Financial Viability of Indian Insurance Industry :

A Comparative Analysis of LIC & ICICI Prudential

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ABSTRACT

Insurance sector for any economy is undoubtedly, the most crucial sector. Being the care-taker of the lives of people, its financial viability becomes crucial. Moreover, the financials of insurance industry are completely diverse from a manufacturing /service sector. It will provide an insight into the financial nitty-gritty of an insurance sector Therefore, the present article aims at appraising the financial viability of the Indian insurance industry on a comparative basis of LIC and ICICI Prudential. These two units have been deliberately chosen to appreciate better the financial performance in a public sector unit vis-à-vis private sector unit.

***Keywords:** Insurance, capital, deposits, loans, interest*

Improving

The history of life insurance in India dates back to 1818 with the establishment of the Oriental Life Insurance Company in Calcutta. Insurance regulation formally began in India with the passing of the Life Insurance Companies Act of 1912 and the provident fund Act of 1912. Several frauds during 20's and 30's sullied insurance business in India. By 1938 there were 176 insurance companies. The first comprehensive legislation was introduced with the Insurance Act of 1938 that provided strict State Control over insurance business.

The Government of India in 1956, brought together over 240 private life insurers and provident societies under one nationalized monopoly corporation and Life Insurance Corporation (LIC) was born.

Present Scenario

The Government of India liberalized the insurance sector in March 2000 with the passage of the Insurance Regulatory and Development Authority (IRDA) Bill, lifting all entry restrictions for private players and allowing foreign players to enter the market with some limits on direct foreign ownership. Under the current guidelines, there is a 26 percent equity cap for foreign partners in an insurance company. There is a proposal to increase this limit to 49 percent.

Key distinguishing factors of insurance companies with other companies with respect to operating activities

1. Fixed assets-very low requirement of fixed assets and capital employed.
2. Earnings-main source of earnings are premiums received and income from sale of investments.
3. Expenses-main expenses include bonuses, commissions paid, non-cash expenses such as change in valuation of liability in respect of life policies.
4. Debt-companies usually have zero debt.
5. Strict entry requirements as specified by IRDA.
6. Strict accounting norms to be followed as specified by IRDA.

Accounting principles set by IRDA for Life Insurance Companies

In the present scenario finalization of accounts of an insurance company involves a lot of complexities, which are unique in nature. The Accounting function of the life insurance companies is quite different from that of other companies. The major reasons for this are due to:

- Ascertainment of liability in respect of insurance policies issued by the company.
- The concept of Policyholders' Fund and Shareholders' Fund.
- The unit linked business and the related

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investment valuations involved in the same.
- Segmental reporting in respect of all the funds maintained by the company.

The Financial Statements of Insurance Company consists of:
- Revenue Account (Policyholders Account)
- Profit and Loss account (Shareholders Account)
- Balance Sheet
- Receipts and Payments account (Cash Flow Statement)
- The segmental reports relating to the funds (Revenue accounts and Balance Sheet)

The above statements are to be in conformity with the Accounting Standards issued by ICAI, to the extent applicable to the life insurance business except that:

Cash Flow Statement needs to be prepared under Direct Method and Segmental Reporting applies to all insurers irrespective of listing and turnover mentioned in AS- 17.

Insurance Regulatory and Development Authority (IRDA) has prescribed specified formats for the preparation of Financial Statements. These formats are in Part V of Schedule A of IRDA (Preparation of Financial Statements and Auditors Report of Insurance Companies) Regulations, 2002.

Scope of the Study

The present study is confined to:
LIC and ICICI Prudential Life Insurance Company.
These units have been chosen due to:
1. Comparison between a private company and a public company.
2. Comparison between a profit making and a loss making company.
3. Comparison between a large company and a relatively much smaller company.
4. ICICI has a greater growth rate than LIC.

LIC

The Life Insurance Corporation of India (LIC) is the largest life insurance company in India and also the country's largest investor. It is fully owned by the Government of India. It also funds close to 24.6% of the Indian Government's expenses. It was founded in 1956. Over its existence of around 50 years, Life Insurance Corporation of India, which commanded a monopoly of soliciting and selling life insurance in India, created huge surpluses, and contributed around 7 % of India's GDP in 2006.In the fiscal year 2006-07 Life Insurance Corporation of India's number of policyholders are said to have crossed 200 million. (table-1(a))

ICICI Prudential

ICICI Prudential Life Insurance Company is a joint venture between ICICI Bank, a premier financial powerhouse, and Prudential plc, a leading international financial services group headquartered in the United Kingdom. ICICI Prudential was amongst the first private sector insurance companies to begin operations in December 2000 after receiving approval from Insurance Regulatory Development Authority (IRDA). (Table -1(a))

