CHAPTER – I

INTRODUCTION

The term development is used in different senses. In an ordinary sense it
implies growth leading to maturity. In the literature of economic development, it
implies economic growth with a better distribution of income for the
improvement in the living condition of a wide spectrum of population possible.
In the opinion of G Myrdal development encompasses the movement upward
the entire social system.¹

Economic development has been measured in terms of national income.
National income is not the sole index of development though it is an index of
economic growth. Economic development implies all-round economic and social
growth in which human development indices like education and health are also
counted. Development presupposes a knowledgeable society with a decent
standard of living and standard of life with full utilization of resources including
human resources. To quote Prof. R Nurkse “Economic development has much to
do with human endowments, social attitudes, political conditions and historical
accidents.”²
In the words of M Narasimham “Economic development can be broadly defined as a process which improves the quality of human life.” 3

According to World Bank’s India Development Policy Report [DPR 2006] development process is not simply a measure of aggregate of economic activity but is an assessment of the inclusiveness of economic growth “with emphasis not only on the distribution of economic gains but also on the security, vulnerability, empowerment and a sense of full participation that people may enjoy in social life.” 4

“Rural Development is a strategy designed to improve the economic and social life of a specific group of people, the rural poor. It involves the extending the benefits of development to the poorest among those who seek the livelihood in the rural areas. The group includes small scale farmers tenants and landless.” 5

Apparently, development stands for both qualitative and quantitative improvement in the economic and social life of the people for the purpose of the study. Development can be defined as a process in which the basic amenities of the people improve so as to lead a minimum decent living showing improvement in the standard of living of the people. 6

Notwithstanding the nature of the economic system- capitalist or socialist or mixed economy the role of every financial institution (FI) has nowadays been regarded as that of mobilisers and deployers of resources for the economic development of the country. Having accepted socialistic pattern of society as one
of its directive principles, the Government of India (GOI) considered FIs as a speedy vehicle for the egalitarian economic growth. The public authority among other things expects FIs to support and sponsor the developmental activities in the economy for balanced development.

At the national level rural development has been the mantra for the last more than half a century. FIs are considered as engines for the socio economic development ever since imposing social control and subsequent nationalization of major FIs. 7

Economic Development is the outcome of the combined efforts of different agencies - financial institutions, government departments and non governmental agencies. Finance, albeit important, is not the only factor deciding the growth. Hence the performances of the supportive agencies deserve evaluation; set backs to be examined and reasons thereof to be ascertained. Performances of all concerned agencies vis-à-vis projections are to be studied. Despite the various developmental efforts the issue of rural development and inclusive growth is still an unfinished agenda.

The tasks of economic development are complicated and economic development is interrelated to other aspects of development like education, health and basic necessities of men, to list a few. This research study analyses the major supportive role performed by the insurance companies in meeting these tasks. Since 1947 efforts have been made to mobilize and canalize credit
for the rural development of the country. In order to ensure the economic growth, FIs role as a deployer of credit is relevant. As a land of villages, rural development is the key to economic development in the country. Distinguished economists like Schumpeter, Kalecki and Keynes have emphasized the critical role played by bank credit in stimulating economic development.  

Rural development apart from economic factors is influenced by socio cultural and psycho factors. The Seventh Five Year Plan Document says “Economic development of the poorer section cannot be achieved without social transformation involving structural changes, educational development, growth in awareness and change in the outlook attitudes and motivation. Despite the allocation of huge funds for the developmental programme the impact of various policies and schemes on the living conditions of the target groups leaves much to be desired.

Vast and varied contributions have been made to the literature on FI’s role in rural development. While some authors have made methodical analysis of the historical facts, many have explained the shortage of the system, its problems and solutions. Still many issues are to be discussed in detail, sans fear or favour or feelings. Such steps can surely bring out the facts and provide solutions. Researchers also have a vital role in this area.

