Chapter 3

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Chapter 3
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3.1 Introduction

Privatization has been extended over large part of the world in past two decades embracing the industrial economies, transition economies of East Europe and less developed world (Ram Mohan, 2005). In recent years, many industrially advanced countries as well least developed countries have been taken macroeconomic reforms, which involved structure adjustment programme. The financial sector which typically owned or controlled by the state itself was the focal point of attention. The developing countries like India along with other semi industrialised countries have opened up their financial sector (Mitra & Ghosh, 2010b). The Twentieth Century A.D. beheld two great transformations, nationalization in the first half of the century, the process of which extended to considerably large portion of the century and privatization in the last two decades of the century, the process of which is still rolling on (Faiz, 2008).

When nationalization went down in line, countries believed that the change of the ownership from private to public would be able to solve most of the social, economic and political problems of the economies (Faiz, 2008). State-led policies, programs, and performance earmarked for critics because of the growing resentment among citizens with bureaucratic inefficiencies, diminishing performance of public enterprises, shrinking public confidence in government institutions, worsening situation of inflation allegedly caused by public sectors deficits and endorsement for market-driven remedies. This criticism for state-centred policy was reinforced further by the decay of major socialist states and the worldwide adoption of market ideology. Therefore, the period between early 1980s and late 1990s saw the escalation of market-centred policies all over the world. In developing countries, the market-driven policies such as liberalization, deregulation and privatization were embraced or forced under stabilization and structural adjustment programs. Among these policies, however, the privatization of public resources, projects, and services has been one of the most persuasive and noticeable changes in the recent history of strategic reforms. Such a pivotal policy change justified on various grounds and brought by various

national and international factors has serious economic, political, and social implications for developing nations (Haque, 2001).

"Is globalization good?" is a moot point among economists. To some people, globalization is a brave new world with no barriers, while to others it spells doom and disaster (Lamsal, n.d.). Neoclassical economists hold that countries should deregulate industries and liberalise markets. In the theory, this will stimulate greater efficiency, greater professionalism in the market, proliferation of more products and services and expansion of market. Contrary to this, a growing number of economists are challenging the benefit of deregulation (Devi, 2011).

3.2 Liberalization and Privatization Concepts

Liberalization is a process through which market forces gain priorities in resource allocation and price setting in contrast with government (Roland, 2008). Liberalization, especially economic liberalization is purging and trimming of state monopolies in the economic sphere. Privatization has been perceived as a centrepiece of economic liberalization and bracing public sector efficiency by ensuring private sector participation in the economy. At the micro level, privatization is the handover of responsibilities, management and ownership held by the government sector to private sector. At a macro level, privatization may be considered as transformation of public sector led mixed or socialist economy into a private sector-dominated market economy. At the broadest level, privatization is economic liberalization bringing market forces into the economy (Lamsal, n.d.).

Privatization is indeed a product of the 1980s. The word found its way into a standard dictionary in 1983 (Ram Mohan, 2005). The term 'privatization' was devised long before but the privatization as policy is the product of the 1980s. The term was coined in 1936 in a chronicle published in the Economist (Faiz, 2008). Privatization in simple words refers to the process of transfer of ownership of state-owned or public owned property to individuals or groups that intend to utilize it for private benefits and run entities with the aim of profit maximization (Kousadikar, 2013). Privatization may also be considered as any material transaction by which the state's ownership of corporate establishment is reduced (OECD, 2009). The word "Privatization" has been receiving much attention in business, government and academic community all over the world. Actually, the language and programme of privatization have spread so

rapidly throughout the world that the phenomenon can be linked to a revolution or a boon (Faiz, 2008).

During the past two decades, various forms of privatization regardless of their economic conditions, ideological positions and political orientations were launched by the governments all over the world. This current trend represents a reversal of the traditional post war policy based on the belief of welfare state, planned development and public-sector-oriented economic growth which prevailed in both developed and developing nations during the period between the 1950s and 1970s (Haque, 2001). It is generally hold that the private sector has higher efficiency in their working since it seeks to maximize profit and in such a condition limited resources of society are utilized optimally and efficiently. Now if privatization process is considered as a basic step towards economic growth and opulence of industrial market economies, it can be hoped that higher economic growth and development will be achieved as the privatization spread in the countries (Rahbar, Sargolzaei, Ahmadi, & Ahmadi, 2012).

3.2.1 Rationale of Privatization

Many industrial advanced countries, socialist economies and developing countries belonging to Asia, Africa and Latin America have introduced mammoth agenda of privatization during the last two-three decades. Many industrial market economies have brought out the programme of privatization on their own privilege, while many developing countries were obligatory to undertaken privatization as a condition for assistance under the economic stabilisation and structural adjustment programmes by International Monetary Fund (IMF) and World Bank. Privatization is generally perceived to have positive outcome. Privatization has ameliorated welfare, profitability, returns to owners and stakeholders, and economic efficiency. But public perceptions of privatization are generally negative and they are getting worse (Birdsall & Nellis, 2005).

There are two broad groups about the possible outcomes of this reform process pointed at financial liberalization: the Goldsmith- McKinnon-Shaw school and Keynes-Tobin-Stiglitz (also called the Structuralist and Neostructuralists School). Each of these groups provides background, rationale and intellectual justification for financial liberalization. McKinnon and Shaw made it clear that the lack of financial deepening was a major hurdle to growth and development (Sen & Vaidya, 1998).

Financial liberalization stimulates productivity in the economy by providing higher incentives to save and enhancing the allocation of funds to the most productive and profitable projects (Ahmed & Islam, 2010). This view is opposed by the Keynesian-Tobin-Stiglitz school of thought. This group (called neostructuralists) has brought forward a number of economic rationales to justify government intervention in the area of prudential regulation and supervision, particularly due to the de facto role of government as an insurer of the financial system (Ahmed & Islam, 2010).

According to the some scholar on privatization, the rationale for privatization is as follows:

Positive Rationale

In general, privatization has been undertaken under the aegis of increasing economic efficiency, streamlining public sector, lessening government borrowing, reducing deficits, generating government revenues, reducing state influence in economy, persuading market forces, enhancing competition, amplifying customers' choices and upgrading service quality (Ghosh, 2013; Haque, 2001). In most countries and sectors around the world privatization yields great benefits at the firm level and macroeconomic level and there is strong correlation between liberalization and return to growth (Nellis, n.d.). Financial liberalization helps to raise growth rate through a number of direct and indirect channels (Sadak, 2005). Some of these directly affect the drivers of economic growth by enhancement of domestic savings, reduction in the cost of capital and transfer of information & communication technology. Indirect channels which in some cases could be even more important than the direct ones include production specialization, better risk management and improvement in macroeconomic policies (Hrab, 2004).

The rationale behind privatization programs in the developing world is the belief that it will increase efficiency through entrepreneurial management and competition, foster economic growth, increase flow of goods and services underpinned by the developments of technology, and enlarge job opportunities in domestic market (Bhattacharya, 2004; Errunza & Mazumdar, 2000). Ahmed and Islam (2010) have briefly discussed some areas where we can have some changes as a result of financial liberalization (a) increase in propensity to save and more savings available to investors, (b) allocative efficiency and improved performance of

investment, (c) reduction of corruption and rent-seeking activities, (d) level of competitiveness, and (e) curb market rate. Some other important reasons for privatization are development of product markets, factor markets and security markets. Welfare economist assumed that efficiency can be reached through competitive marketplace. If privatization stimulates competition, privatization can lead to greater efficiency (Parker & Saal, 2003).

Some scholars tend toward the major rationales of privatization in terms of the following four categories (a) the efficiency argument, which assumes state enterprises responsible for inefficiencies and advocates privatization for better outcomes (Haque, 2001; Walle, 1989), (b) the property ownership argument, which makes the allegation that public ownership is discouraging managers in public enterprises to work efficiently since they have no stake in them (Haque, 2001), (c) the distortion argument, which assumes government intervention liable for creating distortion in resource allocation (Haque, 2001), and (d) the fiscal argument, which considers excessive government intervention as the root cause of budgetary deficits. It is perceived that divestiture will cut government expenditures and help to restore budgetary balance (Haque, 2001; Walle, 1989).

Critical Rationale

Beyond the formal or positive rationale of privatization, there are some pushing factors both internal as well as external behind this radical policy change.

1- The decision to privatize was mainly taken because of fiscal necessity, rather than desire for improved efficiency. Government had raised huge amount by selling state owned enterprise which could be seen as a potential solution to reduce fiscal deficit in many countries or to improve government's finances. Therefore, Privatization can be a result of failure of state ownership (Katsoulakos & Likoyanni, 2002; Parker & Saal, 2003; Sunderland, 2011). In India, when economic reforms began in 1991, the country had confronted with severe balance of payments crisis. Countries that privatized at full tilt did so either because of critical macroeconomic conditions that include hyperinflation, declining GDP, and balance of payments crisis or a sharp political discontinuity leading to a regime change. Under these circumstances, hard economic healing was up to mark. Privatization was a convenient

way to reduce the fiscal deficit and raise foreign exchange, e.g., by selling state enterprises to foreign investors and increase FDI (Kapur & Ramamurti, 2002).

