

Socio-economic Factors Affecting Changes in Demand for Life Insurance



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ABSTRACT

Life insurance has low penetration among Indian households, with insurance premiums accounting for about 2.72 % of GDP⁷. Due to lack of access to formal financial markets and low levels of financial literacy many Indian households do not effectively plan their financial future. With an increasing emphasis by the government towards greater financial inclusion of all sections of the society, it is important to understand how socio-economic and demographic aspects of rural and urban households affect their decisions to acquire or discontinue life insurance coverage.

Introduction

Though life insurance is primarily a means of mitigating financial risks associated with premature death, it is mostly used as a tool for savings and investment through endowment policies in India. Social security or government pension schemes are accessible only to a small part of the population. Indian households often depend on informal social support networks for risk mitigation rather than the formal life insurance sector. This social support may not be available equally to all sections of the society. Hence, life insurance assumes an important role in ensuring the financial well-being of a large section of the population.

With that aim, in this study, we attempt to study the changes in demand for life insurance within the same household over time. We use a short panel dataset from the Indian Household Development Survey which includes 1503 villages and 971 urban neighborhoods across the country, surveyed in 2004-05 and 2011-12. We are interested in both the acquisition as well as the discontinuation of life insurance coverage. We build logistic regression models to estimate the probability of uninsured households acquiring life insurance, and of insured households dropping life insurance coverage.

Motivation for Research

As we can be seen from the review of the literature, there are not many studies (none in India) that have looked at changes in insured status within the same household. While Liebenberg et al. (2012) built a dynamic model of insured status; their focus was primarily to see how changes in life events (such as marriage, new child, divorce, death etc.) affected changes in insured status. However, in the present study the aim is to include different socio-economic as well as demographic factors (such as education and household composition) to understand the factors that affect changes in insured status within the same household observed over two different periods. Given that the socio-economic and demographic characteristics of rural households differ a lot from urban households, we built different models for acquisition and discontinuation of life insurance coverage and the insurance expenditure for these two categories of households.

Acquisition of Life Insurance Results of the Logistic Regression Models

Preliminary analysis: In the preliminary analysis several logit models were built using step wise backward regression. These models were built to check the significance and relative importance of each independent variable. These models are not included in the discussion but have been provided in the Appendix D.

In order to check the relative importance of each category of the variable and to compute change in residual deviance, several nested models were built for acquisition and discontinuation of life insurance. These models are given in Appendix D and Appendix E, only the results of changes in residual deviance have been included in the discussion.

Discontinuation of Life Insurance -Results of Logistic Regression Models

We now turn to discontinuation of life insurance coverage by households. Table 2.7 gives a summary of the results of models that were built to understand the factors that affect the probability of an insured household discontinuing life insurance coverage. We find that most of the socio-economic and demographic variables have in fact a statistically significant effect on the probability of discontinuation of life insurance, due to the large size of the sample. The results of ANOVA of nested models are given in Table 2.8. We discuss these results below. Some of the variables had similar effects in both rural and urban households while some affected only rural households.

Discussion

Prior studies have looked at how demographic and socioeconomic variables affect life insurance demand in a household at a given point of time. With the exception of some studies such as Liebenberg et al. (2012) and Heo et al. (2013) most studies do not look at changes in insured status. In this study, we shed new light on the factors that affect changes in insured status using short panel data

from a large survey of households across India in 2004-05 and 2011-12. The results of the study are robust as they provide consistent β estimates, both in terms of direction and magnitude for both rural and urban household models. The effects are similar but in reverse direction for the models of discontinuation of life insurance.

The single largest determinant of whether an uninsured household will purchase life insurance or an insured household will discontinue life insurance coverage is the financial condition of the household. This is measured by several independent variables such as the socioeconomic category that the household belongs to, reported income and percentage change in household income as well as the reported consumption expenditure. We see both positive and negative effects, consistent with improvement or worsening of financial conditions, on life insurance purchase and discontinuation, in both urban and rural households. We consider this finding to be consistent with several other studies from developed as well as developing countries.

We conclude by observing that the Indian population represents a large and incompletely tapped market for life insurance products. The majority of households surveyed did not have life insurance. The strongest determinant of whether a household acquires or discontinues a life insurance policy is its financial condition, followed by education level. These findings indicate that there is great room for existing life insurance companies to expand their operations, and also tremendous scope for social and governmental agencies to provide more simple and meaningful and widespread education to the public about the role of life insurance in their lives.

Limitations and future research: While this study has covered a very large dataset across Indian households, it was limited by the variables which were already included in the Indian Household Development Survey, the primary aim of which was not targeted towards the life insurance sector. There have been several policy changes with the life insurance sector being opened up to private players in late 1990's. The Insurance Regulatory and Development Authority of India (IRDAI) try to increase the awareness of insurance. Lower premiums and greater awareness led by both IRDAI and advertisements may lead to more people purchasing life insurance products. In this study, we could not see the effect of these specific changes in the life insurance sector in India. These could possibly be studied in future research.

References:

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