

# Effect of Behavioral Strategy on the Financial Stability of Insurers in the Russian Market Environment

**Lyudmila Tsvetkova**

Candidate of Economic Sciences, Associate Professor

[ORCID](#)

E-mail: l.tsvetkova@inno.mgimo.ru

Department of Risk Management and Insurance, MGIMO University, Moscow, Russia

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### Abstract

When moving towards business goals, the insurance company is forced to consider the diverse interests of various stakeholders, who resemble a some kind of informal coalition. The stakeholder relationships may vary and be other than cooperative, with conflicting interests, and even competitive. However, all parties with an interest should be considered as a single whole, the contradictory components of which define the development path of an organization.

Based on the stakeholder theory and the resource-based concept of competitiveness, this article analyzes the optimal communication behavior of insurance provider in the Russian market to build an equivalent system for the exchange of resources with their stakeholders depending on the significance of these acquirable resources. The subject of the study is a way towards accessible resources, one that implies the setting of an adequate exchange price for the most significant resources (in the insurance market, these are the insurance premiums).

The study touched upon the cultural impact on the insurance business in Russia and revealed the focus of top management during the periods of growth and decline in the market. Insurance companies can use the present findings as a framework in strategic risk management regardless of their business scale and territorial affiliation. The article demonstrates that a non-equivalent insurer-stakeholder exchange problem can be solved by establishing a strategic state program for the insurance industry development with foundations laid not only for compulsory insurance but also for the statutory regulation of non-compulsory insurance.

As part the study, impacts on the relationship system present in the insurance business were identified. The results served an input into a resource exchange model, and statistical data on the Russian insurance market situation were compared graphically. The nature of cause-and-effect relationships between macro factors and financially stable companies was defined.

**Keywords:** stakeholders, financial stability, resource approach, acceptable exchange zone, insurance market.

**JEL:** G32, G34

## Introduction

Compliance of the resource exchange arranged by the insurer with its stakeholders (from the perspective of the stakeholder theory stakeholders are understood as suppliers or resources for the company operations interested in steady payments at competitive prices for such resources, i.e. in a stable and efficient company functioning) with the model in which the exchange results meet to the maximum the requirements of stakeholders is one of the crucial preconditions of the insurer's solvency and financial stability. Failure to meet the requirements of offering a competitive price for the resources which should be considered a reasonable price results in loss of relationships with stakeholders and loss of access to the resources they supply [1].

The stakeholder theory asserts that when the company objectives are achieved various interests of different concerned parties (stakeholders) who will represent a kind of informal coalition should be taken into consideration. There may be various relations among the stakeholders which do not always represent cooperation, coincidence of wants, and they also may be of a competitive character. However, all stakeholders may be considered as an integral controversial whole which parts' interests resultant force will define the company development pathway. The precondition for creation of the optimum behavioural strategy is correspondence of significance of resources of each group to the place in the acceptable solution area at the offered purchase price [2]. When considering stakeholders as suppliers of the resources purchased by the company one should consider the interests not just of shareholders, but also of employees, customers, suppliers among which hired manages hold a special place. They bear social responsibility to other concerned parties (employees, government agents, journalists, citizens) and approve of the strategy of satisfying their expectations [3].

Risk of loss of creditworthiness and, consequently, of paying capacity increases if payment to some stakeholders does not correspond to their role in the optimal model of the company strategic management due to misperception of importance of such role or to execution of the task of retaining certain stakeholders' groups. Interests of resource suppliers for an insurance company and consequences of their nonoptimal serving give rise to 5 disconnected points of corporate interests:

