CHAPTER 1
INTRODUCTION

1.1 INTRODUCTION

Insurance is a written contract between an insured and insurer which provides protection against future uncertainties. As per the terms and conditions of the insurance contract the insurer (insurance company) is responsible to pay the sum assured to the insured (policy holder) or the nominees of insured.

Life insurance is a contract between insurance company (Insurer) and the policy holder (Insured), where the insurance company promises to pay a sum of money to the policy holder on the event of death or any other event such as disability or critical illness. Insurer provides security to the insurer against the risk of uncertain events of life such as loss of life, physical disability or serious illness, and for that the insurer pays a sum which is called premium, either as lump sum or regularly.

In law and economics, Insurance is a tool of risk management principally used to hedge with the risk of a conditional loss. For a premium, insurance is a reasonable shift of the risk of a loss from one individual to another. Premium is an amount paid by the policy holder to the insurance company to get the security against the future risk.

The company who sells the insurance policies is called the insurer and the person who buys the insurance policy is called the policy holder or the insured. Insurance premium is an amount charged by the insurance company against the risk coverage provided to the insured. Probability of loss is usually defined as risk.

The word insurance has been explained by various experts on the subject. In the words of D.S. Hansell, “Insurance may be defined as a social device providing
financial compensation for the effects of misfortune, the payments being made from the accumulated contributions of all parties in the scheme.”

In the words of E.W. Patterson, “Insurance is a contract by which one party, for a compensation called the premium, assumes particular risks of the other party and promises to pay him or his nominee a certain or ascertainable sum of money on a specified contingency.”

In the words of Riegel and Miller, "Insurance is a social device whereby the uncertain risks of individuals may be combined in a group and thus made more certain, small periodic contributions by the individuals providing a fund, out of which, those who suffer losses may be reimbursed."

In the words of John Magee, "Insurance is a plan by which large number of people associate themselves and transfer to the shoulders of all, risks that attach to individuals."

In the words of Justice Tindall, "Insurance is a contract in which a sum of money is paid to the assured as consideration of insurer's incurring the risk of paying a large sum upon a given contingency."

In the words of Justice Channel, "Insurance is a contract whereby one person, called the insurer, undertakes in return for the agreed consideration called premium, to pay to another person called the insured, a sum of money or its equivalent on specified event."\(^1\)

**Difference between Insurance and Assurance**

Both the terms ‘insurance’ and ‘assurance’ are generally used in insurance contracts. From 1826, the term ‘assurance’ is used to signify life insurance only and the term ‘insurance’ used for all other kinds of insurance contracts like marine, theft, fire etc. In life insurance the insurer (insurance company) assures to make payment of

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policy to the insured on maturity, death or any other kind of uncertainty. The word ‘Assurance’ point out certainty while on the other hand the word insurance indicates the uncertainty, and thus used against indemnity like marine insurance, theft insurance, fire insurance etc. In these kind of insurance, the insurance company is responsible to compensate only in the case of loss of insured goods, otherwise not, but in life insurance the insurer is liable to pay on the maturity also.

Assurance is the term which is used only for assuring life and it has limited scope while on the other hand the term insurance is used other then the life insurance thus the scope of insurance is wider then assurance. The life insurance contract is a continuing contract whereas the other insurance contracts are not continues. In Assurance there is a certainty of happening the event sooner or later but in insurance nothing is certain. Life insurance can be taken for any amount or any number whereas in other insurance contracts the amount of policy is depends upon the market value of insured assets.

The investment element is present in life insurance contract but in other insurance contracts the investment element is not available. In life insurance the full amount of claim is made on event of death or maturity while on the other hand the amount of actual loss is paid as claim to the insured.

1.2 NATURE AND CONCEPT OF LIFE INSURANCE

Life Insurance: Because of the efforts of LIC (Life Insurance Corporation of India) and other private life insurance companies, the term life insurance has become well known and reliable investment instrument in India. But at the same time it is pertinent to note that it is one of the least understood plans by people and most faultily presented by the life insurance companies. A life insurance policy provides lots of benefits including tax savings, healthy and safe returns on investment etc. A life insurance policy protects the policy holder against the risk from the unforeseen losses and provides a safe financial future to the family of the insured. A life
insurance policy provides handsome returns on investment. In present scenario life insurance is safest and most reliable investment option which gives the tax saving benefit and risk cover as well.

