



July 2010



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COVER STORY

# Indian Infra Companies : On a Fund Raising Spree



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### What is Life Insurance?

In today's world most of us are aware of what Life Insurance means. Life Insurance in a nutshell means a policy that people buy from Insurance Company, which can be the basis of protection and financial stability of the family in case of any unfortunate eventuality (death, disablement). Simply put, Life Insurance is a Protection Tool for the earning member of a family whereby if anything happens to this particular person and his earning stops, then the family should not suffer from financial crisis.

Life Insurance is an Insurance of a person's life. So, if he were to die, his family would receive an amount of money called the Sum Assured, which would help the family to take care of the financial crisis which would arise from the sudden inflow in income. To get this benefit, he would have to pay a certain amount of money called Life Insurance Premium to the Insurance Company every year as per the contract.

### Who needs Life Insurance?

Buying life insurance doesn't make sense for everyone. If you have no dependents and enough assets to cover your debts and the cost of dying (funeral, lawyer's fees, etc.), then insurance is an unnecessary cost for you. Also, if you do have dependents and you have enough assets to provide for them after your death by investments, property, etc., then you may not need life insurance.

However if you fall under any of the following category, then you definitely need insurance:

- ✦ If you have people financially dependent on you

or if you are the sole earning member for your family, then you need Life Insurance

- ✦ If you have any loan or debt that outweighs your assets, then you need Life Insurance.

- ✦ If you are staying at home and providing your family with such services as child care, cooking, and cleaning, you need Life Insurance

- ✦ If both you and your spouse are earning and you would like to protect a surviving spouse against the possibility of the couple's retirement savings being depleted by unexpected medical expenses then you need Life Insurance

- ✦ If you are a parent and you need to protect your child's future against any unforeseen events for your child's security, then you need Life Insurance

If you have a lot of wealth and assets and you would not like the same to run down by the effects of estate taxes or if you wish to transfer wealth to your future generations, then you need Life Insurance

### How much Life Insurance cover should one have?

Most of us are not aware of "how much" insurance one needs to purchase to protect one's family or for his future requirements. Let us understand the factors which influence the amount of insurance cover one should purchase to have a good night's sleep.

**Income Replacement** - One of the biggest factors for life insurance is for income replacement, which is a major determinant of the size of your Life Insurance policy. The simplest way to understand it is if you are earning a certain amount every year for your family, then you need a policy which provides for an interest

earning of an equivalent amount.

Currently, a large portion of the income goes to taxes and to maintain your own lifestyle. Hence the income, net of taxes, need to be determined for calculation of Life Insurance Requirement as Insurance Benefits are usually Income Tax free.

For example, your Income, net of taxes, is Rs 5 lakhs in a year, then you need 'A' amount of Sum Assured which if invested as a Fixed Deposit in a bank at 8% interest per annum will fetch an interest of Rs 5 lakhs in a year's time.

$$8\% \times A = \text{Rs } 5 \text{ lakhs}$$

$$\text{Or, } A = \text{Rs } 5 \text{ lakhs} / 8\% = \text{Rs } 62.5 \text{ lakhs}$$

Thus Sum Assured requirement is a minimum of Rs 62.5 lakhs which doesn't include inflation so as to ensure that income of the earning member of the family can be replaced by interest earning on the Sum Assured without depleting the actual principal amount.

**“...calculating the insurance requirement amount has always been a much debated topic as it is very difficult to estimate the amount of financial loss that the family would face in one's absence.”**

Income replacement for nonworking spouses is also an important and often overlooked insurance need. Coverage should provide for your costs for day care, housekeeping, or nursing care. Any net earnings from part-time employment also need to be added to this.

However as simple as it may sound, calculating it is not very easy, since there are other factors that need to be added.

**Amount of Debt or Loan** - is another very important factor while calculating Insurance requirement to ensure that the liability to repay the same does not fall on your dependents. All your debts must be paid-off in full, including car loans, home loans, credit cards, personal loans, etc. If you have a home loan of Rs 10 lakhs and a car loan of Rs 4 lakhs, then you need at least Rs 14 lakhs in your policy to cover your debts



With the constant increase in the cost of education, it becomes an important factor for calculation of insurance requirement.

(and possibly a little more to take care of the interest as well).