- 1) The staff wishes to have a maximum remuneration at minimum efforts. Growth of the staff remuneration entails increase of unit costs while minimization of efforts causes narrowing of the insurer's competence. Narrowing of competence inevitably impacts on the quality of insurance services which also degrades. Quality deterioration makes it necessary to reduce prices for insurance services transforming competition into a pure price dumping used to avoid loss of the insured. Price decrease when unit costs grow results in decline in business solvency and over the long term – in red ink position.
- 2) The insured make the insurance company increase the scope of coverage and decrease prices for insurance services. The scope of coverage is usually expanded due to higher insurance premiums which form the claims reserve. If insurance premiums are not increased when the scope of coverage is expanded, as a consequence, the company will lose its business solvency which will make the company spend its proprietary funds, decrease the return on equity and over the long term it may cause inconformity of the capital with statutory requirements and loss of the right to carry out the insurance business.
- 3) Insurance agents and brokers insist on increase of their remuneration and react against responsibility for non-conformity of the price of the sold policy to the scope of the risks for which the insurance coverage has been provided. This causes unreasonable expenses related to conducting the case and exceedance of the combined loss ratio of insurance operations over the norm coefficient stipulated in the insurance tariff. The outcome is not just a decline in business solvency, but also loss of the insured discontented with unjustified refusals to pay insurance compensations as well as loss of the market segment by the insurance company [4].
- 4) The shareholders try to increase the profit making the profitability of insurance transactions grow. The easiest way to increase profitability is to reduce unit costs when the prices grow. In such case decrease of costs of the insurance company is usually accompanied by reduction of expenses on staff, advertisement, technical maintenance and information support. Moreover, in the Russian market environment shareholders of the insurance company dictate the payment policy. They demand reduction of the amounts of insurance compensation in order to redistribute the rest of the earned premium among themselves. This means that quality impairment of insurance services is not accompanied by a corresponding reduction in their price. The opportunity to increase prices when the quality declines exists only in monopolized markets. Thus, under the shareholders' pressure the company leaves competitive markets and strives to isolate itself in monopolized markets.
- 5) Public authorities, as well as other stakeholders, try to get the maximum returns applying minimal efforts. Democratically elected public authorities in this case will guard interests of the most numerous stakeholders of the insurance company – the insured, striving to increase the insurance density. The corrupt practices existing among public authorities will transform their functions from the “observer” into the “top owner of the company” interested in financial benefits. Serving these interests increases expenditures of the insurance company.

Thus, the corporate strategies should comprise interests of financial and non-financial stakeholders [5] in order to have an opportunity to solve the conflict of interests of concerned parties by piecemeal at any level, thus ensuring the management of the company value [6]. Apart from that, exactly the balance of interests of various concerned parties guarantees a consistent and ethical creation of value [7].

Used in the corporate strategy the stakeholder approach is implemented into each functional division of the company: for example, depending on the chosen strategy of corporate development and satisfying the interests of stakeholders a different structure of corporate management is observed [8]. This provides a special influence on budgeting and financial analysis of the company. Such influence causes establishment of a new company financial architecture and emerging of new (corporate) indicators of the company performance measurement in the market [9].

Often influence of the concerned parties on the company commercial success is significantly greater than that of many operating procedures, such as, for example, distribution of profits [10]. Thereby the stakeholder management which varies in time the prioritization of interests of one or another stakeholder [11] makes the corporate strategy more adaptive to the market environment and provides facilities to make the functioning of the certain company ecosystem stable.

## Research Methodology

The research is based on use of the graphical method of analysis of quanta data as well as the inductive approach of finding out the set of elements of concerned parties. For processing of quanta data the programs STATISTICA and Graph were used, the latter creates a graphic representation of comparable data obtained at the preparatory stage of data acquisition.

When defining the factors of influence on company corporate strategies institutional analysis and identification of elements of influence on the relational system of the insurance business were applied. On the basis of the obtained results the process of resource exchange with various stakeholder groups was modeled.

## Literature Review and Research Hypotheses

A consistent and long-term application of the strategy of observing the interests of one stakeholder group causes destruction of the resource base of the insurance business. At the same time total capacity of the whole insurance field, as well as the most important types of competence, first of all, companies' innovativeness are reduced [12]. In order to assess the development potential of the Russian insurance market one may define the stakeholder to which the resource exchange of such market is oriented. Inconformity of the model means that distribution of payment for resources in favour of one stakeholder is made at

