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An enquiry on the impact of FDI: Response of Indian insurance sectors

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Abstract

Foreign Direct Investment (FDI) has grown significantly in recent periods as a major instrument of economic expansion and development in a variety of industries, including the insurance industry. FDI is the term used to describe an investment made in the economy of a country by a foreign firm or person. These investments often involve acquiring ownership shares or significant control over local businesses. The transformational and contentious effects of FDI on the insurance industry have sparked discussions about its advantages and potential risks. The decision to liberalize the economy in 1991 completely altered the course of the expansion of the Indian economy. It turned out to be a significant development for the Indian economy, causing an enduring transformation. Economic reform sparked the FDI and catalysed the expansion of the Indian economy. It was believed that approving an increase in the FDI restriction in the insurance domain would enhance the nation's fundamental insurance infrastructure and open the door for new participants. More foreign direct investment was anticipated to enhance private insurance sector businesses by allowing them to compete on an equal footing with state-owned businesses. There was an increase in capital inflow as a result of the higher FDI ceiling. An investment of this size revitalized the nation's insurance industry. Through enhanced infrastructure, better operations, and more staff, the insurance business was able to increase employment opportunities, due to the increased inflow of money. This research paper investigates the influence of FDI on the Indian insurance sector's penetration and density throughout the last two decades, putting focus on insurance products like life insurance and non-life insurance, or industrial insurance. The study leverages a dual-tiered approach, evaluating both penetration and density levels to capture the all-inclusive influence of FDI on the sectors of Indian insurance. The findings reveal a substantial correlation between FDI inflows and penetration levels in both the life and industrial insurance sectors. This was indicative of FDI's catalytic effect on expanding the reach of both the insurance products and services, thereby deepening its presence in the market. However, the non-life insurance segment displayed a distinct pattern as a continuous increase in both penetration and density has been seen. This suggests that while FDI facilitated the sector's expansion and accessibility, it failed to generate an impact on non-life insurance policies. The paper emphasizes the need for targeted strategies to enhance the influence of FDI on the non-life quarter as well as in the life and industrial sector. This research contributes to the broader understanding of FDI's role in shaping the dynamics of emerging market insurance sectors and provides valuable insights for policymakers, practitioners, and researchers alike.

Keywords: Premium, capital formation, insurance business, Nigerian, ordinary least squares

Introduction

Particularly in connection with developing economies, foreign direct investment (FDI) can have a substantial impact on the growth of an economy. FDI is the term used to describe investments made in the industrious resources of a different nation by one or some overseas entities, including firms and individuals. A developing economy may have both positive and negative effects from FDI, depending on a number of variables, including the laws and regulations of the host nation. The effects of FDI on the Indian insurance industry have mostly been favourable. Capital inflow has increased as a result of FDI, which has made Indian insurance companies' capital bases larger and more stable, enabling them to grow their operations. Foreign businesses' entry into the Indian insurance market has led to more competition, which has lowered premiums and led to the development of more cutting-edge goods and services for consumers. Foreign businesses have introduced their newest technologies and expertise to India's insurance industry, which has helped to increase the sector's overall effectiveness and service quality. At the same time, both directly and indirectly, FDI has contributed to the creation of jobs in the Indian insurance industry.

The perceived advantages of FDI in the Indian insurance industry may be listed as:

Increased insurance penetration as FDI has assisted in raising India's still-relatively-low insurance penetration compared to other developed nations.

Financial inclusion has been improved, thanks to FDI, which has increased access to insurance services and products for those living in rural and low-income parts of India.

Enhanced financial stability as FDI has increased the capital base of insurance companies and enhanced their risk management capabilities, which has increased the financial stability of the Indian insurance market.

FDI in the insurance industry has also contributed to India's economic progress through fostering employment growth, boosting investment, and producing tax income.

Empirically, it has brought about an increase in capital inflow, more competition, better technology and skills, the development of jobs, and the penetration of insurance. Consumers, the insurance sector, and the Indian economy as a whole have benefited from this.

Literature Review

M. Rajeev (2016) [9], in his article discussed about the trend of general insurance sector and the effect of FDI on Indian general insurance sector. The article shows that after reforms the quality and price of insurance products, competition in the insurance market has greatly improved. Though, better service, more innovation and a comprehensive insurance cover are needed.

Dr. Subhas D Pawar (2010), in his paper (7) analyzed the impact of increasing FDI threshold on insurance sector. Data collected from IRDA shows despite of strong improvement in penetration and density from 2010 to 2020, India largely remains an under penetrated market.

Amir Hasan (2015) [10], in his paper “IMPACT ANALYSIS OF FDI ON INSURANCE SECTOR IN INDIA” focused on overview of the Indian insurance sector along with the impact of FDI expansion in Indian insurance sector taking account of the growth of penetration and density of life, non-life insurance, share of private-public enterprises in 2001-2013 time period. He remarked that India is one of the fastest growing insurance market and it is expected that Indian insurance industry can grow up to 125% in next decade.