2- In most countries, privatization usually reflects the prevailing state ideology which has been marked as neoconservative, neoliberal or new right position holding pro-market assumptions and favouring market-oriented policies such as privatization, deregulation, subsidy cuts, free trade, market-based interest and exchange rates, foreign direct investment and secured property rights. It has already been acknowledged by some scholars that in advanced developed nations such as Canada, U.K. and U.S., privatization has been an ideologically charged phenomenon which came into the force not due to its intrinsic strengths but due to the influence of neoconservative political leaders and highbrows believing that the private sector is surpassing the public sector. More specifically, the prominent political leaders of the 1980s including Margaret Thatcher in the U.K., Ronald Reagan in the U.S., and Brian Mulroney in Canada allegedly had such neoliberal or neoconservative ideological predispositions (Faiz, 2008; Haque, 2001).

3- Beyond the ideological influence on top policy makers, there were various forms of external pressure which led to the proliferation of privatization in developing countries. Especially for Latin American countries, the propagation of neoliberal approach profoundly was due to rigorous international pressure aggravated by their huge external debts. It has already been pointed out by some experts that vogue of privatization in developing countries went beyond ideological belief, and was considerably determined by international agencies and multinational banks (Haque, 2001). Liberalization and privatization can also be a result of bilateral/multilateral arrangements. The mammoth players in the global marketplace have a crucial interest in liberalization particularly due to saturation in industrialized countries, strong growth in emerging countries, potential future growth in emerging markets, expected efficiency gains through diversification, economics of scale, etc.

4- Finally, The leading political parties have tried to gain public support and win elections by using the privatization rhetoric (Haque, 2001). Therefore, Privatization can also be a political decision taken without proper analysis or consideration of possible short or long-term impact on poverty and income distribution (Nixson & Walters, 2004).

3.2.2 Shortcomings of Privatization

Privatization has plausible implication on social, economical and political landscape of a country but it also has certain critical implications on developing countries.

1- Firstly, in terms of internal economic implications: It is generally argued that the privatization by no means saw any significant improvement in the developing world in terms of expunging poverty, reducing unemployment, bridling trade imbalance, accelerating economic growth and bring down external debt and dependence. Private enterprises tend to retrench workers, introduce capital-intensive technology, hire foreign labour demanding lower wages and worsen unemployment (Haque, 2001). Privatized economy is most of time confronted with a situation where levels of poverty and inequality is rising and overall growth rate in current and projected income per capita become too low to dwarf the increases in inequality and poverty (Nixson & Walters, 2004).

2- Secondly, *with regard to adverse social implications:* Privatization is usually exacerbated income gaps and creating loathsome distributional effects in developing countries. It is all because when the profit-making state enterprises are privatized, the incomes generally shift from public exchequer representing all tax-paying citizens to few opulent investors. Private firms are focus more on profits, prices and costs rather than social objectives (Bayliss, 2002; Kousadikar & Singh 2013). At the centre of all criticism is the notion that privatization has been hard-pressed the poor, beleaguered workers, and privileged the few affluent and powerful. Privatization is throwing people out of work or squeeze them to accept jobs with lower pay and less security, raise prices of goods and services, bestow opportunities to corrupt, and generally makes the rich more richer and the poor more poorer (Birdsall & Nellis, 2005).

3- Finally, in terms of critical political implications: There has been a concern that privatization may be antithetical to democratic institutions due to the shrinking public support for such a policy that may have adverse impact on various state-led social programs. Another political implication of market-based policy has been the increasing power of organized capital and the diminishing power of the working class. This is particularly due to the shift of resources and decisions from the public sector

to the private sector as well as delineation of trade unions (Haque, 2001; Walle, 1989).

3.3 Privatization in India

After independence, India got a choice of how to run the economy. Jawaharlal Nehru, the first prime minister of India, was enormously influenced by avowed success of Soviet planning. He believed that capital intensive industries ought to be handled by the state. This socialist bent led to nationalization of banks, coal, insurance and other industries (Sinha, n.d.). Rajiv Gandhi became the Prime Minister of India initiated a process of simplifying licensing process in the budget of 1985–86 which lasted in 1987 when reform was abandoned. But, the regulations were nevertheless unaffected. Liberalization eventually returned to India in a much more dramatic and lasting form in 1991 (Jenkins, 2003).

In India, it is unlikely that the Narasimha Rao government would have embraced economic reforms out of a genuine desire to lift the performance of the Indian economy if the macroeconomic crisis of 1990–91 had not pushed the country to the stage of near bankruptcy. The economy tread on the heels of crisis due to some policies followed during the 1980s. This forced the Rao government to accept International Monetary Fund and World Bank help on the condition of economic reforms (Chai & Roy, 2006). Fiscal imbalances in India which assumed serious proportions since the mid 1980s had two important facets. First, the outpacing of revenues growth by expenditure growth considerably restrained the resources available for public investment in the economy. Second, the increasing diversion of household savings to meet public consumption requirements not only expand public debt to unfeasible levels, but also reduced the resources available for private investment and resulted in unprecedented balance of payments crisis (Bajpai, 2002).

The debilitating blow of rising fiscal deficits and the steep rise in oil prices during the Gulf crisis of 1990 had put pressure on exchange rate and fuelling expectations about imminent devaluation of the currency. Political instability in 1990, as reflected in two changes of prime ministers within a year led to lack of confidence of Non-Resident Indians (NRIs) in the government's ability to manage the economy. The expectation of devaluation of rupee and the fall in confidence led to withdrawal of deposits in Indian banks by NRIs and withdrawal of capital by other external

investors. Foreign exchange reserves dwindled to a level that was less than the cost of two weeks' worth of imports. The spectre of default on short-term external loans loomed and led to downgrading of India's credit rating (Srinivasan, 2003). To burst out of this dire macroeconomic and balance of payments situation, India's new government got to grips with a fairly comprehensive policy reform package. The reforms tried to consciously fashion the new policy. Long time critics of India's development strategy widely welcomed this change (Nagaraj, 1997).

The major thrusts of reforms were (a) stabilization and macro-economic balance through fiscal, monetary and exchange rate policies, (b) liberalized trade regime with no import licensing and tariff rates, (c) an exchange rate system which makes rupee convertible at least for current account transactions of balance of payments, (d) a competitive financial system with sound regulations, (e) an industrial sector free of many controls, and (f) an autonomous, competitive and streamlined public sectors (Satija, 2009). The Indian government had undertaken fundamental changes in the content and approach to economic policy through pro-market policies, which are classified into (a) fiscal policy reforms including tax reforms, expenditure management, restructuring of the public sector and fiscal & monetary coordination, (b) financial sector reforms including banking sector and capital market, (c) industrial policy and abolition of the license system, (d) foreign investment policy reforms, (e) reforms in the external sector covering foreign trade and exchange rate policies, and (f) agricultural sector reforms regarding internal and external trade in agricultural commodities (Ghosh, 2013).

Extending the ongoing reforms, the Government of India promulgated in the budget of 1998-99 that stake of Government would fall to 26 per cent in PSEs (Public Sector Enterprises) except in the strategic enterprises where the Government will continue to hold the majority of shares. In the same year, the Government of India announced that the strategic enterprises only covered (a) arms, ammunition and defence equipments, (b) atomic energy except use of nuclear power in agriculture, and (c) railway transport (Ram Mohan, 2005). In the following budget of 2000-01, the state was willing to reduce the Government's share even below 26 per cent in non-strategic enterprises if any economic urgency arises (Faiz, 2008).

3.4 Economic & Financial Sector Reforms

Financial liberalization is a pre-eminent part of the process of economic liberalization. Financial sector reforms were started in India in 1992–93 to promote a diversified, efficient and competitive financial system. India's financial sector liberalization has been a comprehensive program involving issues related to banking, capital market, fiscal policy and international financial integration (Sadak, 2009). Financial sector reforms include banking sector and non-bank financial sector. The non-bank financial sector includes reforms relating to the capital market, development finance institutions, insurance and mutual funds and liberalization of capital flows (Joshi, 1996).

