

## Role & Importance of Insurance Corporation for The Development of The Economy

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### ABSTRACT

Insurance is an important sector of an economy -- in particular, an emerging market economy (EME) like India. Figuratively and literally, insurance insures a country against collapse. It also insures the people of the country against adversity. The converse is also true. Insurance can catalyse the growth of an economy. Insurance can promote the financial security of the people. It is therefore not surprising that in the advanced economies we see today, the insurance sector is highly advanced, evolved and continues to evolve. It continues to evolve since business, trade, industry and commerce are not static – they grow all the time and into newer and unexplored areas. Almost all risks, present and foreseeable, can be insured in the advanced economies. Being the proverbial facilitator, the government has a moral responsibility to ensure that the participants in its economy are provided all the help in insuring against all the risks they are likely to face. Being the guardian of its people and the promoter of the welfare of its citizens, the government is bound to help its people ensure their financial security by in turn ensuring that they are in a position to access as many insurance solutions as possible, commensurate with their requirements.

**Keywords:** Insurance, society, Economy, Security, Life.

### 1. INTRODUCTION

The concept of insurance is closely related to security. Insurance acts as a protective shield against risk and future uncertainties. Traditionally, a risk-averse behaviour has been a characteristic feature of Indians who preferred a 'low and certain' disposable income to a 'high and uncertain' income.

Hence insurance has become a close associate of Indians since 1818, when the Oriental Life Insurance Company was set up by Europeans in Kolkata to cater to the needs of their own community. The age was characterised by intense racial discrimination as Indian insurance policy holders were charged higher premiums than their foreign counterparts. The first Indian insurance company to cover Indian lives at normal rates was the Bombay Mutual Life Assurance Society which was established in the year 1870.

By the dawn of the 20<sup>th</sup> century, new insurance companies had started operations. In order to regulate the insurance business in India and to certify the premium rate tables and periodic valuations of the insurance companies, the Life Insurance Companies Act and the Provident Fund Act were passed in 1912. Such statistical estimates made by actuaries revealed the disparity that existed between Indian and foreign companies. (source: <http://business.mapsofindia.com/india-insurance/company.html> )

#### *Objective of the Study*

To Study the existing structure of the insurance industry in India

To study the structure of unit linked insurance policy in LIC

### 2. REVIEW OF LITERATURE

Ponreka Maria D<sup>1</sup> and Surya Rao U argue that insurance is the best form of fortification against risk that has been formulated by man. Since its emergence, insurance has become unavoidable to every aspect of human life - from health

<sup>1</sup> Management Science, Sathyabama University, Chennai 600119 in "Customer Satisfaction with Service Quality with Special Reference to Life Insurance Corporation in Madurai District"



disorders to building properties, from household articles to multimillion dollar projects. The insurance industry in India was opened up to private sector participation in the year 2000. Because of the entry of private players in the insurance market, LIC has lost 26 percent market share to private players although market size and the insurance premium being collected are on the rise. In 2007, LIC accounted for 74.18 percent of the total insurance market in India. The study was done on a stratified random sampling design.

According to **Mantis, George and Farmer, Richard, N (1968)<sup>2</sup>**, the more accurate the demand predictions for any firm or industry, the easier it is to manage the firm or industry efficiently. Thus if an insurance company could predict its sales for the next year accurately, it would be in a position to control costs more precisely and manage its investment accounts more carefully.

According to **Rao, Ramakrishna, T.S. (2007)<sup>3</sup>**, 1999-2000 was a landmark year in the history of Indian insurance industry. The year 2007 was another watershed for the industry. De-tariffication from January 1, 2007 totally changed the complexion of the non-life industry. Financial inclusion is being emphasized in various fora. The insurance industry will have to play a vital role by providing health insurance and other insurance products for the poor.

### 3. LIFE INSURANCE IN PRACTICE – THE INDIAN SCENARIO

Although life insurance debuted in India well over a hundred years ago, its importance has not been appreciated fully. In India, which is one of the most populous countries in the world and social security is conspicuous by its absence, life insurance is relevant.