Smt. K, Dr. Gowda (2016) [11], in their article (9) have put stress on the significance of FDI in Indian life insurance industry. They mainly emphasized on comparative analysis of public and private enterprises of life insurance. They claimed that FDI might bring about product improvement and technical modernism in insurance but simultaneously it brings an overabundance of risks as the unneeded amplification of private companies in the industry, will certainly increase the risk exposure for the country.

Dr. Kanzal, Prof. R (2021), in their article tried to give overviews of Indian insurance sector, discussed about the impact of FDI on insurance sector with special reference to SBI Life insurance Ltd. The research explored that there is a good growth in FDI inflow in insurance sector. As a result, the contribution of banking and insurance sector to GDP increases to about 7%.

Yadav, Mohania (2016) [12], their study ‘’IMPACT OF F.D.I. ON LIFE INSURANCE SECTOR IN INDIA’’ is based on secondary data collected from various paper and IRDA, shows thatincrease in FDI inflow will be beneficial for the Indian insurance industry as huge capital investment is needed to enhance the overall performance. Indian insurance sector is still low penetrated but has good potential.

Methodology

The research is done in a quantitative approach as statistical data collection and analysis have been made. The paper is mostly based on secondary data that has been collected from reliable and authentic sources. Figures and tables have been used to make the data more comprehensive.

- **Data collection:** The study depends on secondary data from reputable sources (e.g., government publications, academic journals, IRDA official websites, and financial reports) to establish verified results.
- **Research question:** What is the influence of Foreign Direct Investment (FDI) on the Indian insurance sector's penetration and density throughout the last two decades, focusing on the life, non-life, and industry insurance segments?

Research objectives

1. To analyze the impact of the FDI inflow in the Indian insurance sector.
2. To have a comparative study of the growth and interconnection among life, non-life, and industrial insurance sectors.
3. To find out the untouched research area of the FDI inflow.

Data analysis tools

- Regression
- Trend analysis

Period of the Study: The study encompasses a timeframe spanning the past twenty years. It focuses on policyholders of life, non-life, and industrial insurance companies in India who acquired insurance coverage between 2001 and 2022, and their data was collected for analysis.

Hypotheses

H0: There is no significant change in the Indian insurance penetration in life, non-life, and industrial insurance due to the influence of Foreign Direct Investment (FDI).

Our task is to check whether this hypothesis holds or not. It is known that FDI inflow enables the opportunity to grow by increasing penetration, density, availability, returns, etc. But the question is the FDI inflow sufficient enough for the prospering insurance sector?

Research background

While some studies have explored the impact of FDI on India's insurance sector, much of the existing literature may be outdated or insufficiently comprehensive. Also, the existing kinds of literature do not encompass the overall comprehensive insurance sectors, i.e., life, non-life, and industry. Key points that are already known and established include:

- FDI liberalization in the Indian insurance sector, particularly the increase in FDI limits over the years.

- An overall positive correlation between FDI and the sector's growth.
- Enhanced product offerings, technological advancements, and increased competition due to FDI inflow.
- The sector's increased penetration and density since FDI liberalization.

Despite existing knowledge, significant research gaps persist. Our study is concerned with the trend of the insurance sector in the recent 2 decades and the response of the insurance sector by change in FDI inflow. This study is essential for policymakers, insurers, investors, and academics. It informs policymakers on FDI regulations, helps insurers strategize market entry, aids investors in risk assessment, and enriches academic understanding of FDI's role in India's insurance sector.

Findings

Table 1: FDI as percentage of GDP during 2001-2022

Year	% of gdp
2001	1.06%
2002	1.01%
2003	0.61%
2004	0.77%
2005	0.89%
2006	2.13%
2007	2.07%
2008	3.62%
2009	2.65%
2010	1.64%
2011	2.00%
2012	1.31%
2013	1.52%
2014	1.70%
2015	2.09%
2016	1.94%
2017	1.51%
2018	1.56%
2019	1.79%
2020	2.41%
2021	1.41
2022	1.5

Insurance penetration is an important parameter to judge the level of performance by insurance sector and it is defined as-

$$\text{Insurance penetration} = \frac{\text{Total premiums collected}}{\text{Countrys Gross Domestic Product (GDP)}} \times 100$$

Table 2: Insurance Penetration of Life , Non-Life and Industrial Insurance during 2002-2022

Year	Life (%)	Non-Life (%)	Industry (%)
2002	2.15	0.56	2.71
2003	2.59	0.67	3.26
2004	2.26	0.62	2.88
2005	2.53	0.64	3.17
2006	2.53	0.61	3.14
2007	4.1	0.6	4.8
2008	4	0.6	4.7
2009	4	0.6	4.6
2010	4.6	0.6	5.2
2011	4.4	0.71	5.1
2012	3.4	0.7	4.1
2013	3.17	0.78	3.96
2014	3.1	0.8	3.9
2015	2.6	0.7	3.3
2016	2.72	0.72	3.44
2017	2.72	0.77	3.49
2018	2.76	0.93	3.69
2019	2.74	0.97	3.7
2020	2.82	0.94	3.76
2021	3.2	1	4.2
2022	3.2	1	4.2

Like Insurance penetration, Insurance density is also a crucial measure used to evaluate the stage of development of a country's insurance sector. It is defined as-

$$\text{Insurance Density} = \frac{\text{Premiums collected by insurance companies}}{\text{Countries population}}$$

It means insurance density actually measures the per capita premium paid.