The three influential reports by the Chakravarty Committee (1985), the Vaghul Committee (1987) and the Narasimham Committee (1991) & (1998) gave impetus to financial sector reforms. The first committee suggested ways of activating treasury bills market so that open market operations could gradually become the dominant instrument of monetary policy. The second committee recommended phased decontrol of money markets and gradual integration of these markets with other short-term markets such as the treasury bills market (Sen & Vaidya, 1998). Mr. M. Narasimham, a former RBI governor was the chairman of the Committee on Financial Systems (CFS) and the Committee on Banking Sector Reforms (CBSR). The report of CFS was submitted in 1991 and that of CBSR was submitted in 1998. The CFS took note of excessive administrative and political interference in internal management and credit decision making in public sector banks. The CBSR was formed to review the progress made in reforming banking sector and to chart the actions needed to strengthen the foundation of banking system. The CFS and CBSR (henceforth the first and second Narasimham Committees) provided the blueprint for reforming the financial system (Bery & Singh, 2006).

RBI has implemented several key recommendations of the Chakravarty committee and the Vaghul committee with introduction of scheme of 182 days treasury bills in 1986, foundations of The Discount and Finance House of India (DFHI) in 1988 and introduction of commercial paper and certificates of deposit in 1989. Consequently, by late 1980s, there was inevitable deregulation and development of short-term segment of financial market with little development in credit and capital market (Nandy, 2010). More radical reforms had to wait till the

endorsement of structural adjustment cum stabilization program by Indian government in 1991. The pre-eminent reforms included deregulation of interest rates, advancement of securities markets, building a credible risk-free yield curve, greater reliance on open market operations, auctions of government securities, phased decontrol of the capital account and streamlining supervision of banking sector with international standards & practices. However, neither committee took up the cudgels for denationalization (Bery & Singh, 2006).

Banking sector reforms were major point of attention in Rao government. Consequently, a number of measures specific to banking system were undertaken to ameliorate its long term viability as a commercial entity. The self determination of price for banking products on commercial considerations, moderation in various balance sheet restrictions in the form of statutory pre-emption and introduction of prudential norms pertaining to income recognition, asset classification and capital adequacy were some measures of banking sector reforms. The early manoeuvre in banking sector was geared towards withdrawing the functional & operational constraints encroaching on banks' operations and providing them greater operational autonomy (Misra, 2007).

As far as capital market reforms are concerned, several plans have been prepared in past few years to ensure smooth functioning of capital market. The capital market reforms witnessed first move when the Capital Issues (Control) Act of 1947 was rescinded and the office of Controller of Capital Issues abolished. The Securities and Exchange Board of India was established to ensure limpidity of trading practices, speedy settlement procedures, full disclosure for investor protection and supervising market intermediaries in the capital markets (Gupta, 1998; Vashisht, 2002; Vijayakumar, 2012). Some important initiatives taken as part of reform process opened up doors of capital market for foreign institutional investors and allowed Indian companies to access international capital markets by the mechanism of global depository receipts and favourable tax treatment (Ahluwalia, n.d.). To provide greater transparency, anonymity and lower transaction cost, a nationwide 'screen-based trading' system was introduced in 1992, through establishment of National Stock Exchange (NSE) (Ansari, 2006).

As far as external payment regime is concerned, most of restrictions on current transactions were withdrawn. The exchange rate regime is officially described as

market driven with no target rate, but RBI reserves the right to intervene in the market and guide the exchange rate in the directions of appropriate competitiveness (Bery & Singh, 2006).

One can broadly classify the financial sector reforms as being three-pronged aimed at (a) liberalizing the overall macroeconomic and regulatory environment within which financial institutions function, (b) strengthening the institutions and improving their efficiency & competitiveness, and (c) establishing and strengthening the regulatory framework and institutions for overseeing the financial system (Chanda, 2008). As a corollary of these reforms, there has been a rapid growth in the extent of monetization and financial intermediation in the economy. Various financial entities outside the banking segment including mutual funds, non-banking financial companies and primary dealers have come to play an important role in resource mobilization and allocation. The role of the private sector has also been increased.

3.5 Insurance Sector Reforms

The Indian insurance industry was revolved around two public sector players, viz., Life Insurance Corporation of India and General Insurance Corporation of India. LIC has been operated in the life segment lodge in the people brain by providing wide range of services, building an extensive network of branches and offering employment to a large number of agents. The non-life insurance sector was overwhelmingly dominated by GIC. One of the major impetuses for the nationalization of insurance companies in 20th century was to channel greater resources towards development programs. It also sought to increase insurance market penetration and bring down incidence of failures of insurance companies which were thought to be a result of mismanagement. But, in the post-nationalization period, GIC and LIC funds were nevertheless used to finance government deficits and this severely constrained their operations. Moreover, these corporations were also asked to channel funds towards meeting social objectives. With the initiation of reforms in financial sector in early 1990s, the need to restructure insurance sector was realized (Gupta, n.d).

3.5.1 Malhotra Committee

A move to liberalise insurance sector was taken in April 1993 with establishment of Malhotra committee so called committee on insurance sector

reforms. Malhotra committee was headed by R. N. Malhotra, a former finance secretary and governor of Reserve Bank of India. "The Committee was established to assess insurance sector strengths and weaknesses in terms of the objective of providing high quality services to the public and serving as an effective instrument for mobilization of financial resources for development, to review the then existing structure of regulation and supervision of insurance sector and to suggest reforms for strengthening and modernizing regulatory system in tune with the changing economic environment" ("Consultation Paper on Revision of The Insurance Act 1938 & The Insurance Regulatory and Development Authority of India Act 1999," 2003; "Malhotra committee recommendation," 1998). The Malhotra Committee recommended introduction of concept of "professionalization" in the insurance sector (Dutta, 2012). The committee recommended opening of insurance sector to private players and setting an independent regulatory authority to create a level playing field for all entities.

The terms of reference of the said committee were:

1. To review present structure of insurance industry and to evaluate its strength and weakness in term of offering wide-range of insurance products with a high quality of services to public and operating as an effective means for mobilisation of financial resources for development of the economy;
2. To formulate recommendation for modifying structure of insurance industry and general framework of policy consistent with the structural changes in the economy and financial sector;
3. To make precise proposal regarding the LIC and GIC with a view to improve their functioning in changing economic environment;
4. To examine present structure of regulations and supervision of insurance sector and to make suggestions for strengthening and modernising the regulatory system in dynamic economic environment;
5. To review and make suggestions on the role of surveyors, intermediaries and ancillaries of the insurance sector;
6. To make suggestions on such other matters as the committee considers relevant for the growth and development of insurance sector (Sethi & Bhatia, 2007).

The Malhotra Committee came up with the recommendations in January 1994. The committee appointed a private opinion poll agency to conduct a market

survey for finding out satisfaction level of users of life insurance and assess their perceptions on possible liberalization of insurance sector. Based on the findings of survey, the committee underlined some positive and negative aspects of development of LIC which are stated as under:

On the positive side,

1. LIC was proliferated insurance culture widely across India,
2. Huge amount of saving was mobilised for national development and fund was used to finance social sectors such as housing, electricity, water supply, sewerage, medical and education,
3. LIC was a name of trust among insuring public, and
4. A large pool of talented insurance professionals was built up.

On the negative side,

1. The enormous market and service network of LIC was inadequately responsive to customer needs,
2. There was lack of insurance awareness among the public,
3. Lack of life insurance product with reference to the customer needs,
4. Term assurance plans were not encouraged and unit linked products were not available,
5. Price of insurance products were quite high and return from life insurance was significantly lower than other saving instruments,
6. LIC was facing some serious problem due to mismanagement and poor structure. The central and zonal offices were excessively overstaffed,
7. Work culture within the organisation was not satisfactory,
8. Trade unions had indulged in restrictive practices,
9. The efficiency of the organisation and quality of customer service had seriously affected due to lack of computerization (Mitra & Ghosh, 2010b).

"The Malhotra Committee touched both life and general insurance business. The report of the committee covered three major topics (a) liberalization, restructuring and regulation of insurance, (b) pricing of product and distribution of services, and (c) surveyors, reinsurance and ombudsmen (Siddaiah, 2012). The main recommendations of Malhotra Committee were:

Liberalization

Liberalization of insurance industry by permitting domestic and foreign private players was among the several important recommendations the committee made so far. Monopolies are awful in themselves especially when they are government monopolies because they do not keep themselves viable. At the time of nationalization of insurance business, it could have been known that state monopolies would not survive over a long time or lead to lack of competition. Yet, at that point of time, it was believed that control over huge funds and their utilization was absolutely necessary to ensure fulfilment of state priorities for investment (Palade, Shah, & Lunawat, 2008). Therefore, Malhotra committee recommended that state monopoly of insurance sector should be broken up by allowing domestic and foreign private firms in the market.