Life insurance is a contract that pledges payment of an amount to the person assured (or his / her nominee) on the happening of an event he / she has insured against. The contract requires the insurer to make payment / payments to the insured:

- Upon maturity of the policy, or
- At periodic intervals, or
- Upon the death of the insured, if it occurs earlier.

Among other things, the contract also warrants the payment of premium periodically to the insurer by the policyholder. Life insurance is universally acknowledged as an institution, which eliminates 'risk', replaces uncertainty with certainty and promptly helps the family of the insured in the event of death of the latter. By and large, life insurance is a partial solution provided by society to the problems arising from the death of the insured. Life insurance, in short, is relevant for the following reasons:

- One could die prematurely, leaving in the lurch the dependent family
- One might have nothing to fall back upon when one gets too old to earn a livelihood.
- Buying an endowment life insurance product involves periodical outflow of cash in the form of premium over an extended period of time. These cash outflows eventually return to the insured though. In the circumstances, the insured is often inclined to compare investment in endowment insurance products with that in other savings products. The following paragraph explains the difference between the two.

### 4. IMPORTANCE OF INSURANCE -LIFE INSURANCE VS OTHER SAVINGS

#### ***Contract of Insurance***

A contract of insurance is a contract of utmost good faith. It is technically called *uberrima fides*. The doctrine of disclosing all material facts is embodied in this important principle, which applies to all forms of insurance.

At the time of taking a policy, the policyholder should ensure that all questions in the proposal form are correctly answered. Any misrepresentation, non-disclosure or fraud in any document leading to the acceptance of the risk would render the insurance contract null and void.

#### ***Protection***

Savings through life insurance guarantee full protection against risk of death of the saver. Also, in case of demise, life insurance assures payment of the entire amount assured (with bonuses wherever applicable) whereas in other savings schemes, only the amount saved (with interest) is paid to the investor.

#### ***Aid to Thrift***

Life insurance encourages 'thrift'. It allows long-term savings since payments can be made effortlessly because of the 'easy instalment' facility built into the scheme. (Premium payment towards insurance is payable monthly, quarterly, half yearly or yearly).

<sup>2</sup> Source: "Demand for Life Insurance", The Journal of Risk and Insurance, 35 (2): 247-256.

<sup>3</sup>Source: "The Indian Insurance Industry the Road Ahead", Journal of Insurance Chronicle, III (I): 31.



For example, the Salary Saving Scheme popularly known as SSS provides a convenient method of paying premium each month by deduction from one's salary. In this case the employer directly pays the deducted premium to LIC.

### **Liquidity**

It is easy to take a loan on the sole security of any policy that has acquired loan value. Besides, a life insurance policy is also generally accepted as security, for a commercial loan.

### **Tax Relief**

Life Insurance is the best way to enjoy income tax and wealth tax shelter in terms of the provisions of the Income Tax Act in force. The result is that the insured in effect pays a lower premium towards insurance.

### **Money When You Need It**

A policy that has a suitable insurance plan or a combination of different plans can be effectively used to meet certain monetary needs that may arise from time to time. Children's education, start-in-life or marriage provision or even periodical needs for cash over a period of time can be less stressful thanks to these policies. Alternatively, policy money can be made available at the time of one's retirement from service and used for any specific purpose, such as, purchase of a house or for other investments. Loans can be raised by policyholders for house building or for purchase of flats, subject to certain conditions.