Life insurance policy is a written legal contract between two parties (insurance company and policy holder). All the terms and conditions are written in the life insurance policy. Claims are made and settled according to the life insurance contract. Life Insurance Company is liable to pay the sum assured to the policy holder or to the nominee of the policy holder.

Life insurance contracts can be classified into two main categories:

- Investment based life insurance contracts – The most important objective of these kinds of insurance contracts is to give the best possible returns of investment made by the policy holder. The premium can be paid on regular basis or by the one time basis.
- Safeguard life insurance contracts - The most important objective of these kind of life insurance contract is to provide a safeguard to the policy holder. It provides the protection against the risk of uncertain events of life. It provides the financial security to the policy holder as well as the family of the policy holder.

Parties of life insurance contract: Insurance is basically a contract between two parties, one is called the insurer (insurance company) and the other is called the insured (policy holder). But there is a difference between the policy holder and the insured. Usually the policy holder and the insured are treated as the same. For instance, if a person purchases a life insurance policy on his life, than that person will be the owner as well as the insured. But if a person purchases a life insurance policy on his wife's life than that person will be the policy holder and his wife will be the insured. The policy holder is basically liable to pay the premium and usually plays the role of a guarantor. Insured is a key parson in the life insurance contract but he may and may not be one of the party of the life insurance contract. Some of the life
insurance companies allows a person to be the owner even if he is not paying the premium amount for example the grandparents purchases the policy for there grandson or grand daughter and pays the premium too but the policy will be owned by the grandchild.

On the event of death of the insured person the nominee receives the claim amount from the life insurance companies. Basically the nominee is not one of the parties of the life insurance contract. He is the person nominated by the policy holder to get the sum assured after the loss of life of the insured. During the running period of the life insurance policy the nomination can be changed any time. The policy holder has to give a written application to change the nominee person of his life insurance policy. Nominee person should be a person in blood relation and who have insurable interest in insured person.

Every life insurance policy has a value which is called the sum assured. This sum assured is determined by the life insurance company. The insurer decides all the terms and conditions of the life insurance contract and the insured person accept all the terms and conditions, then the life insurance contract come into force. First of all the cost of insurance is determined. It is calculated by the actuaries by using the mortality tables. These mortality tables are based on the statistics and mathematical calculations including probability analysis. Actuaries are those professional peoples who determine the cost of insurance by using the actuarial science and prepare the mortality table.

Terms of life insurance contract: The terms and conditions are determined by the life insurance company. All the claims are settle as per the life insurance contracts. Life insurance companies are not liable to pay any claim in those conditions which are not mentioned in the life insurance contract. For example, if the insured commits the suicide, then the life insurance company is not responsible to pay any thing to the nominee. Life Insurance Company is liable to pay only in the case of natural death case or on the maturity of the life insurance policy. When any event occurs other then the specified events of the life insurance contract the contract
automatically becomes null and void. If the policy holder hide any matter of fact from the insurance company then the insurance contract become null and void. Any misrepresentation given by the policy holder makes the insurance contract null and void.

The life insurance policy matures either on the death or on the maturity of the policy. On the maturity of the life insurance policy the initial amount of the policy is paid with bonus and loyalty addition if any. The amount which is paid by the insurance company on the maturity of the life insurance policy is called the maturity value of that policy. The amount which is paid on the death of the policy holder or the insured is called the death claim. The death claim can be more or less then the maturity value.

Major source of the revenue of the life insurance companies is premiums paid by the policy holders. While determining the premium amount of the life insurance policy the insurance companies consider the age of the insured. The premium amount increases with the insurer’s age, it is due to the statistical perception, which says that the people normally die in their old age. Group life insurance policies are not based on this perception, this kind of life insurance policies are the exception. The life insurance company examines the health of the applicant before insuring the life of that person, it is because of the risk assessment. The medical report of the applicant is enclosed with all the necessary documents of the life insurance contract.

The goal of the life insurance contract is establish by the underwriters. The most important objective of the life insurance is to protect the life of the insured and gives the financial protection to the insured and the loved ones of the insured. On the death of the policy holder (insured) the life insurance company gives a sum to the nominee of the insured which is called the death claim. The amount of accidental death claim is always more then the maturity value of the insurance. Investment and tax saving are the additional objectives of life insurance. Income tax can be saved by investing in life insurance. The premium which is paid in life insurance is deductable under 80C of Income Tax act 1962. The maximum limit of deduction under 80C is
Rs. 100000/-. So in present scenario the tax payers usually purchase life insurance to get the deduction and save the income tax. We can say the life insurance is a tool of tax planning as well.