The idea behind this measure was to ensure utilization of untapped potential, introduction of competition, expansion of business and better choices to customers in terms of variety of products, reduction of prices and efficient customer service. In this direction, committee recommend certain measures to be taken (a) no firm should be allowed to do business in both life and general insurance, (b) insurance regulatory authority should be regulatory authority of insurance companies, (c) auditors of the insurance company should report to insurance regulatory authority, and (d) entry to foreign insurance companies should be on selective basis i.e. they should be required to float an Indian company preferably by way of joint ventures with Indian partners (Kumar, 2010; Rao, 2000). In order to ensure financial strength of insurance companies, the committee recommended three basic measures to be taken (a) new entrant should have minimum paid up capital of Rs 100 crores except in case of state level co-operative institution, (b) the promoters' holding in a private insurance company should not be more than 40 per cent of the total and less than 26 per cent, and (c) no person other than the promoter should be allowed to hold more than 1 per cent of the equity (Bhaumik, 1999). The limitation on capital ownership would restrict contribution to those who have a clear sense of responsibility to the corporation. Nobody should be allowed to have monopoly control over the corporation by owning a large chunk of the capital (Venugopa, 2007).

Supervision and Regulation

On nationalization of life insurance in 1956 and general insurance in 1973, LIC and GIC were provided with most of the regulatory function which became previously carried by Controller of Insurance (COI). Though COI a statutory body attached to the ministry of finance continues to be the supervisory and regulatory authority for insurance industry. To ensure prudent practices while opening insurance industry to competition, the committee recommended that COI should be empowered as prescribed in the Insurance Act. It was also proposed that a multimember statutory body on similar lines to SEBI having full functional autonomy and operational flexibility should be established in order to create a level playing field for all insurers. Therefore, establishment of insurance regulatory authority with supervisory and regulatory powers covering all aspects of insurers in conducting transparent and smooth business was among the important recommendation of committee. In brief, insurance regulatory authority should be act as regulator, controller, supervisor, initiator, conductor, mediator and detector of insurance industry. In order to keep it as an autonomous body, the committee recommended that 0.05 per cent of yearly premium income of insurance companies be levied to finance its establishment and activities (Rao, 2000).

Restructuring

The committee observed that both life and non life insurance sector is facing some serious problem due to mismanagement and poor structure. Therefore, committee proposed restructuring of LIC and GIC.

Life insurance sector: The committee recommended that work should be divided between central and zonal offices of LIC. Central office should concentrate on policy formulation, review and evaluation, pricing and actuarial assessment, product development, personnel policies, investments polices, systems development, etc. Zonal offices should look after the insurance business and related matters. It is generally viewed that state ownership lead to delay and rigidity in decisions making. Therefore, LIC's should be bringing out of state ownership. At that time, LIC had a capital of Rs. 5 crore, contributed entirely by the central government. This amount is not adequate for a life insurer giant. Therefore, committee recommended that capital of Rs 5 crore should be raised to Rs 200 crore, where 50% should be held by the

government and the rest by the public at large including company employees (Kapila, 1996).

Non Life insurance sector: The committee recommended that insurance companies should reorganize the staff structures and hierarchies in their offices. At that time, the four subsidiary companies were over staffed in their head offices, regional offices and even divisional offices. Many metropolitan and urban branches were over-staffed; rural and semi-urban branches were often under-manned. Therefore, it became necessary to utilized excess staff for strengthening the branches. There were also numerous restrictive practices which need to be eliminated in order to revamp work culture and productivity. Furthermore, GIC and its subsidiaries were come within the definition of “State”, since the total share capital was directly or indirectly contributed by the Government of India. In the committee’s views, broad basing their shareholding is needed to operate in a more competitive environment. As far as GIC is concerned, it was proposed that GIC should cease to be a holding company of four of its subsidiaries and should act as a national reinsurer. It was further recommended that share capital of GIC should be raised to Rs. 200 crore from its present level of Rs.107.50 crore, where 50% of the equity should be held by the government and the rest by the public at large including employees of GIC. As far as the four subsidiary companies are concerned, it was proposed that they should operate as independent companies run by a board. It was further suggested that the equity capital of each of these companies should be raised to Rs.100 crore with 50% holding by the government and the rest by the public including employees of the respective companies (Kapila, 1996).

Investment Regulations

Keeping in view present developments in the capital market and stiff competition from other saving institutions, the Malhotra committee recommended certain modifications in mandated investment pattern followed by insurance companies. The committee recommended that (a) investment in central government securities should not be less than 20 per cent and the special deposits with government should continue to be considered as investment in central government securities, (b) state government securities and government guaranteed securities inclusive of central government securities should be not less than 40 per cent as compared to the existing 50 per cent, and (c) investments in socially oriented sectors including above should

not be less than 50 per cent as compared to the existing 75 per cent. However, no changes should be made to the present level of investments in other than approved investments. Furthermore, investments of any insurer should not be more than 5 per cent of the subscribed equity share of any company (Venugopal, 2006).

Rural Insurance

The committee proposed that life insurance should provide cheap term insurance coverage to relatively backward sections of society including working women. For bringing insurance to door step of rural people, institutions including panchayats, voluntary organisations, mahila mandals and co-operatives should be sought. Apart from these, new entrants into the life insurance business should be mandate to underwrite a specified proportion of their business in rural areas and penalties are to be imposed by the Insurance Regulatory Authority for defaulters. The sponsored relief-oriented welfare schemes except those having an element of insurance should be transferred from LIC to concerned government authorities (Rao, 2000). Postal life insurance should be allowed to operate in the rural market.

Pension Funds

Pension fund schemes should be fully exempted from tax. Private pension funds should be allowed to pay pension to their members under the careful scrutiny of regulatory authority and unit-linked pension plans should be popularised. The committee emphasised that contribution to pension funds by self-employed professionals, traders and workers in the unorganized sectors should be promoted. It is suggested that substantial concessions should also be available for contributions to pension funds and this should cover schemes managed by all the insurance companies as well (Kumar, 2010).

Customer Service

Information and processing technology was insufficient to carry out number of statistics for efficient rate-setting and supervision of insurance business. There should be an integrated and effective management information system. The committee was set up a time limit of 12 to 18 months for comprehensive computerisation in LIC. The Committee believed that imaginative and prudent use of information technology would be lead to efficient customer service, effective management and meaningful regulation (Kapila, 1996). For ensuring efficient customer services, the committee

further recommended that LIC should continue as a single entity, pay interest on delays of claim beyond 30 days, use the revised mortality table and revise premium after every 10 years. With regard to general insurance industry, the committee recommended that the institutions of ombudsman should be set up (Bhole & Mahakud, 2009; Gulati, 2007).

Immediately after the recommendations of Malhotra committee, a new committee (called Mukherjee committee) was formed in 1995. The Mukherjee committee submitted its report in 1997, but recommendations of Mukherjee committee never made public. Information from unofficial sources unfolded that the committee proposed inclusion of certain ratio in balance sheet of insurance companies to bring more transparency in accounting standards.

3.5.2 Insurance Regulatory and Development Authority of India

The enactment of any legislation is not facile process. It requires lot of efforts and time especially with reference to India. Based on the recommendation of Malhotra committee regarding establishment of a strong, effective and independent regulatory body to protect interest of policyholders and development of insurance industry, the Government of India had established interim regulatory authority in January 1996 through an exclusive order. Later on, this Interim Regulatory Authority becomes Insurance Regulatory and Development Authority of India (Kumar, 2010).

The constitution of IRDAI is a landmark in landscape of financial sector. The Insurance Regulatory and Development Authority of India Act provides for composition of IRDAI, tenure of office chairperson and other members, removal from office, salary and allowances of chairperson and members, duties, power and function of IRDAI, finance, account and audit, and other miscellaneous provision (Insurance Regulatory and Development Authority of India Act, 1999). Insurance Regulatory and Development Authority of India Act made several amendments to the Insurance Act 1938, LIC Act 1956 and GIC Act 1972 which revoked the monopoly conferred to the Life Insurance Corporation of India and General Insurance Corporation of India (Karthikeyan, 2007; Raja Babu, 2012).

IRDAI as an autonomous body was formed on April 19, 1999. IRDAI entrusted with the task of regulating, supervising and developing insurance and re-insurance business in India. IRDAI started its functioning on April 19, 2000 headed

by N. Rangachary as its first Chairperson with 4 full-time directors, 2 part-time directors and 25-members in Insurance Advisory Council. The members of the council represent various industries and professions (Narula, 2012).

IRDAI as a regulatory authority has heavy responsibilities and difficult roles to play. On the one side, it has to protect against malpractices and secure fair treatment to policyholders. On the other side, it has to impose restrictions in such a manner that growth of insurance industry is not hampered. IRDAI regulations cover minimum requirements for best practices in the area of licensing, prudential regulations and requirements, supervisory powers, managing asset qualities and enhancing corporate governance.