- Given the nature of business, most of the transactions are in cash. LIC is a cash rich company. The cash inflow from operating activities is adequate enough to support the operating expenses as well as investments made. (Table-1(b))
- Decrease in surplus in the year 2005-2006 can be owed to comparatively low growth rate in the premiums and subsequent high increase in provision for linked liabilities. The growth in total deduction exceeds the growth in total income. Given the very low margins, there is a decrease in the final profit. (Table -1(b))
- The net surplus to income ratio is on a decreasing trend owing to possibly the competition in the life insurance sector.
- As the Company continues its growth, the cash flow from operations is not adequate to support the high investments made that are required to expand. (Table -2(a))
- The company has opted to raise capital by issuing shares.
- High growth in premium (operating income) and total income, almost double the growth rate of LIC. (Table -2(b))
- Surplus from operations showed negative growth in FY 2006 owing to high percentage increase in actuarial liability increase and comparatively same transfer of funds from shareholder's to policyholder's account.

Profitability Scenario

LIC

From Shareholder's Account (Table -3(a))
Return on equity (PAT/ Net worth)

- Very high ROE due to employment of policyholder's funds to generate profit.
- Decreasing ROE due to increase in general reserves.
- Shareholder's capital negligible as compared to policyholder's funds. Surplus from policyholder's funds is reflected as PAT in shareholder's funds.
- PAT is basically the surplus transferred from policyholder's account to shareholder's account.
- High dividend payout in each year. (Almost entire PAT is paid out as dividend)

From Policyholder's Account (Table -3(b))

Operating Ratio (Operating expenses/Sales)

- Operating expenses are very low as compared to other expenses hence very low operating ratio.
- Major expenses are commissions, benefits paid to policyholders and increase in liability.

Net Profit Ratio (PAT/Sales) (Table -3(c))

- Very high non-operating, non-cash expenses in the business due to IRDA specifications leads to low.
- EBITDA, EBIT and other profitability ratios not calculated because depreciation and interest are not applicable.

ICICI

From Shareholder's Account (Table -4(a))

Return on equity (PAT/ Net worth)

- Negative return on equity due to loss incurred.
- Increased net worth due to share premium.
- Loss increases in the year 2006-2007 due to increased transfer of funds from shareholder's to policyholder's account to maintain the solvency requirements.

From Policyholder's Account (Table -4(b))

Operating Ratio (Operating expenses/Sales)

- High operating ratio as compared to LIC.
- Operating expenses such as training costs, advertisements and publicity are high.

Net Profit Ratio (PAT/Sales) (Table -4(c))

- PAT for ICICI prudential is negative due to transfer of shareholder's funds to policyholder's funds to account for solvency requirements laid down by IRDA. As the number of policies show a remarkable increase, which subsequently to increase in liability valuation, more funds are transferred over the years as the net loss increases.
- No dividend paid by ICICI in view of the loss incurred

Working Capital Efficiency

Working Capital turnover ratio (turnover / working capital)

LIC (Table -5)

- Asset turnover ratio and fixed asset turnover ratio not calculated because of limited fixed assets and total assets of the shareholders. Also, the percentage of debtors and creditors is negligible as compared to the sales.

ICICI (Table -6)

- High negative working capital in previous two fiscal years
- Positive working capital in FY 2007 due to increase in short term investments.
- High percentage change in absolute figures denotes the rate at which company is expanding its operations.

Liquidity Position

1. Current Ratio (current assets/current liabilities)
2. Super Quick Ratio (cash and bank balances/current liabilities) .

LIC (Table -7)

- High current ratio and super quick ratio as desired.
- Increasing trend in both the ratios denotes sound financial health and cash flows.

As solvency needs to be maintained over the very long periods for which policies are written it is necessary to ensure that assets currently exceed liabilities.

ICICI (Table -8)

- Current ratio is less than 1 for two fiscal years.
- High percentage of cash and bank balances in terms of total current assets.

Note: Solvency ratios are not applicable, as both the companies have no long-term debt obligations.

Conclusion

LIC is a cash rich company. The cash inflow from operating activities is adequate to support the operating expenses as well as investments made. In case of ICICI, as the company continues its growth, the cash flow from operations is not adequate to support the high investments made that are required to expand.

Income wise, there is high growth in premium (operating income) and total income in case of ICICI, almost double the growth rate of LIC. But, LIC has a very high ROE of 264% in 06-07 as compared to ICICI which has a negative ROE due to loss incurred.

Operating expenses are very low in LIC, around 5% as compared to ICICI which has an operating ratio around 20%.

There has been an increasing trend in liquid ratios in LIC which denotes sound financial health and cash flows. ICICI also has high percentage of cash and bank balances in terms of total current assets. So, 'cash richness' can be regarded as an industry scenario.

So, LIC, being the oldest player in insurance industry is fully capitalizing upon its key advantages to its fullest.