### **Unit Linked Insurance Plans (ULIPs)<sup>4</sup>**

#### **Introduction**

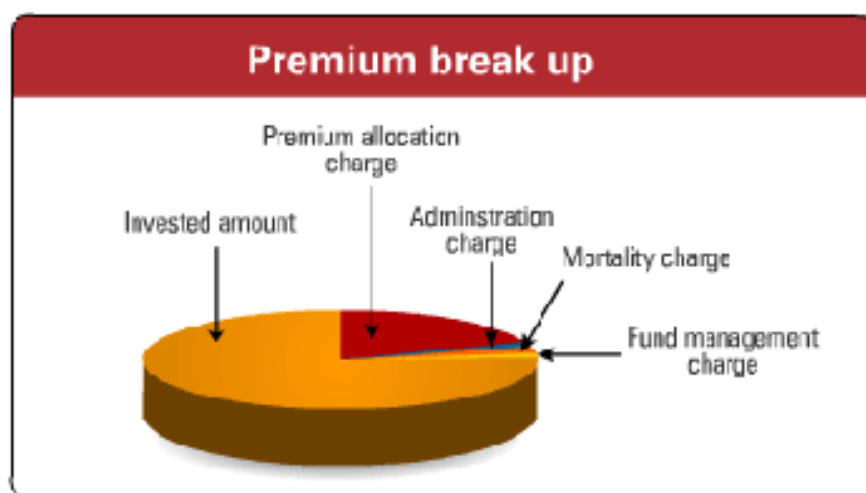
**ULIPs** are a category of goal-based financial solutions that combine the safety of insurance protection with wealth creation opportunities. In **ULIPs**, a part of the investment goes towards providing life cover to the insured. The residual portion of the **ULIP** is invested in a fund which in turn invests in stocks or bonds; the value of investments alters with the performance of the underlying fund opted by the insured.

Simply put, **ULIPs** are structured in such a way that the protection element and the savings element are distinguishable, and hence managed according to the specific needs of the insured. In this way, the **ULIP** plan offers unprecedented flexibility and transparency.

#### **Working of ULIPs**

When the insured decides on the amount of premium to be paid and the amount of life cover needed from the **ULIP**, the insurer deducts some portion of the **ULIP** premium upfront. This portion is known as the premium allocation charge, and varies from product to product. The rest of the premium is invested in the fund or mixture of funds chosen by the insured. Mortality charges and **ULIP** administration charges are thereafter deducted on a periodic (mostly monthly) basis by cancellation of units, whereas the **ULIP** fund management charges are adjusted from NAV on a daily basis.

Since the fund chosen by the insured has an underlying investment (the investment could be either in equity or debt or a combination of the two), the fund value will reflect the performance of the underlying asset classes. At the time of maturity of the plan, the insured is entitled to receive the fund value as at the time of maturity. The pie-chart below illustrates how the **ULIP** premium is split for the purpose.



**Figure-1: Premium Split in ULIP**

<sup>4</sup> Source: ICICI Prudential Life Insurance (<http://www.iciciprulife.com/public/Retirement-Plans/Unit-Linked-Insurance-Plans.htm>)



### Types of ULIPs

One of the significant advantages that a ULIP offers is that whatever be the specific financial objective of the insured, chances are that there is a ULIP which is just right for the insured. The figure below depicts the different goals that people belonging to various age-groups and at various life-stages, pursue.

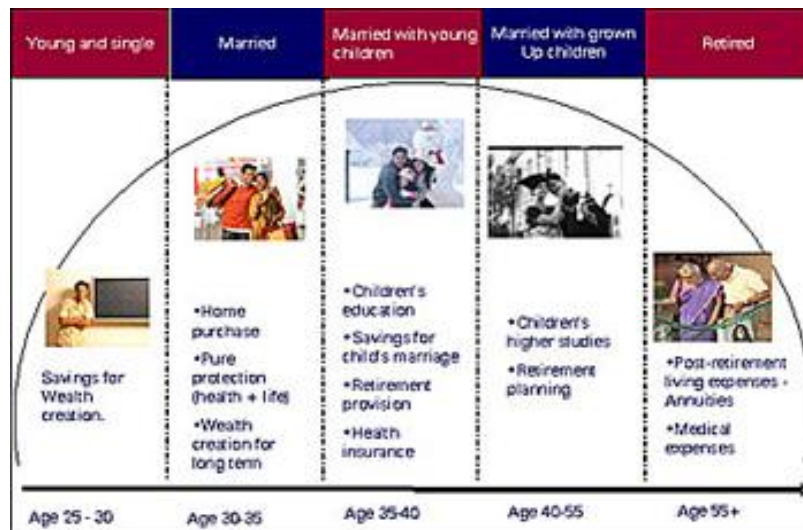


Figure-2: Goals Pursued by People of Various Age-groups

Depending on the specific life-stage and the corresponding goal, there is a ULIP which can help the insured to plan for it.