Objectives of the Insurance Regulatory and Development Authority of India

1- To protect the interest of policyholders of insurance policies;

2- To bring about speedy and orderly growth of the insurance industry and to provide long term funds for accelerating growth of the economy;

3- To set, promote, monitor and enforce high standards of integrity, financial soundness, fair dealing and competence of those it regulates;

4- To ensure speedy settlement of genuine claims, to prevent insurance frauds and other malpractices and put in place effective grievance redressal machinery;

5- To promote fairness, transparency and orderly conduct in financial markets dealing with insurance and build a reliable management information system to enforce high standards of financial soundness amongst market players;

6- To take action where such standards are inadequate or ineffectively enforced;

7- To bring about optimum amount of self-regulation in day-to-day working of the industry consistent with the requirements of prudential regulation.

Functions of Insurance Regulatory and Development Authority of India

1- Issue to the applicant a certificate of registration; to renew, modify, withdraw, suspend or cancel such registration;

2- Protection of the interests of the policy holders in matters concerning assigning of policy, nomination by policy holders, insurable interest,

settlement of insurance claim, surrender value of policy and other terms and conditions of contracts of insurance;

3- Specifying requisite qualifications, code of conduct and practical training for intermediary or insurance intermediaries and agents;

4- Specifying the code of conduct for surveyors and loss assessors;

5- Promoting efficiency in the conduct of insurance business;

6- Promoting and regulating professional organisations connected with the insurance and re-insurance business;

7- Levying fees and other charges for carrying out the purposes of this Act;

8- Calling for information from, undertaking inspection of, conducting enquiries and investigations including audit of the insurers, intermediaries, insurance intermediaries and other organisations connected with the insurance business;

9- Control and regulation of the rates, advantages, terms and conditions that may be offered by insurers in respect of general insurance business not so controlled and regulated by the Tariff Advisory Committee under section 64U of the Insurance Act, 1938 (4 of 1938);

10- Specifying the form and manner in which books of account shall be maintained and statement of accounts shall be rendered by insurers and other insurance intermediaries;

11- Regulating investment of funds by insurance companies;

12- Regulating maintenance of margin of solvency;

13- Adjudication of disputes between insurers and intermediaries or insurance intermediaries;

14- Supervising the functioning of the Tariff Advisory Committee;

15- Specifying the percentage of premium income of the insurer to finance schemes for promoting and regulating professional organisations referred to in clause (f);

16- Specifying the percentage of life insurance business and general insurance business to be undertaken by the insurer in the rural or social sector; and

17- Exercising such other powers as may be prescribed.

3.5.3 Milestones in Post Reform Period

Year	Milestone
1999	Introduction of Insurance Regulatory and Development Authority of India Act, 1999
2000	Constitution of IRDAI on 19th April, 2000 & Framing of Various Regulations Entry of domestic and foreign private firms into the Indian insurance market Insurance Regulatory and Development Authority of India (Investment) Regulations, 2000
2001	Establishment of Life Insurance Council and General Insurance Council Introducing Third Party Administrators for health insurance services
2002	Regulation on Protection of Policyholders' Interests Introducing New Insurance Intermediaries: Brokers and Corporate Agents Four subsidiary companies of GIC became independent companies
2003	Referral Arrangement with Banks Strengthening of Insurance Councils
2004	Various Committees / Working Groups on issues viz. Earthquake pool, Intermediaries, and Health Insurance Regulation on qualifications of actuary
2005	Guidelines on Group Insurance Policies Introduction of Micro Insurance Regulations De-Tariffing of Marine Insurance Guidelines for Unit Linked Insurance products Report of KPN Committee on Provisions of Insurance Act, 1938
2006	Guidelines on Anti Money Laundering/ Counter Financing of Terrorism Entry of Stand-Alone Health Insurance Company
2007	Guidelines on Advertisement, Promotion & Publicity of Insurance Companies, and insurance intermediaries De-tariffing of General insurance sector Creation of Motor Pool for Third party Insurance
2008	Benefit Illustrations for Unit Linked Products Innovation in Products Strengthening on-site & off-site Monitoring
2009	Guidelines for Corporate Governance Guidelines on Health plus Life Combi Products Grievance Redressal Mechanism
2010	Regulations on Treatment of Discontinued Linked Insurance Policies Regulations on Sharing of Database for Distribution of Insurance Products Mandating Public Disclosures

	Creation of IRDAI Grievance Call Centre & Guidelines for Grievance Redressal
2011	Framework for life insurance companies to raise capital through public issue Insurance Regulatory and Development Authority of India (Scheme of amalgamation and transfer of general insurance business) Regulations 2011 Insurance Regulatory and Development Authority of India (Issuance of capital by life insurance companies) Regulations 2011 Creation of Integrated Grievance Management System Portability of Health insurance policies Mobile application to compare insurance products and premium rates Insurance awareness initiative "Bima Bemisaal"
2012	Web Enabled Facility to Ascertain Insurance Particulars of Motor Vehicles Online application to compare Non Life Insurance products Revised ULIP Guidelines Creation of Consumer Education Website-for Public
2013	Insurance Regulatory and Development Authority of India (Issuance of Capital by General Insurance Companies) Regulations 2013 Insurance Regulatory and Development Authority of India (Health Insurance) Regulations, 2013 Insurance Regulatory and Development Authority of India (Places of Business) Regulations, 2013 Linked & Non-linked Life Insurance Regulations Insurance Repository System for Individual Policy Holders Common Service Centres to sell simple policies in rural areas Circular on Insurance Fraud Monitoring Framework
2014	Report of the working group on File & Use guidelines for General insurance products
2015	The Insurance Laws (Amendment) Act, 2015, which provides for raising the foreign investment cap from 26 per cent to 49 per cent Permission to set up IFSC Insurance Office in special economic zones Norms on maintenance of insurance records
2016	IRDAI (Registration and Operations of Branch Offices of Foreign Reinsurers other than Lloyd's) (First Amendment) Regulations, 2016 IRDAI (Lloyd's India) Regulations, 2016

3.6 Growth and Development of Indian Insurance Sector during Post Privatization

The growth and development of insurance sector has been one of the important objectives of insurance reforms. The insurance reforms in other countries resulted into higher growth of the sector. A natural question therefore arises that what happen to the growth of insurance sector since privatization of Indian insurance sector in 2000. Growth and development of Indian insurance sector is measured on the basis of insurance penetration and density, number of insurance companies, premium underwritten, new policies issued, expenses, profitability, equity capital, insurance offices and incurred claim ratio. To analyze the impact of insurance reforms on the growth of the insurance sector the study divides the insurance sector into life and non-life.

- **Growth of Life Insurance Sector**
- **Growth of Non-Life Insurance Sector**

3.6.1 Growth of Life Insurance Sector

Table 3.1: Life Insurance Penetration and Density in India

Years	Penetration (Percentage)	Density(USD)
2001-02	2.59	11.7
2002-03	2.26	12.9
2003-04	2.53	15.7
2004-05	2.53	18.3
2005-06	4.10	33.2
2006-07	4.00	40.4
2007-08	4.00	41.2
2008-09	4.60	47.7
2009-10	4.4	55.7
2010-11	3.4	49.0
2011-12	3.17	42.7
2012-13	3.10	41.0
2013-14	2.6	44

Sources: Compiled by Researcher from Various Annual Reports of IRDAI from 2002 to 2015

Table 3.1 shows the life insurance penetration and density in India from 2001-02 to 2013-14. In the year 2001-02 life insurance penetration was 2.59 per cent which grew to 4.60 in 2008-09, but it finally slipped to 2.6 per cent in 2013-14. Table 3.1 further shows that life insurance density had been consistently gone up from USD 11.7 in 2001-02 to USD 55.7 in 2009-10 and slipped in consequent years to USD 49.0 in 2010-11, USD 42.7 in 2011-12 and further slipping to USD 41.0 in 2012-13. During the year under review 2014, the life insurance density was USD 44.

Table 3.2: Number of Life Insurance Companies in India

Years	Public	Private	Total
2001-02	1	12	13
2002-03	1	12	13
2003-04	1	13	14
2004-05	1	13	14
2005-06	1	15	16
2006-07	1	16	17
2007-08	1	20	21
2008-09	1	21	22
2009-10	1	22	23
2010-11	1	23	24
2011-12	1	23	24
2012-13	1	23	24
2013-14	1	23	24
2014-15	1	23	24

Sources: Compiled by Researcher from Various Annual Reports of IRDAI from 2002 to 2015

Table 3.2 shows total number of life insurance companies operating in India from 2001-02 to 2014-15. As the table depicts, there are 24 life insurance companies presently in operation, one is in public sector namely LIC and twenty three in private sector.