The life insurance companies play a role of an underwriter. The procedure and practice of underwriting is different in all the life insurance companies. For this the applicant may be classified into three categories:

- Finest
- Preferred
- Standard

In the category of finest, the life insurance companies generally include those applicants who don’t have any illness history. Major part of the population is covered under this category. All those people who have good health and don’t ever have any illness (like cancer, diabetes, heart trouble, aides and any other serious disease) can be included into this category. And also include those people who don’t have any illness background in their family. Those applicants are included into the preferred category who have any illness history of himself or his family or who are currently having any medical treatment. Those applicants are included in the category that is not having any disease but their lifestyle increases the possibility of illness in future. This category includes those people who usually work on those places where the possibility of illness is high. Some of the people go to those countries for work where the rate of illness from a specific disease is high. These kinds of people may or may not suffer from those diseases in future but the possibility of their illness is very high.

On the death of the policy holder (insured), the insurance companies require a valid proof of death which is normally a death certificate. The nominee of the insured has to produce the death certificate of the insured to Life Insurance Company and ask for the death claim. The life insurance company then investigates the matter and find out the reason of death. When the life insurance company satisfied with the documents produced, and find out all the things true and fair, then the life insurance
gives a sum to the nominee of the insured, which is called the death claim. If after the investigation life insurance company found any kind of misrepresentation, fraud, false demand of claim or any other thing which is other then life insurance contract, then the life insurance company can reject the claim.

1.3 TYPES OF LIFE INSURANCE

Life insurance can be classified into two fundamental categories: temporary and permanent. Further it can be classified into the following subcategories: endowment, money back, term, whole life, universal, with profit, without profit etc.

1.3.1 Term Insurance

Term life insurance policy provides the life insurance coverage only for a specified time period. In term insurance, the claim is made only on the event of death of insured. No amount is paid to the insured on the maturity of the policy in term life insurance.

As compare to the other life insurance policies, the premium paid in this plan is lower. It is the most suitable option for those people who can’t afford the high premium and want to insure their life. Term insurance is called the ‘pure’ insurance. The insurance benefit is only given on the event of death of the insured. If the policy holder survives till the end of the policy period, no benefit will be given to the insured and the risk cover will be lapse. This kind of term insurance gives only the risk cover for a specific time period, nothing else.

Following three factors are generally considered in term insurance:

1. Premium
2. Face Value
3. Time Period
Mortgage life insurance is a common type of term insurance, in which the face value of the policy is equal to the amount of the mortgage on the insured’s property. In present scenario the people usually prefer other insurance plans in which they get maximum benefit including good returns with risk cover, which gives growth to the investment with the protection to the life of the insured as well.

1.3.2 Permanent Life Insurance

Permanent life insurance is that kind of life insurance which remains active till the maturity of the policy, if the policy holder pays the premium of the insurance regularly. Permanent life insurance policy can be cancelled by the insurer in case of misrepresentation or fraud only. The permanent life insurance policy has the cash value. It can be surrender with in the life of the policy. The term life insurance doesn’t have its maturity value while on the other hand the permanent life insurance has its maturity value. Term life insurance gives benefit only on the death of the insured but in permanent life insurance the insurance benefit is given to the insured on the maturity of the policy. As compare to the term life insurance policy, the premium paid in permanent life insurance is higher.

Generally the permanent life insurance can be classified into four categories:

(i) Whole life insurance
(ii) Universal life insurance
(iii) Limited Pay life insurance
(iv) Endowment Plan

(i) **Whole life insurance plan:** Whole life insurance plans provide the insurance benefit for the whole life. The amount of premium increases with the increase in age of the insured. Loan can be taken on the policy. The whole loan amount and the amount received on the maturity of the policy is tax free. Whole life insurance plans provide the life coverage as well as the other insurance benefits such as tax saving, loan facility, growth of the funds. The premium paid under this plan is much higher then the term life insurance plans. These kind of insurance plans provide
risk cover for the whole life of the insured. This is a perfect example of permanent life insurance policy. If any loan amount is unpaid on the time of death claim, the life insurance company deducts such amount from the death claim amount, which is to be given to the nominee of the insured.