The issue in India with regard to rural economic development is not the shortage of policies or programmes or schemes or even institutions. There are
too many schemes but too little commitment to implement them. For the last few decades the country has been striving for the upliftment of the rural poor but the fact is that it still remains an unfinished agenda. This is clear in the latest statistics on the financial inclusion. This shows that though the nation has been running, it is still where it was. The present study is an attempt to examine the finished and unfinished agenda.

Insurance is the process of averaging risks, based on the theory of probability and the law of large numbers. Risk is a consequence of uncertainty and the loss resulting from it; and the consequence is that the observed outcome deviates from the expected outcome. This notion of risk and its ramifications permeate decision making process in day to day life and the involvement of risk and the instinct for security against such risk has a bearing on the attitudes of human beings and it might have given birth to the concept of life insurance.

1.1. HISTORY OF INDIAN INSURANCE INDUSTRY.

The early history of life insurance is enveloped in the mists of antiquity. Collective co-operation among persons exposed to a particular risk in order to share that risk is as old as the dawn of human civilization. The Aryans had
evolved a system of village and community life which was proof against the ravages of time and gave sustenance to everyone.

A reference is available in the Rig Veda that some kind of commercial insurance was practiced by the Aryan tribes in India nearly 3000 years ago and the Vedic Rishis knew about it. The fact that the State is to concern itself with the welfare of its subjects proves that ‘Yogakshemam’ mentioned in Rig Veda is something like the idea of a welfare state. The Manu Smriti also supports the system of ‘collective co-operation’ as practiced by the Aryans and the society provided against many eventualities for every one. The mutual help system of the Aryans started with the birth of the child. Besides, other social institutions like village panchayats, temples and charitable institutions also provided protection from the rigours of misfortune to a person and his dependants.

Life insurance in its existing form came to India from the United Kingdom (UK) with the establishment of a British firm, Oriental Life Insurance Company in Calcutta in 1818 followed by Bombay Life Assurance Company in 1823, the Madras Equitable Life Insurance Society in 1829 and Oriental Government Security Life Assurance Company in 1874. The Indian Life Assurance Companies Act, 1912 was the first statutory measure to regulate life insurance business. Later, in 1928, the Indian Insurance Companies Act was enacted, inter alia, to enable the Government to collect statistical information about both life and non life insurance business transacted in India by Indian and foreign insurance, including the provident insurance societies. In 1938, with a view to protecting the
interest of insuring public, earlier legislation was consolidated and amended by the Insurance Act, 1938 with comprehensive provisions for detailed and effective control over the activities of insurers. The Act was amended in 1950, making far-reaching changes.

Many legal developments, government controls and fund investment by insurance companies started from 1938 and Life Insurance Corporation (LIC) of India, the biggest insurance company in India, was set up in 1956. The outlook and framework of LIC gives adequate thrust for investing people’s money for people’s welfare and the deployment of funds is made in such a way that the community at large is getting the best advantage with due attention to the national priorities and obligation of ensuring reasonable return to the policy holders.

Irrespective of the change in the political set up, the national policy has given adequate thrust to explore and enhance the quality of life of people through financial security in both urban and rural area and to ensure social security to the populace at large. LIC of India has proved to be a catalyst in this mission, next to Indian Railways, by making both long term and short term investments in the prescribed class and pattern based on the policy frame work made by the government from time to time.

Section 27 of the Insurance Act earmarks the approved, specified and scheduled investments in Central and State Governments by insurance
companies in general and section 27 A deals with the investment of life insurance funds in India; Section 43 narrates the applicability of various matters dealing with investment and its permissible range of variations.