Table 3.3: Premium Underwritten by Life Insurance Companies in India

(Amount in crore)

Years	Public	Private	Total
2001-02	49821.91	272.55	50094.46
2002-03	54628.49	1119.06	55747.55

2003-04	63533.43	3120.33	66653.75
2004-05	75127.29	7727.51	82854.80
2005-06	90792.22	15083.54	105875.76
2006-07	127822.84	28253.00	156075.86
2007-08	149789.99	51561.42	201351.41
2008-09	157288.04	64497.43	221791.26
2009-10	186077.31	79369.94	265450.37
2010-11	203473.40	88165.24	291638.63
2011-12	202889.28	84182.83	287072.11
2012-13	208803.58	78398.91	287202.49
2013-14	236942.30	77340.90	314283.20
2014-15	239667.65	88433.49	328101.14
CAGR	11.87%	51.14%	14.37%

Sources: Compiled by Researcher from Various Annual Reports of IRDAI from 2002 to 2015

Table 3.3 given above shows the premium underwritten by life insurance companies in India. It can be seen from the table that life insurance industry underwrote premium of Rs. 50094.46 crore during the financial year 2001-02, which was increased to Rs. 291638.63 crore in 2010-11, but the total life insurance premium collection dropped in the year 2011-12 to Rs. 287072.11 crore. However following the year 2011-12 it increased to Rs. 328101.14 crore in 2014-15. Life insurance industry grew at a CAGR (Compound Annual Growth Rate) of 14.37 per cent. LIC recorded a premium income of Rs. 49821.91 crore in 2001-02 which was increased to Rs. 203473.40 crore in 2010-11, but LIC premium collection slipped to Rs. 202889.28 crore in the year 2011-12. However following the year 2011-12 it increased to Rs. 239667.65 in 2014-15. LIC premium collection increased at a CAGR of 11.87 per cent. Private sector recorded a premium income of Rs. 272.55 crore in 2001-02 which was increased to Rs. 88165.24 crore in 2010-11, but private sector premium collection dropped in the subsequent years to Rs. 77340.90 crore in 2013-14. However, private sector premium collection was Rs. 88433.49 crore in 2014-15. Private sector premium collection increased at a CAGR of 51.14 per cent.

Table 3.4: Expenses of Life Insurance Companies in India

(Amount in crore)

Years	Commission			Operating		
	Public	Private	Total	Public	Private	Total
2001-02	4519.31	49.09	4568.40	4260.39	419.36	4679.75
2002-03	5015.07	153.02	5168.09	4571.75	838.27	5410.02
2003-04	5742.91	415.41	6158.32	5186.49	1402.44	6588.93
2004-05	6203.23	854.72	7057.95	6241.26	2229.46	8470.72
2005-06	7100.19	1543.10	8643.29	6041.56	3569.48	9611.04
2006-07	9173.58	3109.65	12283.20	7080.86	6520.04	13600.9
2007-08	9614.69	5089.61	14704.30	8309.32	12032.46	20341.78
2008-09	10055.09	5474.27	15529.40	9064.29	16763.03	25827.32
2009-10	12132.56	6052.75	18185.30	12245.82	16561.11	28806.93
2010-11	13347.29	4982.12	18329.40	16980.28	15962.02	32942.30
2011-12	14063.06	4458.05	18521.10	14914.40	14760.19	29674.59
2012-13	14790.26	4471.19	19261.50	16707.66	14844.70	31552.36
2013-14	16762.88	4083.49	20846.40	20277.88	14773.88	35051.76
2014-15	15118.14	4342.54	19460.68	22395.45	14466.14	36861.59
CAGR	9.01%	37.74%	10.91%	12.58%	28.78%	15.88%

Sources: Compiled by Researcher from Various Annual Reports of IRDAI from 2002 to 2015

Table 3.4 shows commission and operating expenses of life insurers in India. Total commission expenses of life insurance sector stood at Rs. 19460.68 crore in 2014-15, as against Rs. 4568.41 crore in 2001-02. It expanded at a CAGR of 10.91 per cent. Commission expenses of LIC increased from Rs. 4519.31 crore in 2001-02 to Rs. 15118.14 crore in 2014-15. Commission expenses of LIC grew at a CAGR of 9.01 per cent. Commission expenses of private insurers increased from Rs. 49.09 crore in 2001-02 to Rs. 4342.54 crore in 2014-15. Private insurers' commission expenses grew at a CAGR of 37.74 per cent.

Similarly, total operating expense of life insurance sector was increased from 4679.75 crore in 2001-02 to 32942.30 crore in 2010-11, but it was declined to 29674.59 crore in 2011-12 and increased thereafter to 36861.59 crore in 2014-15. Operating expenses of life insurance industry expanded at a CAGR of 15.88 per cent. Operating expenses of LIC increased from Rs. 4260.39 crore in 2001-02 to Rs. 22395.45 crore in 2014-15. Operating expenses of LIC grew at a CAGR of 12.58 per

cent. Operating expenses of private insurers increased from Rs. 419.36 crore in 2001-02 to Rs. 14466.14 crore in 2014-15. Operating expenses of private insurers expanded at a CAGR of 28.78 per cent.

Table 3.5: Profitability of Life Insurance Companies in India

(Amount in crore)

Years	Profit after tax			Investment income		
	Public	Private	Total	Public	Private	Total
2001-02	821.79	-227.81	593.98	23857.37	11.74	23869.11
2002-03	9761.80	-9651.16	110.64	26038.98	176.6	26215.58
2003-04	10962.60	-11377.2	-414.56	29855.86	267.59	30123.45
2004-05	15884.26	-16049.1	-164.83	37066.76	363.39	37430.15
2005-06	12733	-13185.4	-452.42	40056.35	1222.42	41278.77
2006-07	773.62	-1933.22	-1159.60	46800.52	2747.32	49547.84
2007-08	844.63	-4257.44	-3412.81	56595.06	6602.62	63197.68
2008-09	957.35	-5835.84	-4878.49	42804	10416	53220
2009-10	1060.72	-2049.54	-988.82	112425	42831	155256
2010-11	1171.80	1485.24	2657.04	95949	25718	121667
2011-12	1313.34	4660.19	5973.53	84545	7083	91628
2012-13	1437.59	5510.8	6948.39	117486	28878	146364
2013-14	1656.68	5931.32	7588	143001	43741	186742
2014-15	1823.78	5787.22	7611	168063.58	78701.54	246765.12

Sources: Compiled by Researcher from Various Annual Reports of IRDAI from 2002 to 2015

Profitability of insurance industry has not been showing any consistency during the period of study. Insurance industry has seen various ups and downs during last countable years. Profit after tax and investment income has taken as measure of profitability for life insurance business in India. Profit after tax of life insurers reported an increase at the end of 2002 & 2003 and reflected negative results for seven consecutive years, but it again started gaining during 2011 to 2015. Profit after tax of LIC has reported profit for all years under study while private insurers has reported profit from 2010-11 onwards.

The investment income of life insurers was increased from Rs. 23869.11 crore to Rs. 246765.12 crore in 2014-15. In case of LIC, investment income was Rs. 23857.37 crore in 2001-02 which increased to Rs. 168063.58 crore in 2014-15. In

case of private insurance industry, investment income was at Rs. 11.74 crore in 2001-02 which increased to Rs. 78701.54 crores in 2014-15.

Table 3.6: Equity Share Capital of Life Insurance Companies in India

(Amount in crore)

Years	Public	Private	Total
2001-02	5.00	1664.00	1669
2002-03	5.00	2229.13	2234.13
2003-04	5.00	3238.71	3243.71
2004-05	5.00	4347.81	4352.81
2005-06	5.00	5887.05	5892.05
2006-07	5.00	8119.41	8124.41
2007-08	5.00	12291.42	12296.42
2008-09	5.00	18249.77	18254.77
2009-10	5.00	21015.00	21020
2010-11	5.00	23656.85	23661.85
2011-12	100.00	24831.92	24931.92
2012-13	100.00	25418.72	25518.72
2013-14	100.00	25838.51	25938.51
2014-15	100.00	26144.14	26244.14
CAGR	23.86%	21.74%	21.75%

Sources: Compiled by Researcher from Various Annual Reports of IRDAI from 2002 to 2015

Total paid up capital of life insurance companies was Rs. 26244.14 crore in 2014-15 which was Rs. 1669.00 crore in 2001-02. Total paid up capital of life insurance companies grew at a CAGR of 21.75 per cent. Paid up capital of LIC has Rs. 100.00 crore in 2014-15 which was Rs. 5.00 crore in 2001-02. Total paid up capital of LIC expanded at a CAGR of 23.86 per cent. Paid up capital of private life insurers was Rs. 26144.14 crore in 2014-15 which was Rs. 1664.00 crore in 2001-02. Total paid up capital of private life insurance companies increased at a CAGR of 21.74 per cent.