Whole life insurance plans gives double benefits to insured. It gives full life risk cover with loan facility as well. It gives tax saving benefit with the tax free cash value of the loan which can be taken on the policy. Whole life insurance plans are different from the term life insurance, as the no loan facility is available in term life insurance plans. And similarity between the term life insurance and the whole life insurance is the sum assured is paid to the nominee of the insured on the event of the death of the policy holder. The term insurance plans are for the specified time period, where as the whole life insurance plans are for the whole life. The whole life insurance plans are differ from the other life insurance plans in terms of maturity value. In whole life insurance plan the sum assured is given to the nominee but in other life insurance plans the sum assured is given to the insured other then the death claim before the maturity of the life insurance.

The plus points of the whole life insurance plans are:

1. Loan facility
2. Tax saving,
3. Risk Cover for the whole life
4. Cash value
5. Death benefits

The disadvantages of the whole time life insurance plans are the stiffness in premiums and the sum assured is only given to the nominee of the insured. The rate of return is not competitive with other life insurance plans and saving schemes. The policyholder can not get the sum assured in his life. Loan can be taken on the policy. The whole life insurance policy provides whole life risk cover but the benefit is given only to the nominee. Whole life insurance plans are suitable for those people, who
want to secure their family from the financial difficulties after his death. While this risk cover benefit is given by the term insurance as well, but usually people prefer the whole life insurance plans to get the loan facility as well.

(ii) **Universal life coverage:** Universal life insurance plans are an example of permanent life insurance plans. In the universal life insurance plans, various kinds of life insurance products are offered by the life insurance companies. Universal life insurance plans provides the better growth to the cash value. The premium paid under the universal life insurance plans is flexible as compare to the other plans. Equity indexed universal life insurance plans, guaranteed death benefit, traditional fixed life insurance plans etc are some examples of universal life insurance plans.

Universal life insurance plans includes the cash value. The cash value of in universal life insurance policy is increased by the premium paid and decreased by the cost of insurance. The difference between the whole life insurance plans and universal life insurance plan is the premium is fixed in the whole life where as the premium is flexible in universal life insurance plans. Death benefit is predetermined in the whole life insurance plans but in the universal life, death benefit is also flexible. But in certain plans of guaranteed death benefit, it is predetermined, not flexible.

The universal life insurance plans gives the facility of flexible death benefit. The policy holder has the option to increase the death benefit. Similarly the policy holder has the option too decrease the death benefit also. But in case of increase the death benefit, the policy holder has to go through a fresh underwriting. The death benefits options offered by the life insurance companies are different in all companies. The insured can opt any kind of death benefit option according to his needs. Some life insurance companies design the death benefit options according to the levels of the life of the insured. If the insured opted a death benefit option at the time of purchasing the policy, he can change the death benefit option during the running time of the life insurance contract. Premium of the life insurance policy
changes with the option of the death benefit. If insured wants high death benefit, he has to pay high premium.

(iii) Limited Pay life insurance plans: Limited pay life insurance plans are the most suitable plans for those who want to secure their family from the financial problems after the death of the policy holder. In limited pay life insurance plans the policy holder needs to pay the premium for a specified number of years or the event of his death, whichever is earlier. The sum assured is paid to the nominee of the insured only after the death of the insured. So the payment of the sum assured depends on the life of the insured.

(iv) Endowment Policy: Endowment plans are most popular plans in present scenario. The premium paid under endowment plans is higher than the whole life insurance plans. Endowment life insurance plan is a permanent life insurance plan. Endowment life insurance policy runs for a particular time or till the death of the insured whichever is earlier. The sum assured is payable on the maturity of the policy or on the event of the death of the insured. Loan can be taken in this life insurance plan. This policy provides the tax saving benefit as well. Endowment life insurance plans are complete life insurance plans, which provide maximum benefits to the insured. Rate of return is higher in this policy as compare to the other life insurance plans. In term insurance and whole life insurance, no amount is paid to the insured if he is alive, but in endowment life insurance plans the sum assured is given to the insured on the maturity of the policy. The endowment life insurance plans provide the risk cover for a specified period with a lot of benefits as well.