Hence in addition to Rs 62.5 lakhs (from the above example), Rs 14 lakhs + interest = Rs 77 lakhs (assuming Rs 50,000 as interest) need to be added as a loan component for repayment.

**Child Education Requirement** - With the constant increase in the cost of education, it becomes an important factor for calculation of Insurance Requirement. The basic school education needs to be considered initially.

Fee per month x 12 months in a year x Number of years remaining for child to complete education is the amount that needs to be added to Insurance Requirement.

For example: If the fee is Rs.2000 per month and the child is in 2nd class – Rs 2000 x 12 months x 10 years remaining for the child to complete class 12 = Rs.2.4 lakhs, which needs to be added to Insurance Requirement. Higher Education needs to be factored in separately depending on what you would want your child to study and where and how much you are willing to

spend on his or her education.

Thus, in continuation with the previous example, Rs 2.4 lakhs need to be added to the Insurance Requirement of Rs 77 lakhs, which equals Rs 79.4 lakhs, plus maybe an amount of Rs 10 lakhs for the child's higher education, totalling to Rs 90 lakhs approximately.

**Dreams and Goals** - All dreams and goals need to be considered separately as it is not a necessity but only a wish of the Life Insured. New house, car, foreign trips, child's wedding, etc. would fall under this category. The amount that you wish to spend on such occasion need to be added to the Insurance Requirement, after incorporating inflation

For example if you wish to spend Rs 10 lakhs for your daughter's wedding 15 years later and the expected rate of Inflation is 6%, then you actually need to add

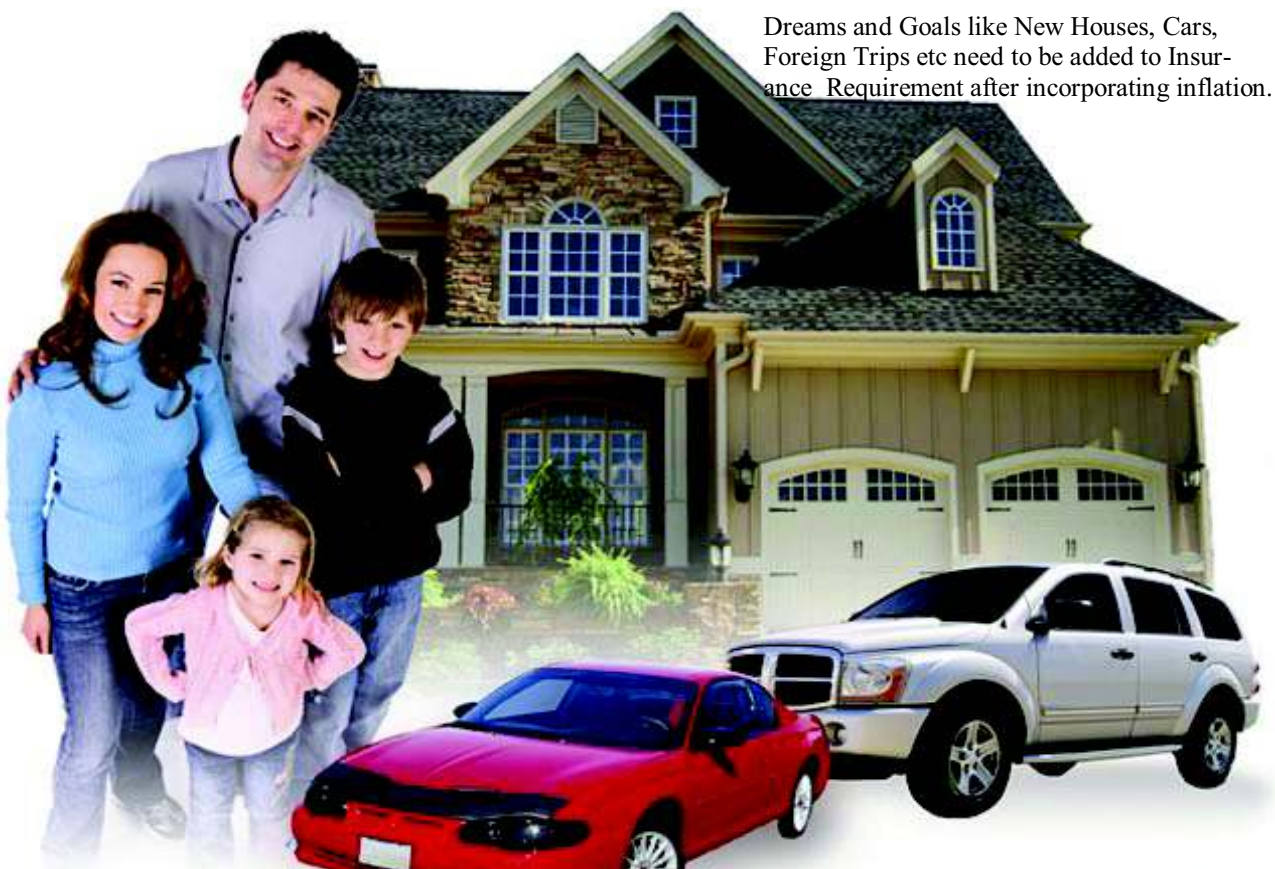
Between the Age Group	Multiple of Annual Income
20 years – 29 years	20 times Annual Income
30 years – 39 years	15 times Annual Income
40 years – 55 years	10 times Annual Income
More than 55 years	5 times Annual Income