The study about the investment made by insurance companies in government sector (Agarwal Ram Kishore-1960), The Pioneering Role of LIC in Financing the Promotional Activities of Industrial Undertakings (Acharya Ravindra Prakash-1984), LIC’s Investments and Policy Holder’s Funds (Gupta Leeladhar-1971), The Pattern of Investment Made by LIC (Bhatia Jai Kishan- 1971), Life Insurance Fund and Industrial Growth in India (Dwivedi Raj Kishore-1977), Development Schemes in the Industrial Sector (H.T.Parekh-1979), Role of LIC in Developing Corporate, Co-operative and Social Sector (R.M.Ray-1982), Funding Practices of LIC in Established Sectors in India (Douglas Morris- 1990), Investment Policy of LIC Since 1958 (Pandey Yagyadatt-1984), Promotion of Entrepreneurial Activity of Small Medium and Large Entrepreneurial Class by LIC (Perumalswamy-1994), The Investment of LIC in Central & State Government Funds and Special Deposit with Governments (Mathew-1986), The Linkage Between Government, Planners and Investing Community for The Economic Progress (C. Sullivan-1992) are clear indicators of LIC’s role in fostering development in the industrial and social sector in many states in the country and it naturally has groomed into a rational thinking – why not have a similar study on LIC’s investment practices and development funding in Kerala, by blending the methodologies adopted in the works mentioned above.
Based on the recommendations of the various committees like Administrative Reforms Committee, Nayudu Committee, Thappar Committee, Ranganathan Committee and Malhotra Committee reports, many changes were introduced in the Insurance Sector and it reduced the Government stake and the mandatory investments of LIC Funds in government securities. In tune with the recommendations laid down by the Planning Commission, the LIC of India began to provide Development Finance from the 7th Plan period itself. The Kerala state also received LIC funds for development projects since 1990. As the parameters of investment in Central and State government has changed considerably, the deployment aspects of insurance sector has become more competitive and transparent. It becomes necessary to evaluate the avenues of investments, and the consideration given to different industries in different sectors. Hence an attempt is made to identify and evaluate the priorities of allocation and utilization of different types of funds in different sectors and different industries in Kerala.

1.2.0. RESEARCH DESIGN

1.2.1. TITLE.

This study titled “Development Finance and Life Insurance Corporation” is an assessment of the role and participation of LIC in the developmental activities. The title is justified by the detailed analysis as it encompasses various factors like
progress attained in the field of stock market operations, industrial growth and infrastructure development and social sector investment.

1.2.2. STATEMENT OF THE PROBLEM.

LIC of India has established itself as a major funding agency with a national outlook and social commitment, especially during the last few decades. The entry of many international insurance companies to Indian soil has affected LIC of India to a certain extent. LIC of India is financially sound and experienced but as a competitive player in the market, existing practices in product development, operational efficiency, lending and investment pattern etc. needs to be reviewed at definite intervals. This study is focusing on the developmental activities initiated by LIC of India, which has a competitive edge without losing the social concern, particularly when dynamism is brought in by the new generation insurance companies from within and outside.

This study is an assessment of the funding pattern made by LIC of India in tune with the changes observed in the economic front of the country and particularly with the entry of new generation insurance companies. Basically the study is centered round the structure and pattern of funding made by LIC of India particularly in the state of Kerala.
1.2.3. SIGNIFICANCE OF THE STUDY

LIC of India has achieved certain social and economic goals through public ownership since its nationalization. Economic liberalization, reforms in the financial sector and many other catalysts in the economic scenario have brought in radical changes in the insurance sector. To combat the changes in the economic front, specific changes have been made in the investment pattern of LIC of India over the last few years. But there is shortage of literature relating to the investment and funding aspects made by LIC in Kerala and an attempt has been made to fill the lacunae and this study is intended to line up the developmental activities initiated and promoted by LIC of India, in Kerala.

The findings and recommendations emerging from the study will enable the authorities concerned in designing various strategies towards the betterment of the existing schemes, plans and outlook towards the deployment of Funds.

1.2.4. OBJECTIVES OF THE STUDY.

Major objective of the study is to make an assessment of the contribution of LIC of India in the field of development finance through direct and indirect participation, with particular reference to the state of Kerala. More specifically the objectives of the study are:
i. To verify whether the ratio of investment made by LIC of India varies significantly within the corporate sector and between the corporate and co-operative sector undertakings in Kerala.

ii. To ascertain whether any significant variation is observed among different segments of industries so far as the funding pattern followed by LIC in Kerala is concerned.

iii. To review the share of LIC in securities market with reference to Kerala.

iv. To narrate the pattern of allocating the funds by LIC in Kerala, in social sector investments.

v. To describe the utilisation of different types of funds by public and private sector Life insurance companies in India.