Endowment life insurance plans provide the protection form the financial difficulties to the insured as well as his family. If the insured need money urgently, he can take loan to meet his financial needs. After the death of the insured it provides the financial security to the family of the insured. The premium paid in the endowment plans can be claimed as deduction under sec 80C as per the income tax act 1962.
Life Insurance Companies does not cover the life’s of those people who is presently suffering from any serious disease. At the time of death claim, if it is found that the insured was suffering from any serious disease at the time of life insurance contract and he has given the false statement of good health, then the life insurance contract will become null and void, and insurance company can reject the claim. The death claims of those people who commit subside is rejected by the life insurance companies because life insurance companies are not liable to pay any claim in case of subside. The amount of the accidental death claim is generally double of the face value of the policy.

1.3.3 Riders

Some other features can be added to the policy as per the need and want of the applicant. The most common feature is the accidental death. Mostly the premium waiver benefit is desired by the applicant, in which the premium will be waived if the pensioner will be disabling to pay the premium in future.

Joint life insurance policy can be of two types. Either it can be of permanent life insurance policy or it can be of term life insurance policy. The claim can be payable on the event of the death of first or on the death of second insured person. Those joint life policies, in which the death claim is made on the death of the second person, those plans are called survivorship whole life insurance plans.

1.3.4 Group Life Insurance

The life insurance plan in which a life insurance company issue a insurance policy to assure the life’s of a group of people, is called the group insurance plan. Group of people is generally an association of people of same category. Usually the group of the employees of an organization or the members of a union or the pensioners or any association of people who work as group for the same objectives. Premium of the life insurance is collected by the organization and deposited to the life insurance company. Group insurance policy is similar to the term insurance, as the
group insurance policy is issued to insure the applicant for a certain time period and nothing is paid on the maturity of the group insurance cover. Premium paid under group insurance is lower than other life insurance plans. Group insurance plan only provide the risk cover benefit for a specified time period.

1.3.5 Money Back life insurance plans

Money back life insurance plans are those plans in which the insured get his money back with a certain time interval. These kinds of life insurance plans provide the rotation of money with the risk cover. Facility of loan is available on the money back policies. The insured get his invested money back within a certain time period and on the maturity of the policy, the balance amount with bonus is given to the insured. Money back plans are suitable for those people who wants risk cover but don’t want to block their money for a long time.

1.3.6 Term insurance with return of the premiums collected

In term life insurance plans the insured has to pay the premium and the life insurance company provides the risk cover for the specified period. Nothing is paid to the insured on the maturity of the policy. The innovative life insurance product in this series is the term insurance plan with return of the premium collected. In this life insurance plan, the insured has to pay premium and the life insurance companies provides the risk cover to the insured and at the time of maturity of life insurance plan the life insurance companies return the premium amount deposited by the insured as maturity value. So the interest earned on the premium amount keep the policy in force. The amount given by the insured is given to the insured on the maturity of the policy after the specified time period.

1.3.7 Unit Linked Insurance Plans

The unit link life insurance plans are the innovative products offered by the life insurance companies. After the year 2000, life insurance sector was opened for the private player. The entry of private player has increase the competition.
The present innovative life insurance products are the results of this competition. Unit link plans are one of them. Unit link plans are basically a mixture of mutual funds and term insurance plans. The premium paid by the insured is invested to the units of the stock market. The profit of the policy is subject to the market risk. The insurance companies keep a certain amount from the premium for the charges of the company and rest amount is invested in the units of the stock market.

Some unit link plans provide the risk cover factor as well with the additional premium. And some are linked with the pension plans according to the needs of the applicant. These kinds of plans are suitable for the investors. Those who want to get good returns with tax benefit usually prefer unit link plans of insurance.

Unit link plans are for a specified time period (term). After a certain time period the insured can Ancash his or her units. The market rate will be applicable to the unit at the time of purchase and sales of the units. Life insurance companies play a role of a mediator in unit link plans.

Insurance companies get money from the applicants and invest it in the units of the stock market and for this insurance companies charge a specified amount from the applicant and deduct the same from the premium amount deposited by the applicant. If the applicant wants to opt other benefits such as risk cover, then he or she has to pay the additional premium. The rate of return is not certain in the unit link plans. The profit depends on the market conditions. It can be either high or low. Unit link plans are very popular in present scenario.