### ULIPs for Retirement Planning

Retirement is the end of active employment and brings with it the cessation of regular income. Today an increasing number of people have started planning for their retirement for the following reasons:

- Almost 96% of the working population has no formal provision for retirement
- With joint families on the ebb, the traditional support system for senior citizens from the younger earning members is no longer available
- Advancements in the healthcare space have led to an increase in life expectancy
- Cost of living has been rising at an alarming rate

Pension plans from insurance companies ensure that regular, disciplined savings in such plans can accumulate over a period of time to provide a steady income, post-retirement. Usually all retirement plans have two distinct phases:

- The accumulation phase when the insured is saving and investing during the earning years to build up a retirement corpus and
- The withdrawal phase when the insured actually reaps the benefits of investment as the annuity payouts begin

In a typical pension plan the insured has the flexibility to make a lump sum payment or a regular contribution every year during the earning years. The money is invested by the insurer in funds of the insured's choice. The insured can opt to receive the annuity at any time after the vesting age (age at which the insured becomes eligible for pension).

Most of the unit linked pension plans also come with a wide range of annuity options which give the insured a choice in structuring the post-retirement benefit pay-outs. Also at the time of vesting, the insured can make a lump sum tax-exempted withdrawal of up to 33 percent of the accumulated corpus. In a retirement plan, the earlier the insured buys the plan, the greater the insured gains, post retirement, due to the power of compounding. It is never too early to invest in a ULIP for retirement planning.

### ULIPs for Long Term Wealth Creation

ULIPs are the right insurance solutions if one is looking for a strong wealth creation proposition allied to a core insurance benefit. Such plans are ideal for people who are in their late 20s and early 30s and by investing in such a plan, they get the flexibility of using it to fund any of their long-term financial goals such as purchase of a house or funding their children's education. The added element of life cover serves to make these plans a wholesome financial investment option.

Wealth Creation ULIPs can be primarily classified as



- Single premium - Regular premium plan

Depending upon one's needs and premium paying capacity one can either opt for a single premium plan where one needs to pay premium only once during the term of the entire policy or regular premium plans where one can pay premium at a frequency chosen by one depending upon one's convenience

- Guarantee plans – Non guarantee plans

Today there are wealth creation ULIPS which also offer guaranteed benefits. These plans are ideal insurance-cum-investment options for those who want to enjoy the potentially higher returns (over the long term) of a market linked instrument, without taking any market risk. On the other hand, non-guaranteed plans come with an in - built range of fund options to choose from – ranging from aggressive funds (primarily invested in equities with the general aim of capital appreciation) to conservative funds (invested in cash, bank deposits and money market instruments with the aim of capital preservation) so that one can decide to invest one's money in line with one's market outlook, time horizon and investment preferences and needs.

- Life Stage based – Non life Stage based

Life-stage based ULIPS factor in the fact that one's priorities differ at different life stages and hence distribute one's money across equity and debt. Here the initial allocation is decided according to one's age since age is a significant indicator of risk appetite. Such a strategy ensures that asset allocation at all times is in sync with one's age and changing financial needs.

### ***ULIPs for Children's Education***

One of the most important responsibilities of a parent is to ensure that the child gets the best possible education. Apart from conventional schooling, it becomes important to expose the child to different activities such as dance, painting and sports training for holistic development. As a parent, one would want to ensure that the development of the child is not hampered either by rising costs or unforeseen circumstances.

Today, there are ULIPs that offer money at key milestones of the child's education thus ensuring that the child's education continues unhampered even if something unfortunate happens to the parent. While, the death of a parent is an irreparable emotional loss, child education plans safeguard the child against the financial implications of the death of a parent. Apart from this benefit, child plans also offer the following features:

- Flexibility of adding on various riders like income benefit rider, disability rider, etc, to get additional benefits. For example, thanks to the income benefit rider, in the event of the death of the parent, the child will receive a regular, pre-determined amount every year to meet the educational expenses.
- In case of the unfortunate death of the parent, the child will receive the sum assured immediately; the child will also continue to receive money at key educational milestones.