Table 3.7: Number of Life Insurance Offices in India

Years	Public	Private	Total
2001-02	2190	116	2306
2002-03	2191	254	2445

2003-04	2196	416	2612
2004-05	2197	804	3001
2005-06	2220	1645	3865
2006-07	2301	3072	5373
2007-08	2522	6391	8913
2008-09	3030	8785	11815
2009-10	3250	8768	12018
2010-11	3371	8175	11546
2011-12	3455	7712	11167
2012-13	3526	6759	10285
2013-14	4839	6193	11032
2014-15	4877	6156	11033
CAGR	5.89%	32.80%	11.83%

Sources: Compiled by Researcher from Various Annual Reports of IRDAI from 2002 to 2015

Number of life insurance offices had increased from 2001-02 to 2009-10 and decreased thereafter till 2012-13. The decreasing trend of number of life offices reverted in 2013-14 and 2014-15. Number of life insurance offices opened by insurance sector increased at a CAGR of 11.83 per cent. Number of life insurance offices opened by private sector had increased from 116 in 2001-02 to 8768 in 2009-10 and decreased thereafter in subsequent years. Number of life insurance offices opened by private insurance sector grew at a CAGR of 32.80 per cent. The number of life offices established by LIC had increased to 4877 in 2014-15 from 2190 in 2001-02. Number of life insurance offices opened by LIC expanded at a CAGR of 5.89 per cent.

3.6.2 Growth of Non-life Insurance Sector

Table 3.8: Non-Life Insurance Penetration and Density in India

Years	Penetration (Percentage)	Density(USD)
2001-02	0.67	3.0
2002-03	0.62	3.5
2003-04	0.64	4.0
2004-05	0.61	4.4
2005-06	0.60	5.2
2006-07	0.60	6.2
2007-08	0.60	6.2

2008-09	0.60	6.7
2009-10	0.71	8.7
2010-11	0.70	10
2011-12	0.78	10.5
2012-13	0.80	11.0
2013-14	0.70	11.0

Sources: Compiled by Researcher from Various Annual Reports of IRDAI from 2002 to 2015

Table 3.8 given above shows non-life insurance penetration and density in India from 2001-02 to 2013-14. Non life insurance penetration was saw some mix trend over 2001-02 to 2004-05 which was 0.67 per cent in 2001-02 and 0.61 per cent in 2004-05, then it became constant at 0.60 per cent during 2005-06 to 2008-09 and finally increasing 0.70 per cent in 2013-14. During the years from 2002 to 2014, non-life insurance penetration remained in the range of 0.60-0.80 per cent Non life insurance density has been continuously increasing from USD 3.0 in 2001-02 to USD 11.0 in 2013-14.

Table 3.9: Number of Non-Life Insurance Companies in India

Years	Non life			Reinsurer
	Public	Private	Total	
2001-02	5*	8	13	1
2002-03	6*	8	14	1
2003-04	6*	8	14	1
2004-05	6*	8	14	1
2005-06	6*	9	15	1
2006-07	6*	11**	17	1
2007-08	6*	14**	20	1
2008-09	6*	15**	21	1
2009-10	6*	18**	24	1
2010-11	6*	18**	24	1
2011-12	6*	21**	27	1
2012-13	6*	21**	27	1
2013-14	6*	22**	28	1
2014-15	6*	22**	28	1

Sources: Compiled by Researcher from Various Annual Reports of IRDAI from 2002 to 2015
*Includes Specialised Insurance Companies
** Includes Standalone Health Insurance Companies

Table 3.9 given above shows total number of non life insurance companies and reinsurance companies operating in India from 2001-02 to 2014-15. As the table depicts, in 2013-14, there are 28 non-life insurance companies and GIC acts as a sole national reinsurer. Of the 28 non life insurance-companies, six are in public sector including two are specialized insurers namely Export Credit Guarantee Corporation of India Limited and Agriculture Insurance Company of India Limited, and twenty two in private sector including five standalone health insurance companies.

Table 3.10: Premium Underwritten by Non-Life Insurance Companies in India

(Amount in crore)

Years	Public	Private	Total
2001-02	11917.59	467.65	12385.24
2002-03	13520.44	1349.80	14870.24
2003-04	13337.08	2257.83	15594.91
2004-05	13972.96	3507.62	17480.58
2005-06	15976.44	5362.66	21339.1
2006-07	16258.90	8646.57	24905.47
2007-08	16831.84	10991.89	27823.73
2008-09	18030.74	12321.09	30351.83
2009-10	20643.45	13977.00	34620.45
2010-11	25151.85	17424.63	42576.48
2011-12	30560.74	22315.03	52875.77
2012-13	35022.12	27950.53	62972.65
2013-14	38599.71	32010.30	70610.01
2014-15	42549.48	35090.09	77639.57
CAGR	9.52%	36.13%	14.01%

Sources: Compiled by Researcher from Various Annual Reports of IRDAI from 2002 to 2015.

Note: Specialized and Standalone Health Private Insurers are not included.

Table 3.10 given above shows the premium underwritten by non-life insurance companies in India. There is a steady increase in the total premium collection by the non-life insurance sector during the period. The total premium collection went to Rs. 77639.57 crore in 2014-15 from Rs. 12385.24 crore in 2001-02. Non-life insurance industry expanded at a CAGR of 14.01 per cent. Public sector non-life insurers recorded a premium income of Rs. 11917.59 crore in 2001-02 which was increased to

Rs. 42549.48 crore in 2014-15. Public sector non-life insurer's premium collection increased at a CAGR of 9.52 per cent. Private sector recorded a premium income of Rs. 467.65 crore in 2001-02 which was increased to Rs. 35090.09 crore in 2014-15. Private sector non-life insurance premium collection increased at a CAGR of 36.13 per cent.

Table 3.11: Number of New Policies Issued by Non-Life Insurance Companies in India

(Amount in crore)

Years	Public	Private	Total
2001-02	-	-	-
2002-03	4.18	0.16	4.34
2003-04	4.44	0.31	4.75
2004-05	4.46	0.51	4.97
2005-06	4.39	0.89	5.28
2006-07	3.39	1.26	4.65
2007-08	3.85	1.87	5.72
2008-09	4.51	2.19	6.7
2009-10	4.51	2.19	6.7
2010-11	4.34	2.40	6.74
2011-12	3.29	5.28	8.57
2012-13	6.89	3.80	10.69
2013-14	6.00	4.24	10.24
2014-15	6.78	5.05	11.83
CAGR	3.79%	30.41%	8.02%

Sources: Compiled by Researcher from Various Annual Reports of IRDAI from 2002 to 2015.

Note: Specialized and Standalone Health Private Insurers are not included.

Number of new policies issued by non-life insurance sector has been increased throughout the study period. Number of new policies issue in non-life insurance sector increased from 4.34 crore in 2002-03 to 11.83 crore in 2014-15. New policies issue in non-life insurance sector increased at a CAGR of 8.02 per cent. Public sector non-life insurance companies issued 4.18 crore new policies in 2002-03 which increased to 6.78 crore in 2014-15. New policies issue by Public sector non-life insurance companies increased at a CAGR of 3.79 per cent. Number of new policies

issued by private non-life insurers was increased from 0.16 crore in 2002-03 to 5.05 crore in 2014-15. New policies issue by private life insurers increased at a CAGR of 30.41 per cent.

Table 3.12: Expenses of Non-life Insurance Companies in India

(Amount in crore)

Years	Commission			Operating		
	Public	Private	Total	Public	Private	Total
2001-02	657.41	5.91	663.32	2525.78	175.09	2700.87
2002-03	935.70	42.55	978.25	2766.61	317.71	3084.32
2003-04	1092.28	109.65	1201.93	3647.68	495.16	4142.84
2004-05	1233.19	228.19	1461.38	3640.30	691.98	4332.28
2005-06	1431.41	394.28	1825.69	4016.92	1060.51	5077.43
2006-07	1489.74	585.97	2075.71	3606.74	1700.15	5306.89
2007-08	1519.54	637.39	2156.93	3652.96	2482.30	6135.26
2008-09	1670.86	682.79	2353.65	4347.21	3017.22	7364.43
2009-10	1825.81	676.9	2502.71	5262.59	3129.61	8392.2
2010-11	1943.34	794.21	2737.55	6688.60	3931.88	10620.48
2011-12	2258.09	1079.80	3337.89	6563	4614	11177
2012-13	2505.47	1515.36	4020.83	8037	5503	13540
2013-14	2869.72	1753.96	4623.68	8791	6327	15118
2014-15	3105.11	1760.72	4865.83	11181	7527	18708
CAGR	11.73%	50.22%	15.30%	11.21%	30.82%	14.83%

Sources: Compiled by Researcher from Various Annual Reports of IRDAI from 2002 to 2015.