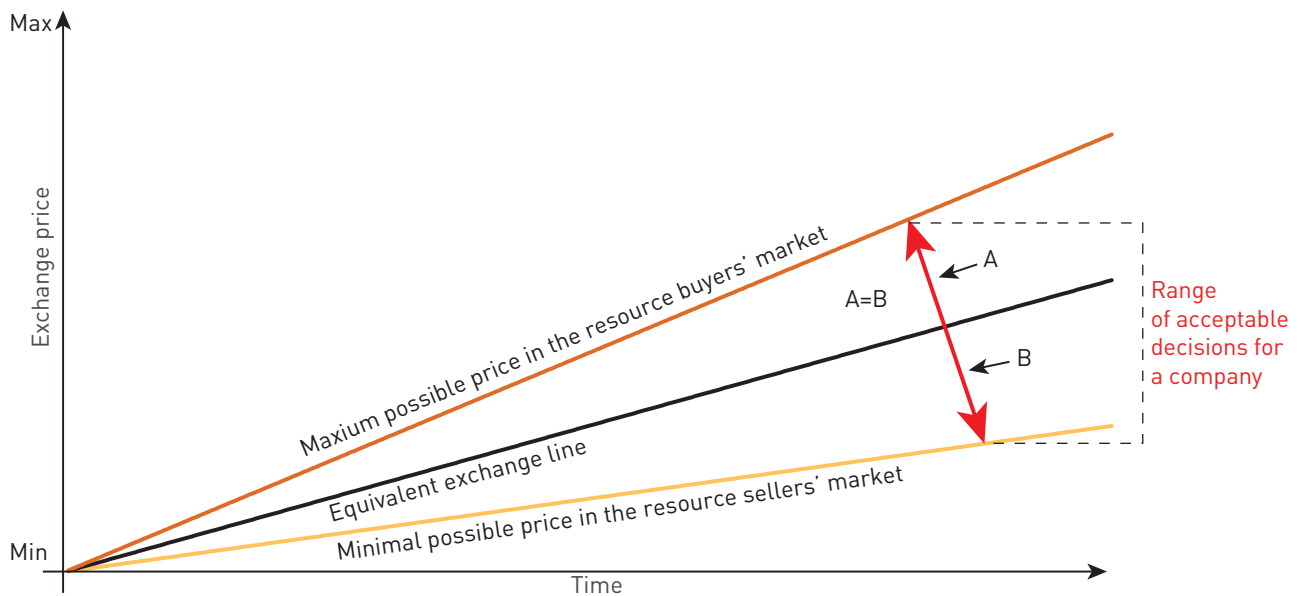
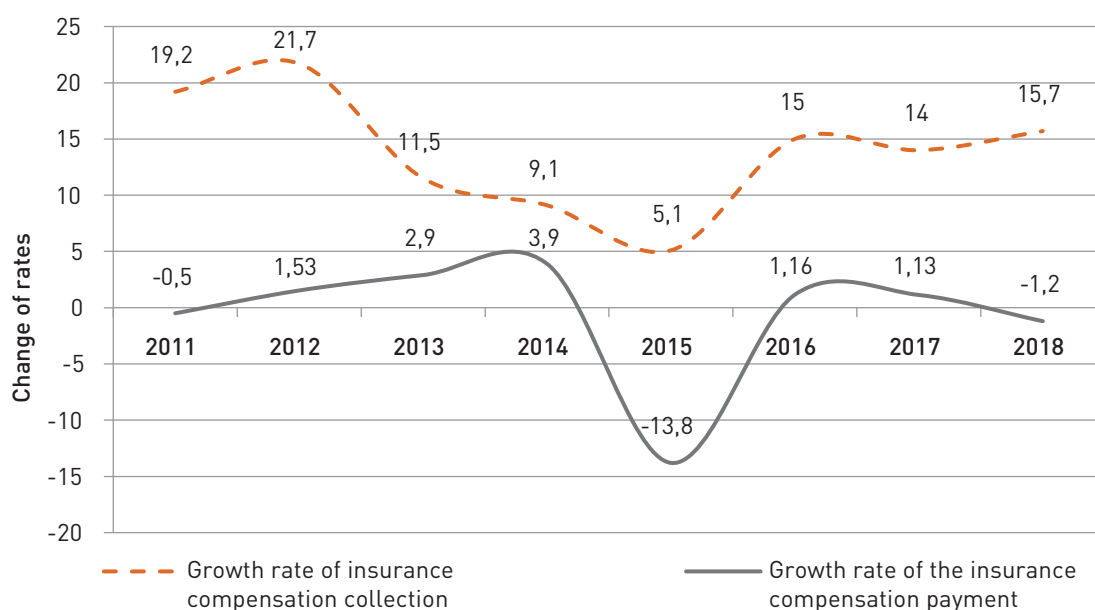
the expense of an unjustified reduction of payment to the others. It is also necessary to consider absence of insurance culture in the market, among the economic entities and citizens where the insured's opportunities to obtain insurance protection are greatly limited, to be the factor which influences the practice of non-equivalent exchange [13].

When studying the risk level of non-equivalent exchange for the developing insurance business one should define whether the real position in the acceptable prices zone of each stakeholder corresponds to its role in the exchange model [14]. In this case the consumer of the insurance services, i.e. the insured, whose money provide rendering of this service in case of an ideal corporate scenario as a result of distribution of the cumulative risk in the insurance fund by payment of insurance premiums should be acknowledged the most important stakeholder.