### ***ULIPs for Health Solutions***

When one is young and working one saves for various goals like marriage, education, retirement, etc. However, saving for health care is never considered or left for later. During these years one can rely on various sources of income or savings on which one can rely for health emergencies.

But with the cost of healthcare rising, the proportion of this spend is increasing at an alarming pace. This is forcing families to borrow or sell assets to meet expenses during medical emergencies. During old age health care expenses rise. Thus it is important to invest in health insurance today so that one is fully prepared to meet rising healthcare expenses in future with the right health insurance plan.

Health ULIP is a recent innovation from the health insurance industry. In a health ULIP, part of the premium is allocated for investment designed to build a health fund to meet future health related expenses. It aims to create a health savings kitty by investing in a long-term flexible savings plan with multiple fund options. The health fund thus created allows one to claim for health related expenses of any kind and fund one's future health insurance charges. One can also avail of tax benefits on premium paid u/s 80D.

### ***Insurance in India<sup>5</sup>***

Insurance in India can be traced back to the Vedas. For instance, *Yogakshema*, the name of Life Insurance Corporation of India's corporate headquarters, is derived from the Rig Veda. The term suggests that a form of "community insurance" was prevalent around 1000 BC and practised by the Aryans. Burial societies of the kind found in ancient Rome were operational in the Buddhist period to help families build houses, protect widows and children. The Bombay Mutual Assurance Society, the first Indian life assurance society, was formed in 1870. Other companies like Oriental, Bharat and Empire of India were also set up in the 1870s-90s.

It was during the Swadeshi movement in the early 20th century that insurance witnessed a boom in India with more

<sup>5</sup> Source: IRDA web site ([http://www.irda.gov.in/ADMINCMS/cms/NormalData\\_Layout.aspx?page=PageNo4&mid=2](http://www.irda.gov.in/ADMINCMS/cms/NormalData_Layout.aspx?page=PageNo4&mid=2))





companies being set up. As these companies grew, the government began to exercise control on them. The Insurance Act was passed in 1912, followed by a detailed and amended Insurance Act of 1938 that looked into investments, expenditure and management of these companies' funds. By the mid-1950s, there were around 170 insurance companies and 80 provident fund societies in the country's life insurance sector. However, in the absence of regulatory systems, scams and irregularities were almost a way of life at most of these companies. As a result, the government decided to nationalise the life assurance business in India.

### ***LIC of India***

The Life Insurance Corporation of India was set up in 1956 to take over around 250 life companies. For years thereafter, insurance remained a monopoly of the public sector. It was only after seven years of deliberations and debate, after the R.N. Malhotra Committee report of 1994 became the first serious document calling for re-opening it to private companies, that the sector was finally opened up to private companies in 2001. The Insurance Regulatory & Development Authority (IRDA), an autonomous insurance regulator set up in 2000, has extensive powers to oversee the insurance business and regulate it in a manner that will safeguard the interests of the insured.

LIC had five zonal offices, 33 divisional offices and 212 branch offices, apart from its corporate office in the year 1956. Since life insurance contracts are long term contracts and during the currency of the policy it requires a variety of services, the need was felt in later years to expand the operations and open a branch office at each district headquarters. A reorganization of LIC took place and a number of new branch offices were opened. As a result of reorganization, policy-servicing functions were transferred to branches. Branches were made accounting units. It worked wonders for the corporation. With about INR 200 crores of new business in 1957, the corporation crossed INR 1,000 crores in the year 1969-70. It took only another ten years for LIC to cross the INR 2,000 crore mark in new business. But with another bout of re-organisation happening in the early 1980s, LIC had crossed INR 7,000 crores of sum assured on new policies, by 1985-86.

Today LIC functions with 2048 fully computerized branch offices, 109 divisional offices, 8 zonal offices, 992 satellite offices and a corporate office. LIC's wide area network or WAN covers 109 divisional offices and connects all the branches through a metro area network or MAN. LIC has tied up with some banks and service providers to offer on-line premium collection facility in selected cities. LIC's ECS and ATM premium payment facility is an addition to customer convenience. Apart from on-line kiosks and IVRS, Info Centres have been commissioned in Mumbai, Ahmedabad, Bangalore, Chennai, Hyderabad, Kolkata, New Delhi, Pune and many other cities. With a vision of providing easy access to its policyholders, LIC has launched its Satellite Sampark offices. The satellite offices are smaller, leaner and closer to the customer. The digitalized records of the satellite offices will facilitate anywhere servicing and many offer many other facilities to customers in the future.