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Annual Report'07 - LIC

Annual Report'07 - ICICI Prudential

Table 1(a) Cash Flow Picture LIC (Rupees in lacs)

	2006-2007	2005-2006	2004-2005
Operating Activities	4894276.98	3431676.46	2820877.09
Increase in inflow	42.62%	21.65%	-
Investing Activities	(4844672.27)	(3200581.21)	(2792875.10)
Increase in outflow	51.36%	14.59%	
Financing Activities	-	-	

Table 1(b) Operational Performance LIC

Parameter	2006-2007	2005-2006
Growth in premium (% increase)	40.79	20.87
Growth in total income (% increase)	31.99	17.57
Total Deductions (% increase)	32.04	17.75
Surplus from Operations (% increase)	21.87	(10.74)

Table 2(a) Cash Flow Picture ICICI Prudential (Rupees in lacs)

	2006-2007	2005-2006	2004-2005
Operating Activities	535582.13	317158.60	169095.21
Increase in inflow	68.87%	87.56%	-
Investing Activities	(60,463,360)	(33,020,103)	(18,164,529)
Increase in outflow	83.11%	81.78%	-
Financing Activities	88251.51	26000.00	25000.00

Table 2(b) Operational Performance ICICI Prudential

Parameter	2006-2007	2005-2006
Growth in premium (% increase)	85.62	80.26
Growth in total income (% increase)	63.22	112.06
Total Deductions (% increase)	61.19	114.14
Surplus from Operations (% increase)	1251.49	(68.3)

Table 3 (a) ROE (Rupees in lacs)

	2006-2007	2005-2006	2004-2005
PAT	77362.03	63158.01	70836.50
Net Worth	29280.99	17699.85	13718.89
ROE	**264%**	**356%**	**516%**

Table 3 (b) Operating efficiency (Rupees in lacs)

	2006-2007	2005-2006	2004-2005
Operating expenses	708086.14	604156.06	598718.41
Sales	12778225.94	9075919.72	7508337.01
Operating Ratio	**5.5%**	**6.6%**	**7.9%**

Table 3 (c) Net profit margin (Rupees in lacs)

	2006-2007	2005-2006	2004-2005
PAT/Surplus	77362.03	63158.01	70836.50
Sales	12778225.94	9075919.72	7508337.01
Net Profit Ratio	**0.6%**	**0.7%**	**0.9%**

Table 4 (a) ROE (Rupees in lacs)

	2006-2007	2005-2006	2004-2005
PAT	(64890.72)	(18787.89)	(21162.10)
Net Worth	207168.28	118500.00	92500.00
ROE	**(31%)**	**(16%)**	**(23%)**

Table 4 (b) Operating efficiency (Rupees in lacs)

	2006-2007	2005-2006	2004-2005
Operating expenses	152295.87	72500.37	46151.74
Sales	789681.77	425421.02	235999.95
Operating Ratio	**19%**	**17%**	**20%**

Table 4 (c) Net profit margin (Rupees in lacs)

	2006-2007	2005-2006	2004-2005
PAT	(64890.72)	(18787.89)	(21162.10)
Sales	789681.77	425421.02	235999.95
Net Profit Ratio	**(8%)**	**(4%)**	**(9%)**

Table 5 Working capital turnover ratio (Rupees in lacs)

	2006-2007	2005-2006	2004-2005
Turnover	12778225.94	9075919.72	7508337.01
Current Assets	3431573.80	3104328.07	2419860.98
Current Liabilities	2026671.36	2130755.92	2052990.77
Short term investments	439116.71	437137.17	520527.11
Working Capital	1844019.15	1410709.32	887397.11
WCT Ratio	**6.92**	**6.43**	**8.46**

Table 6 Working capital turnover ratio (Rupees in lacs)

	2006-2007	2005-2006	2004-2005
Turnover	789681.77	425421.02	235999.95
Current Assets	71831.06	35800.46	27102.28
Current Liabilities	100610.83	59349.17	37908.9
Short term investments	36343.76	12167.61	4137.02
Working Capital	7563.99	(11381.10)	(6669.60)
WCT Ratio	**104.40**	**(37.38)**	**(35.38)**

Table 7 Liquidity (Rupees in lacs)

	2006-2007	2005-2006	2004-2005
Current Assets	3431573.80	3104328.07	2419860.98
Current Liabilities	2026671.36	2130755.92	2052990.77
Short term investments	439116.71	437137.17	520527.11
Net Current Assets	3870690.51	3541465.24	2940388.09
Cash and BankBalances	1329806.98	1031250.92	800155.67
Current Ratio	**1.90**	**1.66**	**1.43**
Super Quick Ratio	**0.65**	**0.48**	**0.38**

Table 8 Liquidity (Rupees in lacs)

	2006-2007	2005-2006	2004-2005
Current Assets	3431573.80	3104328.07	2419860.98
Current Liabilities	2026671.36	2130755.92	2052990.77
Short term investments	439116.71	437137.17	520527.11
Net Current Assets	3870690.51	3541465.24	2940388.09
Cash and BankBalances	1329806.98	1031250.92	800155.67
Current Ratio	**1.90**	**1.66**	**1.43**
Super Quick Ratio	**0.65**	**0.48**	**0.38**