1.3)	(5.4)	(0.2)	(3.3)	(1.8)	
2003-04	100.0	10.5	41.6	0.1	20.2	13.5	12.8
	(14.0)	(1.5)	(5.8)	(0.0)	(2.8)	(1.9)	
2002-03	100.0	8.9	40.9	1.7	17.4	16.1	15.5
	(13.1)	(1.2)	(5.4)	(0.2)	(2.3)	(2.1)	
2001-02	100.0	9.7	39.4	2.7	17.9	14.2	13.5
	(12.7)	(1.2)	(5.0)	(0.3)	(2.3)	(1.8)	
2000-01	100.0	6.3	41.0	4.1	15.7	13.6	12.9
	(11.9)	(0.7)	(4.9)	(0.5)	(1.9)	(1.6)	
1999-00	100.0	8.7	37.5	7.1	12.1	12.0	11.3
	(12.3)	(1.1)	(4.6)	(0.9)	(1.5)	(1.5)	
1998-99	100.0	10.5	38.8	3.4	13.6	11.3	10.6
	(11.9)	(1.3)	(4.6)	(0.4)	(1.6)	(1.3)	
1997-98	100.0	7.4	46.6	2.9	12.9	11.3	10.6
	(11.3)	(0.8)	(5.3)	(0.3)	(1.5)	(1.3)	
1996-97	100.0	8.6	48.1	6.6	7.4	10.2	9.5
	(11.6)	(1.0)	(5.6)	(0.8)	(0.9)	(1.2)	
1995-96	100.0	13.3	42.5	7.3	7.7	11.2	10.4
	(10.5)	(1.4)	(4.5)	(0.8)	(0.8)	(1.2)	
1994-95	100.0	10.9	45.5	11.9	9.1	7.8	7.2
	(14.4)	(1.6)	(6.5)	(1.7)	(1.3)	(1.1)	
1993-94	100.0	12.2	42.6	13.5	6.3	8.7	8.0
	(12.8)	(1.6)	(5.4)	(1.7)	(0.8)	(1.1)	

Source : Economic Survey 2005-06.

The literacy rate in India over the years is increasing which shows an increasing demand for the life insurance.

TABLE 4
DEMOGRAPHIC TRENDS AND PROJECTIONS-I

	1996	2001	2006	2011
Total Population (Million)	934.22	1012.39	1094.13	1178.89
Urban Population (%)	27.23	28.77	30.35	31.99
Sex Ratio (Males per 100 Females)	107.9	107.2	106.6	106

TABLE 5
DEMOGRAPHIC TRENDS AND PROJECTIONS-II

	1996-2001	2001-2006	2006-2011
Growth Rate of Population (% pa)	1.62	1.57	1.5
Expectation of Life at Birth (Male/Years)	62.36	63.87	65.65
Expectation of Life at Birth (Female/Years)	65.27	66.91	67.67

Source : Census Statistics

insurance (Burnett and Palmer, 1984).

Increasing population, increasing urban population and increased expectancy ratio both for male and female as demonstrated from the demographic projection made by central statistical organization, shown in table 4 and table 5 evidence the fact of increasing need and demand for insurance in the coming period.

Education

The education level of the population or of a household affects insurance consumption. The expectation is that more literate a person or household the greater the likelihood of understanding the need of insurance. The literacy rate in India over the years is increasing which shows an increasing demand for the life insurance.

Household Structure

The structure of the households continues to evolve. Whether nuclear or extended, families remain perhaps the most fundamental source of physical and economic security in societies worldwide. However in today world we have more of nuclear family system, so the need of insurance is being increasingly felt be it for family security or children education or otherwise.

Industrialization and Urbanization

Industrialization has brought about a new social order in which the predominant economic and social security formerly provided by families, friends and an acquaintance was supplanted to varying degrees by formal public and private arrangements and a necessity for greater financial self-reliance. Research has documented the positive relationship between industrialization and urbanization, insurance consumption (Kim, 1988).

The Social Environment

Consumers today are better educated and more demanding and higher educational levels are associated with increased insurance consumption. Education is one dimension of the social environment that influences insurance consumption, and the culture is another. Cultural perceptions of the role of the life products can vary substantially. In many countries, especially in Asia, life products are sought primarily as savings instruments, and this is consistent with a high cultural propensity to save. In other countries, especially those are

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In view of the present developments in the factors affecting life insurance industry in India it is expected that insurance consumption is bound to increase in the coming period of time. Indian insurance industry has good regulatory environment, political stablility, changing demographic profile, good economic condions in its favour.

predominantly Muslim; life insurance is sometimes viewed as inappropriate because of religious benefits.

The Political Environment

Country political and economic stability influences insurance demand (Beenstock et al, 1986). An unstable political environment depresses insurance demand because citizen cannot fully rely on insurers meeting their promises, as laws may be unenforceable. Therefore, the decision made by public policymakers-insurance regulators, the courts, legislatures, and other-can have a profound impact on insurance consumption. Their decisions determine what life and retirement products can be sold, who can sell them, and how they can be sold. Government policy also determines how attractive such products are from a tax standpoint and the extent to which government itself will supply life and retirement benefits. Levine et al. (2000) highlight that countries with better creditor rights, more rigorous law enforcement and better accounting information tend to have more highly developed financial intermediaries. This is particularly relevant to the insurance industry where consumers can be at risk of opportunistic behavior by insurance companies. For example, this could include companies refusing to pay claims, or alternatively reducing the investment returns due on a policy.

Internationalization

The continuing internationalization of financial services adds a new dimension to insurance consumption. Countries can no longer view themselves as isolated economic islands. Increasing internationalization can bring increased capital from abroad, product and marketing innovations, and a different way of managing companies. Increased capital strengthens the financial capacity of insurers and can result in more competition and therefore, consumption (Harold, 2005) Moreover, product and marketing innovations and different management style can lead to greater consumer choice and value.

In view of the present developments in the factors affecting life insurance industry in India it is expected that insurance consumption is bound to increase in the coming period of time. Indian insurance industry has good regulatory environment, political stability, changing demographic profile, good economic conditions in its favour. However, rising inflation and competition from other financial products may be areas for concern for the insurance industry.

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