LIC continues to be the dominant life insurer even in the liberalized Indian insurance scenario. It has embarked on a new high-growth trajectory surpassing its own records. It crossed the milestone of issuing one crore new policies in 2005. To be precise, it issued 1,01,32,955 new policies by October 15, 2005. Since then, LIC has crossed many milestones. It has set unprecedented performance records in various spheres of life insurance business.

### ***Life Insurance Corporation of India's Performance<sup>6</sup>***

With a first-year premium (FYP) volume of Rs.70,891 crores as on March 31, 2010, the LIC dominated the market with a share of 64.86 per cent. The FYP volume of the private insurance companies in the corresponding period was Rs.38,399.32 crore, with a market share of 35.14 per cent. While the LIC registered a 33.87 per cent growth during the period, the private companies together registered a growth of only 12.43 per cent.

LIC's FYP market share as on June 30, 2010 rose to 73.43 per cent. In spite of opening up the sector, LIC's FYP volume has been growing at a fast rate over the years. While it was Rs.15,976 crores in 2002-03, it increased to Rs.59,996 crore in 2007-08. In 2008-09, it fell to Rs.52,953 crore, but again grew to Rs.70,891 crore in the last fiscal.

There has been an increase in the number of LIC policies. From 2.45 crore policies in 2002-03, it rose to 3.89 crore in 2009-10. Death claims and maturity claims paid by the LIC have also risen. In 2006-07, the LIC paid 4,443 death claims. This went up to 7,034 death claims in 2009-10. During the latter period, 94.47 per cent of the maturity claims were settled on or before the due date. In 2006-07, the LIC paid 32,094 maturity claims. In 2009-10, a total of 46,921 maturity claims were paid by the LIC.

According to IRDA statistics, the monetary value of LIC assets has also registered a sharp increase from Rs.6,51,883 crore in 2006-07 to Rs.11,52,057 crore in 2009-10. The total amount paid to claimants in 2009-10 touched Rs.53,955 crore. As on March 31, 2010, the LIC had 27.82 crore customers.

With a total of 1,15,966 employees and 14,02,807 agents as on March 31, 2010, the LIC operates from eight zonal offices, 111 divisional offices, 2,048 branch offices and 1,008 satellite offices. It has overseas branches in three countries and joint ventures in the Gulf countries and Sri Lanka, Kenya and Nepal.

<sup>6</sup> Source: *The Hindu*, Aug 23, 2010 (<http://www.hindu.com/2010/08/23/stories/2010082355050500.htm>)



### ***Performance of the Life Insurance Industry in India***

In India, the life insurance industry made a sedate beginning as explained in the previous paragraphs. Upon nationalisation in 1956, the industry picked up steam. Provision of fiscal carrots, the ever growing community of salaried employees and some product innovation saw acceleration in the growth of the life insurance business. Deregulation of the industry a decade ago led to improved penetration of the life insurance market. The customer base widened with more and more of rural and semi-urban Indians taking to life insurance. On their part, the life insurers too came up with innovative products like unit-linked insurance plans and pension products. They leveraged information technology to effectively reach their customers, existing as well as prospective and inspire confidence in them.

### **5. CONCLUSION**

In the Indian context, the insurance sector has come a full circle. It was in private hands once only to be completely taken over by the government subsequently owing to obvious reasons – many insurers folded up, leaving those who had insured their lives with them in dire straits. The latter did not know how to fend for themselves during their twilight years. But as the country opened up its economy and became a market economy owing to various reasons, the government had to throw open the insurance sector to private investors – domestic as well as foreign. Its own insurance companies were unable to cope with the demand being placed by a revitalised and resurgent Indian economy. The infusion of additional capital necessary to underwrite more and more business was simply beyond the government. More and more of insurance expertise was needed to design and market newer insurance products to cover emerging risks.

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