1.3.8 With-profits Policies

Life insurance companies decide the amount of premium based on the mortality rates or the interest earned by the insurance companies on the amount invested by the insured. Insurance companies earn the profit on the amount of investment. This earned profit of the life insurance companies is retained. The major part of this profit is distributed to the policyholders of that company as bonus. A
certain amount added to the sum assured of a policy holder is called the bonus. So all those policies on which the life insurance companies gives bonus are called with profit policies and all those life insurance policies on which no bonus is given by the life insurance companies are called the without profit policies. With profit life insurance policies gives good rate of return on investment to the insured as an additional amount of bonus increases the sum assured.

1.3.9 Pension Plans

Pensions: Life insurance companies also offer the pension plans to the customers. People want to secure their future and for that they opt the pension plans. In the pension plans, the policy holder needs to pay one time premium or regular premium till a certain time period and after that the life insurance start giving pension per month. Pension plans are also a kind of life insurance. Life Insurance Companies pays the pension to the insured by the amount earned as interest on the investment of the insured given as premium. A pension fund is made with the premium amount of the insured and the pension is given by this fund to the insured each month until his death.

1.3.10 Annuities

Annuity life insurance plans are similar to the pension plans. The insured pays the premium on one time installment basis or the regular premium basis and after a certain time the life insurance company start the series of annuities to the policy holder. If in case insured dies during the period of annuities, then the nominee or the legal heirs will get the rest annuities.

Annuity life insurance plans are basically two types: Deferred annuities and immediate annuities. In deferred annuities, the annuities starts after a certain time period or after a certain age of the insured. While in immediate annuity plan, the annuity begins immediately. This type of immediate annuity is purchased by single premium basis. After the payment of premium, the annuity begins immediately.
1.3.11 Taxation Saving

In present scenario the life insurance plans are tool of tax saving. The life insurance plans are used as the tax saving instrument for the income tax payer. Maximum limit to claim the deduction under 80C of Income Tax Act 1962 is Rs.100,000. So the tax on the income of one lakh can be saved by investing in life insurance plans or public provident fund or other tax saving schemes defined in the sec 80C of Indian Income Tax Act. Premiums paid in life insurance, can be claimed as deduction from the gross total income up to one lakh.

1.4 SIGNIFICANCE OF LIFE INSURANCE

The classic argument to avoid life insurance runs, “If I die, why do I need money?” You don’t — but your family, your business or your favorite charity might. So anyone with dependents, human or otherwise, might need life insurance.

Insurance can be defined as a provision to reduce the risk of future uncertainties. It’s a tool to overcome the financial difficulties in future due to any misfortune. Insurance is a tool to reduce the risk of one person. Insurance provides protection against the uncertainties of life.

Life insurance is a policy that people buy from a life insurance company on the basis of protection and financial stability after one’s death. Its function is to financially help beneficiaries after the owner of the policy dies.

The advantage for the policy owner is “peace of mind”, in knowing that the death of the insured person will not result in financial hardship for loved ones and lenders. There are many things in life that the average household can live without, but life insurance should not be one of those things. The importance of life insurance increases as the number of people in a household increases. A single person with few, if any, close relations can get by on a very little life insurance or perhaps no insurance
at all. The same cannot be said for persons who have family members or other types of responsibilities.

Life insurance is a way to protect one’s family against possible financial trouble or even ruin, depending on one’s circumstances. Life insurance is also a way to relieve some of the anxiety that family members may feel as they wonder how they will get by should a breadwinner in the family pass on. Some forms of life insurance can even be used as a means of saving money over the long term.

The fundamental need of financial planning is to make a provision for the family members of a person after his death. Life insurance secures the life of the family members of the insured from the financial difficulties after the event of death of the insured. The objective to purchase a life insurance policy is to secure the lives of the loved ones, so it can be said that the life insurance is the insurance of future of the loved ones of the insured.

Life insurance plays important role to meet the immediate expenses on the event of the death of the insured. The amount of death claim supports the family of the insured to meet the financial needs. Immediate expenses such as hospital bills, funeral expenses or any other expenses can be settle with the help of death claim amount received by the life insurance company.

No amount of money can ever replace a person. But more than anything, life insurance can help provide protection for the uncertainties in life. Without a doubt, having life insurance coverage will bring a person and his family peace of mind.