**Multiple of annual income with different Age Group**

Rs 23.966 lakhs to the Insurance Requirement instead of Rs 10 lakhs.

**Insuring Others** - Obviously there are other people in your life who are important to you and you may wonder if you should insure them. As a rule, you should only insure people whose death would mean a financial loss to you. The death of a child, while emotionally devastating, does not constitute a financial loss because children do not contribute to the household income. The death of spouse, whether earning or not, does create a situation with both emotional and finan-

Dreams and Goals like New Houses, Cars, Foreign Trips etc need to be added to Insurance Requirement after incorporating inflation.



cial losses and hence needs to be insured.

### Is Life Insurance an Investment?

Many people see life insurance as an investment, but when compared to other investment tools, insurance cannot be really looked at as an investment tool. Certain types of life insurance are referred to as tools for saving or investing money for retirement, etc. These are insurance policies in which you build up a pool of capital that gains interest. This interest accrues because the insurance company is investing that money for their own benefit and is paying you a percentage for the use of your money, much like how banks operate.

However, if you were to take the money from the forced savings program and invest it in an index fund, you would likely see much better returns. For people who lack the discipline to invest regularly, a cash-value insurance policy may be beneficial. A disciplined investor, on the other hand, has no such need since he can manage the same himself.

### Alternatives to Life Insurance

Once the total amount has been calculated for Insurance Requirement, the other areas of investment also need to be considered. Property, bank deposits, other savings, bonds, mutual funds, stocks, gold, etc. form asset accumulation, which needs to be subtracted from Insurance Requirement to arrive at the correct amount.

Term Insurance, a pure protection tool, suffices most of the requirement in your absence. However an individual's situation needs to be considered as only death benefit would not be the answer to all requirements. A mixture of Endowment and Term plan along with other forms of assets would form an ideal portfolio for an individual after considering risk appetite of the individual.

### Easy Calculation of Insurance Requirement

There is a quick calculation without getting into such nitty-gritty. Multiples of annual income is considered as according to the different age groups.

This is a simple and quick reference to calculate the Life Insurance Requirement. Although it would not apply to everyone uniformly, it gives an approximate value for the same.



Other areas of investment like property, bank deposits, bonds etc also need to be considered

### Conclusion

The topic of calculating the Insurance Requirement amount has always been a much debated topic as it is very difficult to calculate the EXACT amount of financial loss that the family would face in one's absence. Hence there has been many ways and means to come to a figure that is somewhat close to the actual requirement. The factors mentioned above, if considered and calculated appropriately, also would yield a result somewhat close to the actual Insurance Requirement.

Calculating the actual figure for Insurance Requirement is not possible. Do you really think it is possible to quantify exactly "how much" financial loss a family would face in a person's absence? Only when the person is actually absent, the family gets to feel the difference. Till such time, a lot of small aspects of life are taken for granted and are not really valued.

Therefore to arrive at a conclusive figure of exact amount of Insurance Requirement depends a lot on assumptions and expected loss. The rate of expected inflation, the future value of money and other factors considered are all on assumptions.

Being adequately covered would also ensure a good night's sleep without having to worry for the family's security. Or, are we putting our families in the slightest of trouble if something unfortunate were to happen? Thus, the above factors and calculation would now help a lot of us to re-value ourselves and find out if we are adequately covered or not.