Table 3: Insurance Density of Life, Non-Life and Industrial Insurance during 2002-2022

Year	Life (in %)	Non-Life (in %)	Industry (in %)
2002	9.1	2.4	11.5
2003	11.7	3	14.7
2004	12.9	3.5	16.4
2005	15.7	4	19.7
2006	18.3	4.4	22.7
2007	33.2	5.2	38.4
2008	40.4	6.2	46.6
2009	41.2	6.2	47.4
2010	47.7	6.7	54.3
2011	55.7	8.7	64.4
2012	49	10	59
2013	42.7	10.5	53.2
2014	41	11	52
2015	44	11	55
2016	43.2	11.5	54.7
2017	46.5	13.2	59.7
2018	55	18	73
2019	55	19	74
2020	58	19	78
2021	59	19	78
2022	69	22	91

Regression Result
Time variable: YEAR, 2002 to 2022
Delta: 1 unit
y = penetration of life insurance, x = FDI inflow. reg Penetration of life FDI In flow of GDP

Number of obs: 21

F(1, 19): 6.52
Model | 2.5655897 1 2.5655897 Prob> F : 0.0194
Residual | 7.47827697 19 .393593525 R-squared: 0.2554
Adj R-squared : 0.2163
Total | 10.0438667 20 .502193333 Root MSE : .62737

Penetra ~ Flife | Coefficient S.E..: t P > |t| [95% C.I.]

FDI in flow of~P | 52.61705 20.609 2.55 0.019 9.481922 95.75217
_cons | 2.21807 .3800848 5.84 0.000 1.422543 3.013596

Y= penetration of non-life insurance, x= FDI inflow
. reg PENETRATIONOFNONLIFE FDIINFLOWOFGDP

Number of obs: 21
F(1, 19) : 0.08

Model | .001702077 1 .001702077 Prob > F : 0.7869
Residual | .430078876 19 .02263573 R-squared : 0.0039
Adj R-squared:-0.0485
Total | .431780952 20 .021589048 Root MSE : .15045

PENETRA~NLIFE t P >|t| [95% C.I.]

FDIINFLOWOF~P | -1.355259 4.942312 -0.27 0.787 -11.69964 8.989118
_cons | .7623645 .0911494 8.36 0.000 .5715866 .9531424

Y= penetration of industrial insurance, x= FDI inflow
. reg PENETRATIONOFINDUSTRY FDIINFLOWOFGDP
Number of obs: 21
F(1, 19) : 6.81

Model | 2.66526916 1 2.66526916 Prob> F : 0.0172
Residual | 7.43118799 19 .391115157 R-squared : 0.2640
Adj R-squared: 0.2252
Total | 10.0964571 20 .504822857 Root MSE : .62539

Penetration~Y | Coefficient-. S.E. . t P>|t| [95% Conf. Interval]

FDIINFLOWOF~P | 53.62946 20.54401 2.61 0.017 10.63035 96.62856
cons | 2.948747 .3788863 7.78 0.000 2.155728 3.741765

Inference

a) The SLRM table shows that we have Life and Industry insurance is significant at 5% level, but not at 1% level. Non-life is not significant.
b) In terms of penetration, 26.4% of variation in Industrial insurance could be explained by the changes in FDI inflow, which is quite significant. For life insurance, the amount of explained variation is 25.54%. But for non-life insurance the value is 0.39%.
c) In terms of insurance density, all three segments has shown a steady growth of density over the time. But again in case of non-life the share is less than 25%, while for other two segments it is as high as 70% and over.
d) There is almost a stationarity observed in terms of insurance penetration across all the three sectors.
e) So we may conclude that there is a significant change in the Indian insurance penetration in life and industrial insurance due to the influence of Foreign Direct Investment (FDI), but no such perceived change is observed for non-life insurance sector due to FDI shock.

Policy Recommendations

There may be few policy recommendations that might be considered as relevant in respect to present study, that might be carried out as follows:-

1) Taking more customers friendly policy and increasing the market coverage using FDI inflow.
2) Judging the credibility of foreign companies.
3) More channelization of savings to insurance.
4) Keeping an eye to local workforce's interest as foreign investors will be more inclined to developing infrastructure and technology.
5) Protect infant industry which may be affected due to growth of giant industries.

Conclusion

It's obviously crucial to underline that FDI has offered the Indian insurance industry numerous advantages, but there are also difficulties like regulatory compliance, cultural differences, and market instability. In order to reconcile attracting foreign investment with defending the interests of the Indian insurance market and its customers, policymakers and industry players must find a balance. As this paper finds, we require a band of targeted strategies to enhance the shock of FDI on the non-life domain of insurance as well as the life and industry sector.

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