1.2.5. HYPOTHESES.

Based on the objectives, the following hypotheses have been framed for this study.

H₀. 1. The proportion between the investment made in government and corporate securities doesn’t vary significantly, on account of the quantum of investment in stock exchange securities in Kerala as well as India.
2. Sectoral allocation, in terms of value of investment, made in stock Exchange securities in Kerala doesn’t deviate significantly from the national pattern followed by LIC of India.

1.2.6. SOURCES OF DATA.

Both primary and secondary data were used in this study. Primary data was gathered from the officials of Central Office, Zonal Office, and from the Officials of various departments of the government of Kerala.

1.2.6.1. Primary data.

Data gathered from the officials of Central Office and Zonal Office through direct interview revealed the following.

LIC of India with its Central Office at Mumbai has eight Zonal Offices in the country and the state of Kerala comes under Southern Zone. Southern Zone is divided into thirteen Divisional Offices including Kozhikode, Ernakulam, Kottayam and Thiruvananthapuram.

The interviews with the senior officials of the client organizations, including retired hands, and the existing staff in the accounting department of Zonal office, senior officials of state government and the selected Central & State Public Sector Undertakings in Kerala and the Officers of New Generation Insurance companies provided the core of primary data. The respondents were contacted in person, with prior notice. Primary data was collected from them
through a pre structured and edited interview schedule. Total number of such respondents came to twenty and the representation from rural development, irrigation, water supply, power generation, local administration and housing came to three each, while two respondents were available from other departments.

1.2.6.2. Secondary data.

Details pertaining to direct participation, indirect participation, industry-wise details, securities market operations, etc., were gathered from the Central office at Mumbai, Zonal Office at Chennai and the Library & Training centre at Ambattur. Reference materials available from LIC Divisional offices at Kozhikode, Ernakulam, Kottayam and Thiruvananthapuram were also made use of.

Particulars regarding the utilisation of funds by different industries in different sectors and funds released to the government and government guaranteed schemes were collected from Zonal office and the data relating to defaulted accounts and outstanding balances availed of from the Zonal office. Information on special deposit with governments, allocation for special housing schemes and ordinary housing schemes, infrastructure development of specified categories coming through local administration, segregation between rural and urban water supply, bifurcation between water supply for drinking water and that for irrigation, power distribution for lighting purpose and irrigation purposes in the rural areas, have been ascertained on an equitable basis and are obviously
the estimates, due to technical reasons, especially the matters which are deemed confidential.

The distribution of LIC funds among irrigation & drinking water supply, power supply & energy distribution, rural & urban development, government housing finances, housing schemes of local administration, advances under government guarantee schemes etc. were gathered from the respective corporate offices in Kerala.

Allocations made to different sectors and industries were gathered from the internal reports maintained at the Zonal office. The allocation of total fund to policy holders’ fund, distribution of surplus by Actuary and the corresponding accounting information were extracted from the published and unpublished records of LIC.

1.2.7. TOOLS AND METHODS OF DATA COLLECTION.

The study is mainly based on primary and secondary data. Since most of the primary data required from the respondents are of technical in nature, direct interview method was followed.

The direct interview with the officials of LIC has given a clear picture of the screening parameters pertaining to production or service, personnel, profitability and risk factors such as creditor investigation, collateral valuation risk, lending regulations for different categories, exposure norms, tenure norms for exposure
and rating, ECGC special approval list, CIBAL Data Base, Capital Market Indicators and External Rating Indicators.

The procedure adopted by LIC in selecting the clients for various funding activities, was gathered from the officials at Central and Zonal offices of LIC. The officials have given adequate information about the listing procedure like equating of CRR and FRR, Gearing and Liquidity, Regulatory Risk and Transaction Risk of different industries in each sector and that of the social sector. The mechanism of gauging the financial strength, market dynamics, restricted and permitted investments and competitive positioning was also given by them.