Note: Specialized and Standalone Health Private Insurers are not included.

Table 3.12 given above shows commission and operating expenses of non-life insurance sector in India. Total commission expense of non life insurance sector increased from Rs. 663.32 in 2001-02 to Rs. 4865.83 crore in 2014-15. Commission expenses of non life insurance industry increased at a CAGR of 15.30 per cent. Commission expenses of public sector non-life insurers increased from Rs. 657.41 crore in 2001-02 to Rs. 3105.11 crore in 2014-15. Commission expenses of public sector non-life insurers grew at a CAGR of 11.73 per cent. Commission expenses of private sector non-life insurers increased from Rs. 5.91 crore in 2001-02 to Rs.

1760.72 crore in 2014-15. Commission expenses of private sector non-life insurers expanded at a CAGR of 50.22 per cent.

Similarly, total operating expense of non life insurance sector increased from Rs. 2700.87 crore in 2001-02 to Rs. 18708 crore in 2014-15. Total Operating expenses of non-life insurance industry increased at a CAGR of 14.83 crore. Operating expenses of public sector non-life insures increased from Rs. 2525.78 crore in 2001-02 to Rs. 11181 crore in 2014-15. Operating expenses of public sector non-life insurers expanded at a CAGR of 11.21 per cent. Operating expenses of private sector non-life insurers increased from Rs. 175.09 crore in 2001-02 to Rs. 7527 crore in 2014-15. Operating expenses of private sector non-life insurers grew at a CAGR of 30.82 per cent.

Table 3.13: Profitability of Non-Insurance Companies in India

(Amount in crore)

Years	Profit after tax			Investment income		
	Public	Private	Total	Public	Private	Total
2001-02	-49.49	-61.77	-111.26	2188.48	67.47	2255.95
2002-03	625.16	6.75	631.91	2519.88	116.94	2636.82
2003-04	1358.32	67.04	1425.36	3818.20	154.32	3972.52
2004-05	1171.60	121.90	1293.5	4330.18	184.42	4514.6
2005-06	1319.28	154.38	1473.66	5610.63	269.47	5880.1
2006-07	2907.36	229.74	3137.1	5784.23	415.04	6199.27
2007-08	2205.48	43.83	2249.31	6247.51	742.05	6989.56
2008-09	498.33	-101.26	397.07	4799.78	1091.20	5890.98
2009-10	1293.07	-88.56	1204.51	6347.27	1334.29	7681.56
2010-11	-161.51	-857.43	-1018.94	7842.20	1539.63	9381.83
2011-12	1152.48	-1120.15	32.33	7424.26	2083.65	9507.91
2012-13	2602.72	679.11	3281.83	8610.52	2991.09	11601.61
2013-14	2899.76	1539.14	4438.9	9394.63	3982.36	13376.99
2014-15	3093.99	1643.51	4737.5	10725.02	4931.01	15656.03

Sources: Compiled by Researcher from Various Annual Reports of IRDAI from 2002 to 2015.

Note: Specialized and Standalone Health Private Insurers are not included.

Profitability of insurance industry has not been showing any consistency during the period of study. Insurance industry has seen various ups and downs during

last countable years. Table 3.13 given above shows profitability of non life insurance sector in India. Profit after tax and investment income has taken as measure of profitability for non-life insurance business in India. Profitability of non-life insurance sector has reported negative results for 2 years out of 14 years. Profit after tax of public sector non-life insurance companies has reported loss for 2 years out of 14 years. While private sector non-life insurers have reported negative results for 5 years out of 14 years.

The investment income of non-life insurers was increased from Rs. 2255.95 crore in 2001-02 to Rs. 15656.03 crore in 2014-15. In case of public sector non-life insurers, investment income was Rs. 2188.48 crore in 2001-02 which increased to Rs. 10725.02 crore in 2014-15. In case of private non-life insurance industry, investment income was at Rs. 67.47 crore in 2001-02 which increased to Rs. 4931.01 crores in 2014-15.

Table 3.14: Equity Share Capital of Non-Life Insurance Companies in India

(Amount in crore)

Years	Public	Private	Total
2001-02	400	726.50	1126.50
2002-03	400	883.00	1283.00
2003-04	400	1048.96	1448.96
2004-05	450	1048.96	1498.96
2005-06	500	1279.01	1779.01
2006-07	550	1400.87	1950.87
2007-08	550	1801.70	2351.70
2008-09	550	2533.23	3083.23
2009-10	550	3160.04	3710.04
2010-11	550	3955.70	4505.70
2011-12	550	4860.68	5410.68
2012-13	600	5974.72	6574.72
2013-14	600	6226.37	6826.37
2014-15	650	6972	7622
CAGR	3.53%	17.53%	14.63%

Sources: Compiled by Researcher from Various Annual Reports of IRDAI from 2002 to 2015.

Note: Specialized and Standalone Health Private Insurers are not included.

Total paid up capital of non-life insurance companies was Rs. 7622 crore in 2014-15 which was Rs. 1126.50 crore in 2001-02. Total paid up capital of non-life insurance companies increased at a CAGR of 14.63 per cent. Paid up capital of public sector non-life insurance companies was Rs. 650 crore in 2014-15 which was Rs. 400.00 crore in 2001-02. Total paid up capital of public sector non-life insurance companies expanded at a CAGR of 3.53 per cent. Paid up capital of private non-life insurers was Rs. 6972 crore in 2014-15 which is less than that of Rs. 726.50 crore in 2001-02. Total paid up capital of private life insurance companies grew at a CAGR of 17.53 per cent.

3.15: Incurred Claim Ratio of Non-Life Insurance Companies in India

Years	Public	Private	Total
2001-02	90.19	23.03	88.81
2002-03	79.80	52.06	78.27
2003-04	79.91	50.97	77.20
2004-05	81.63	51.16	77.42
2005-06	89.94	54.47	83.03
2006-07	85.22	68.02	81.27
2007-08	90.43	72.21	84.88
2008-09	91.30	76.89	86.30
2009-10	88.27	80.30	85.50
2010-11	97.03	86.71	93.30
2011-12	89.22	88.22	88.85
2012-13	84.79	79.56	82.79
2013-14	83.20	79.58	81.74
2014-15	82.09	79.69	81.15
CAGR	-0.67%	9.27%	-0.64%

Sources: Compiled by Researcher from Various Annual Reports of IRDAI from 2002 to 2015.

Note: Specialized and Standalone Health Private Insurers are not included.

The incurred claims ratio (net incurred claims to net earned premium) of the non-life insurance industry was 81.15 per cent during 2014-15 which is less than 88.81 per cent during 2001-02. Incurred claim ratio of non-life insurance companies exhibited a CAGR of -0.64 per cent. The incurred claims ratio for public sector insurers was 82.09 for the year 2014-15 which decreased from 2001-02 incurred

claims ratio of 90.19, whereas for the private sector incurred claims ratio increased from 23.03 in 2001-02 to 79.69 in 2014-15. Incurred claim ratio of public sector non-life insurance companies declined at a CAGR of -0.67 per cent while incurred claim ratio of private sector non-life insurance companies grew at a CAGR of 9.27 per cent.

3.7 Conclusion

Over the past century, Indian insurance industry has undergone through tremendous changes. It began as a fully private system with no restriction on foreign participation. After the independence, the industry went to the other extreme. It became a state-owned monopoly. In 1991, when rapid changes took place in many parts of the Indian economy, nothing happened to the institutional structure of insurance, it remained a monopoly. Only in 1999, a new legislation came into effect signalling a change in the insurance industry structure. There are numerous reasons that promoted the government to bring reforms in the insurance sector. Among other convincing reasons, it was also realized that India has vast potentials, which is waiting to be tapped, and this could only be achieved when sufficient competition is generated and it is exposed to the developments in the rest of the world. The Government of India liberalized the insurance sector which lifted the entry restrictions for private insurance players, allowing foreign players to enter into the Indian market and start their operations in India. Each foreign company needed to have a 26% equity capital to enter into the Indian insurance market. Many foreign companies have joined their hands with the Indian companies and started their operations in early 2001. Now, FDI limit has increased to 49%. It is gratifying to note that the new insurance companies have approached the business in a proper perspective. Both the life and non-life business is growing beyond the normal expectations. The actual growth is slightly beyond the forecasted growth of insurance sector. There is substantial increase in the total premium collection by insurance companies in both life and non-life sector after privatization. Insurance penetration and insurance density which have been marginal in both life and non-life sector seems improving. The share of private companies is continuously improving in both life and non-life sector but an interesting fact is that the rate of growth of the PSEs in the sector has not shown any trend of decline after privatization of the sector. The public sector in turn has redrawn its priorities, redesigned their market strategy and together the public sector and private sector have enlarged the market.