None of us know when we’ll pass away. It could be today, tomorrow, or 50 years into the future, but it will happen eventually. Life insurance protects your heirs from the unknown and helps them through an otherwise difficult time of loss.
1.5 MEANING AND OBJECTIVE OF PROFITABILITY

Profit maximization is the most important objective of every business. In the words of Lord Keynes, “Profit is the engine that drives the business enterprise”. A business needs profit not only for its existence but also for the expansion and diversification. “Profit is the barometer of the success of the business. It is indeed, a magic eye that mirrors all aspects of entire business operations including the quality of output.” If an enterprise fails to make profit, capital invested is eroded and if this situation prolongs, the enterprise ultimately ceased to exist. Profits are the soul of the business without which it is lifeless. In fact, profits are useful intermediate beacon towards which a firm’s capital should be directed.

A company should earn profits to survive and grow over a long period of time. Profits are essential, but it would be wrong to assume that every action initiated by the management of a company should be aimed at maximizing profits, irrespective of social consequences. It is unfortunate that the word ‘Profit’ is looked upon as a term of abuse since some always act to maximize profits at the cost of employees, customers and society. Except such infrequent cases, it is a fact that sufficient profits must be earned to sustain the operations of the business to be able to obtain funds from investors for expansion and to contribute towards the social overheads for the welfare of the society.

The difference between total revenues and total expenses in a specified time period is called profit. Earn sufficient profit is essential for a company to survive for a long time. Even in totally planned economies, profit criteria has been accepted as the basis of efficiency.

The financial manager should continuously evaluate the efficiency of its company in terms of profits. The operating efficiency of a company and its ability to ensure adequate returns to its shareholders depends ultimately on the profits earned by it.

The profitability is composed of two words “profit” and “ability”. On this basis, the concept of profitability may be defined as the ability of a given investment to earn a return from its use. The word profit has been defined in a number of ways. The profit is not simply the increase in cash made available from business activities but includes some value (positive or negative) arising from the changes in resources commended during the period. The word ‘ability’ herein attached to profit means the ‘earning power’ or ‘operating performance’. The state of profitability is not a condition that exists and can be measured for limited period of time only. It is variable like the temperature of the body.

The term ‘profitability’ should be distinguished from ‘profits’. Profits refer to the absolute quantum of the profits whereas the profitability refers to the ability to earn profits. Profitability is the relative measure - it indicates the most profitable alternative profit, on the other hand, is an absolute measure - it indicates the overall amount of profit earned by transactions. Profitability is taken into consideration in judging the degree of operational efficiency of the management and controlling operations and performance. It is also used to study the ‘relative efficiency’ with the other firms.

Profitability analysis shows how much profit is earned during a year by the business transactions. This analysis indicates the flow of funds of the business organization. Profitability analysis gives the fair view of the financial position of the organization. Profit ratios are used to find out the efficiency of an organization. These ratios are generally used by the management of the organization to find out the efficiency for further planning and decision making.
Generally, two major types of profitability ratios are calculated:

1. Profitability in relation to sales.

2. Profitability in relation to investment.

Profit is the primary motivation force for economic activity. Profit is the report card of the past, the inventive gold star for future, it is a very important aspect of business. Most business enterprises exist with the object of earning profit that drives business enterprises. The task of management is maximization of profit. The efficiency of business is measured by the amount of profit earned, greater the profit the more efficient the business is considered to be. Profit is the soul of the business, without it, business is lifeless.

Mostly the word profit and profitability is used interchangeably. But actually there is a difference between the two. Profit is an absolute term, whereas, the word profitability is a relative term. Both the words are closely related terms and having separate roles in business. Profit reveals the total income earned by the organization during a specified time period, while the word profitability indicates the operating efficiency of an organization.

The word profitability can be defined as the ability of as given investment to earn a return from its use. The state of profitability is a variable thing like temperature and humidity of a day.

The profitability is the most important factor for the health of an organization, without which no business can survive. To make the future strategies the profitability analysis is essential. The growth of a business is measured by the profits earned during a specified time period. So in present scenario profitability is the backbone of any organization. All the decisions of the organization are depends of the profits earned.
1.6 FACTORS AFFECTING PROFITABILITY

The profitability is a collective term. It depends upon a number of factors, in other words, it can be said that there are numerous factors which can affect the overall profitability of a business organization.