Financial and statistical information available from published accounts, Annual Reports, Chairman’s Review and websites of LIC have provided the base for secondary data. Major portion of the internal secondary data as disclosed by the Zonal Office were available in ready to use format and the remaining part was derived and inferred with the help of financial and statistical tools.

Secondary data from external published materials, computerized data base, internet and syndicated services and web sites of insurance companies and Five Year Plan reports were also used for the study.

1.2.8. DEFINITION OF CONCEPTS

1.2.8.1. Return on assets.

The average gross rates of interest yielded by the assets may be determined expressing the investment income as percentage of the mean fund.
\[ i = \frac{2 \times I}{(A + B - I)}; \quad \text{where } i \text{ is the gross yield;} \]

\[
\begin{align*}
I & = \text{Investment Income;} \\
A & = \text{the assets at the beginning of the financial year,} \\
B & = \text{the assets at the end of the financial year.}
\end{align*}
\]

Investment Income (shown in the Revenue Account) should include the Amount of the unrealised gain taken into revenue account, A and B have to be the adjusted value of assets shown in the Balance Sheet.

1.2.8.2. Investment.

The term investment includes government securities, approved securities, special deposit with government, and investments in call deposit and investments in socially oriented units.

When investments are functionally classified and presented in the annual reports it is grouped as central and state govt. security, industrial securities (both public and private) mortgage/ Investment in real estate, investment in the housing sector and Investment in other assets. However, on an operational basis the term investment in a study which concentrates on development finance, includes central and state government securities, approved securities, special deposit with government and investments in socially oriented units.

1.2.8.3. Socially oriented Investments.

LIC has approved and included the following types of advances under the head socially oriented investments.
(a) Loan to municipal committees & Zilla Parishad for water supply & sewage schemes.

(b) New /augmentation schemes for supply of drinking water in dry areas.

(c) Sewage schemes in those areas which are endemic or which are tourist centers or centre of pilgrimage.

(d) Loan to transport corporations for purchase of buses.

(e) Loan to electricity boards, for generation of electricity.

(f) Loan to state government for housing.

(g) General housing loan schemes for economically weaker section, low-income group, middle income housing scheme, rental housing scheme for state government employees, land acquisition and development scheme, slum clearance / improvement scheme.

1.2.8.4. Diversification of Investment by LIC

LIC’s Investment has been made with a positive outlook towards diversification. Diversification in the sense that it is spread over different channels, and in the following form.

(a) Geographical distribution

(b) Distribution among divergent economic enterprises.

(c) Distribution among different securities maintained at different periods.

(d) Distribution of funds according to industries, firms and sectors.
1.2.8.5. Investments governed by Exposure Norms.

Insurance Regulatory and Development Authority (IRDA) has given guidelines for investments of LIC from 2000 onwards. Accordingly 35 percent of the investments shall be Exposure Norms (Regulations- 5). Regulation 5 is included with a view to reducing the risk of concentration and excessive self-investments, it includes,

a) Equity and preference shares
b) Convertible portion of debentures at face value.
c) Debentures including NCDS and private NCDs
d) Short term / medium term/ Long Term loans

1.2.8.6. Norms for Investment.

Prior to 1950 LIC was to keep 55 percent of assets in government and other approved securities and the remaining 45 percent was left to the discretion of LIC. But since 1950, they are required to keep 25 percent of assets in government or other approved heads, 35 percent in approved Investments. The Investment Regulatory and Development Authority (IRDA) formulated Investment Regulations in August 2000 and subsequently amended them in May 2001. In terms of the explanation in Section 27 A of the Insurance Act, the authority had determined the latest regulations which are applicable to Life Business as per Regulation (3) are:
i) Government Securities - not less than 25 percent.

ii) Government Securities or Other approved Securities including (i) above – not less than 50 percent.

iii) Approved Investments as specified in schedule

(a) Infrastructure and Social Sector – not less than 15 percent.

(b) Other than Approved Investments to be governed by Exposure/Prudential Norms – not exceeding 35 percent.

1.2.8.7 Pension and General Annuity Business

Every insurer shall invest and at all times keep invested funds belonging to his Pension Business, General Annuity Business in the following manner:

i) Government Securities being not less than 20 percent.

ii) Government Securities and Other Approved Securities – not less than 40 percent of the fund (including (i) above).

iii) Balance to be invested in Approved Investments as specified in Schedule, subject to Exposure/Prudential Norms – not exceeding 60 percent.

1.2.8.8 ‘Unit Linked Life Insurance Business’

Every insurer shall invest and at all time keep invested his segregated fund of Unit Linked Business as per investment offered to and approved by policy
holders, where the units are linked to categories of assets which are both marketable and easily realisable.

1.2.8.9 Infra structure facility.

The following sub heads are included under the head infrastructure.

(a) Road, highway, bridge, airport, sea port, railway including BOLT, road transport system, water supply project, irrigation project, industrial parks, water treatment system, solid waste management system, sanitation and sewage system.

(b) Generation or distribution or transmission of power.

(c) Telecommunication.

(d) Project for housing and

(e) Any other public facility of a similar nature as may be notified by the authority.

1.2.9. TOOLS OF ANALYSIS.

The study is both descriptive and analytical in nature. Secondary data from internal and external sources constitute the core data. The data collected from both the sources have been scrutinized, edited, tabulated and suitably classified and analysed keeping in view the objectives of the study.

The statistical analyses, both inferential and descriptive, have been made with the support of SPSS package and index calculations, graphs etc. using
Microsoft Excel. Mean values, coefficient of dispersion, coefficient of variation, percentages, growth rates, index values, correlation & regression coefficients, Smirnov’s index and scale values were used for analyzing the data.

1.2.10. PERIOD OF STUDY.

The Insurance Regulatory and Development Authority Regulations, specifying the obligations of insurers to rural sector came into force in 1999. Considering this aspect, the study is limited to a consecutive period of ten years, i.e. From 1998-’99 to 2007-’08.

1.2.11 FRAME OF ANALYSIS.

For the purpose of analysis, both descriptive and inferential statistical tools were used. Graphs and diagrams were also made use of for analyzing the data. Common size analysis, trend analysis and ratio analysis were also used appropriately. The statistical analysis has been made with the help of the SPSS package.

1.2.12. SCOPE AND LIMITATIONS OF THE STUDY.

The coverage is limited to the state of Kerala. The scope is thus limited to the developmental programmes supported by LIC of India, utilizing the policy holder’s fund and the sectoral utilization of various funds by Life Insurance Corporation of India. It covers the central and state government undertakings and departments, corporate sector including public and private sector as well as the co-operative undertakings functioning in Kerala.
The researcher is aware of the following limitations pertaining to the study. Despite the limitations earnest efforts have been made to make this study accurate, useful and meaningful.

The major share of the material used for the study is in the nature of secondary data.

i. The Life insurance companies are hesitant to disclose many of the sub details on account of safety aspect. So the investigator had to depend more on estimates.

ii. The amount released by LIC to various government schemes and industries in each sector, are presumed as spent on development activities.

iii. The mode of presentation and contents of the published accounts were being modified from time to time, to satisfy the disclosure norms suggested by IRDA. This made the researcher rely on averages and proximate values for synthesizing and analyzing the data.

1.2.13. SCHEME OF REPORT.

The thesis is divided into seven chapters. The first chapter deals with introduction and methodology.
The second chapter gives the review of literature and the legal framework of funding pattern of LIC of India towards development Finance. The third one gives an account of the various funding patterns followed by LIC in Kerala, consisting of direct and indirect participation, corporate and co-operative sector funding, and funding made to different industries in Kerala. The fourth chapter highlights the market share of LIC of India in the securities market in Kerala. The fifth chapter describes the investments made by LIC in Kerala specifically towards the social sector as labeled by the government of Kerala. The sixth Chapter compares the utilization of various funds by private and public sector Life Insurance companies in respect of development finance in Kerala. The last chapter sums up the findings, conclusions and recommendations emerging from the study.