These can be summarized as below:

1. **Expenses:** Expenses are of two types i.e. direct and indirect. The direct expenses are less controllable while indirect expenses are controllable to a great extent. Among the indirect expenses, there are certain expenses which can be reduced or curtailed or totally avoided. If selling price remains constant and one controls or reduces the total cost, the profit will ultimately increase.

2. **Selling Price:** One of the important factors affecting profit is selling price of the product. In a competitive market, one has to keep the selling price at a competitive level. However, by increasing value of the product or in a situation of a monopoly, the selling price of the product may be increased so as to achieve a desired level of profit.

3. **Cost Reduction and Cost Control:** There are various techniques of cost reduction and cost control. By applying appropriate cost reduction techniques and developing cost consciousness will certainly increase the profit.

4. **Research and Development:** Research and development are of two types - Basic Research and Applied Research. Applied research is directed towards a particular object. The success in research and new products areas and techniques developed by continuous research will increase the demand of product and simultaneously it will add to the profit.

5. **Operating and Financial Leverage:** The financial leverage increases profit by applying low cost fixed capital while operating leverage increase profit by producing more in the same amount of fixed expenses. An appropriate combination of
operating leverage and financial leverage will accelerate the increase in the amount of profit.

6. **Capital Structure and Financial Planning:** Capital structure and financial planning broadly refers to long-term own funds, long-term borrowed funds and working capital. The appropriate amount of capital will increase the company’s chances of obtaining goods and services at lower rates and will add to the goodwill. This will help in increasing profit.

7. **Purchase of Raw Material:** Raw materials play an important role in determining cost. The raw material should be purchased (a) at right price (b) in an accurate quantity (c) in exact time (d) of right quality and (e) from the correct source (so as to avoid transportation and other costs). All the factors listed regarding purchase of raw material will affect various types of costs such as total expenditure on raw material (will be affected by price), storage expenses, wastage and production delays (will be affected by right quantity), advantage of season etc. and availability of appropriate raw material (will be affected by right time).

8. **Stock Levels:** Stock levels should be determined properly. To save cost and achieve economy, Reorder Level, Maximum Level, Minimum Level, and Economic Order Quantity (EOQ) must be properly determined for each type of important raw material.

9. **Government Policy:** Government policy affects both selling price as well as costs. In some products selling prices are controlled directly by government, and in some products selling price is indirectly controlled by custom rules, import of product etc.

The cost of the product is also affected by supplying raw material through quota system framing various labor laws to regulate salaries and wages and various other control measures which affect overhead expenses like pollution control etc. Therefore, government policy directly affects the profit.
10. **Credit Control**: Credit or lending policy is directly controlled by Reserve Bank of India as well as by government through various financial institutions like State Financial Corporation, Industrial Financial Corporation, Insurance Companies and other such institutions. The credit policy determines the cost of borrowed funds and also affects the profit margin policy of a concern. These factors will also affect the total amount of profit.

11. **Location**: Location of a business will affect the approach to the needy customers as well as cost. In case of life insurance companies, at a good location, one can find plenty of customers willing to take the policy and vice versa.

12. **Business Cycle**: Business cycle is related with the long-term. In long-term, the business may have a recession recovery or boom period. The profit depends on the stage of business cycle.

13. **Technology**: Fast changes in technology affects favorably or adversely the amount of profit. Those concerns which change according to changes in technology will earn more profit as compared to those who are rigid.

14. **Political and Social Environment**: The political system like democracy, socialism, socialistic pattern of society etc. affects the amount of profit. However, the pattern of economy and social system also affects the amount of profit.

### 1.7 OPERATING PROFIT

Operating Profits shows that quantum of profit, which has been earned from the main business activities, which is much important from long-term point of view. The profitability of the company should also be evaluated on the basis of firm’s investment in assets and on the basis of capital contributed by owners and creditors. If the Company is not able to earn a reasonable return on investment, its survival is in danger.
Before liberalization, Life Insurance Corporation of India enjoyed monopoly in the life insurance sector, as Life Insurance Corporation of India was the only player in life insurance sector. But after liberalization, new private life insurers raised and they are grown up rapidly. At present, LIC is facing a tough competition in the insurance market by these private players. In the present study, we analyze, interpret and compare the profitability condition of LIC and ICICI Prudential Insurance Co. Ltd. for the period from the year 2002-03 to 2011-12.