A qualitative development of the Russian insurance market, first of all, may be related to reforming of the statutory and regulatory base related to OSAGO (compulsory civil liability insurance for vehicle owners). However, the existing problems of reinsurance, imperfection of insurance mediation and absence of automation of insurance activity slow down the procedures of improvement of the insurance services quality [15]. The objective economic need in use of insurance as a tool of protection of public production, individual entrepreneurship and general level of citizens' welfare is associated with disintegration of economic entities where the level of financial risks and property interests is constantly growing. A public inquiry stimulates transfer to the insurance market which functions on the basis of professional application of economic laws and management tooling. The specific nature of insurance services in the Russian Federation depends significantly on dynamics of development of insurance relations inside the market and mentality of prospective insured [16].

In theoretical approaches to the practical regulation of the insurance market the researchers have opposite opinions where, on the one hand, they adduce arguments for active involvement of the state into business operations of private-sector organizations [17], and on the other hand, they substantiate the position that change of the average qualitative level of insurance services is possible only in case of a competitive market [18], and this provides facilities to distinguish the role of specifics of the corporate strategies in assessment of the insurance business efficiency and helps to study the typical behavioral models of management.

Paradigm divergences, which exist when corporate strategies of Russian insurers are formed, result in disequilibrium of the resource exchange in the business "tradition" of the insurance market and absence of stability (first of all, the financial one) in companies' development. Thus, the need in modeling of the resource exchange processes with various stakeholders' groups arises in order to define the optimum ways of achievement of a sustainable financial development of insurers taking into consideration the Russia market situation.

**Figure 1.** Model of the acceptable exchange zone with the company resource suppliers [19]**Figure 2.** Correlation of growth of the insurance compensations collection rate and the growth rate of the insurance compensation payments coefficient (calculated on the basis of [21-30])

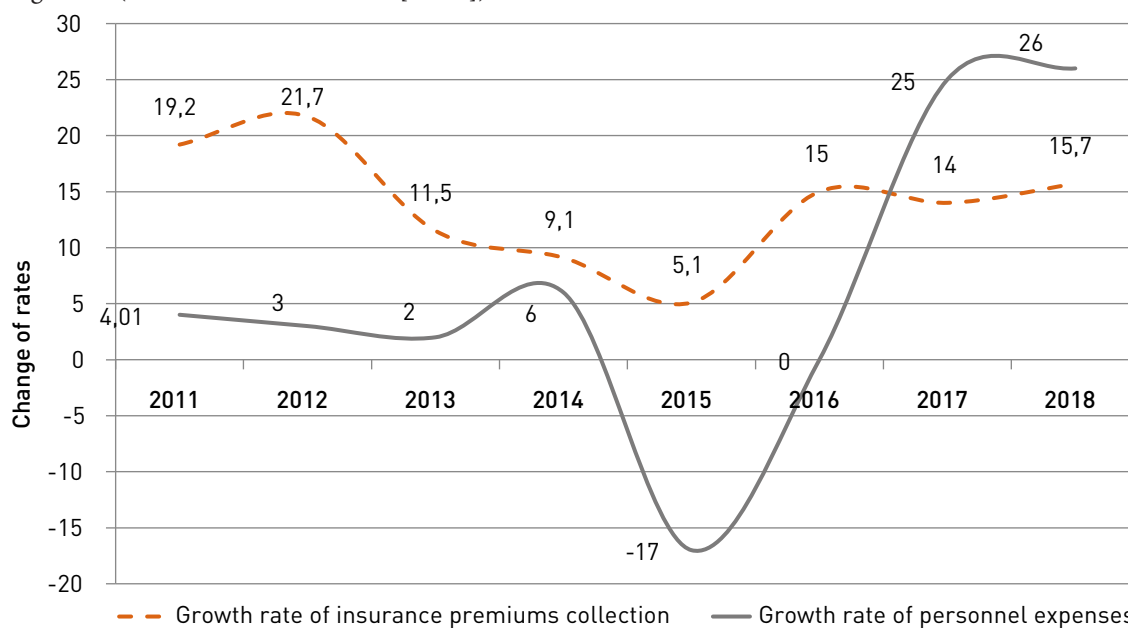
## Research Results

Each party assesses the exchange acceptability on the basis of the level of matching of the exchange price with the acceptable solution zone (figure 1). Location of the exchange price with each stakeholder within the acceptable terms means stability of the insurer's access to the resources it needs [19]. Hence, the conclusion on the necessity of control of criticality of deviation of the prices established by the insurer from the equilibrium price in favour of the insurer or the buyer sounds logical.

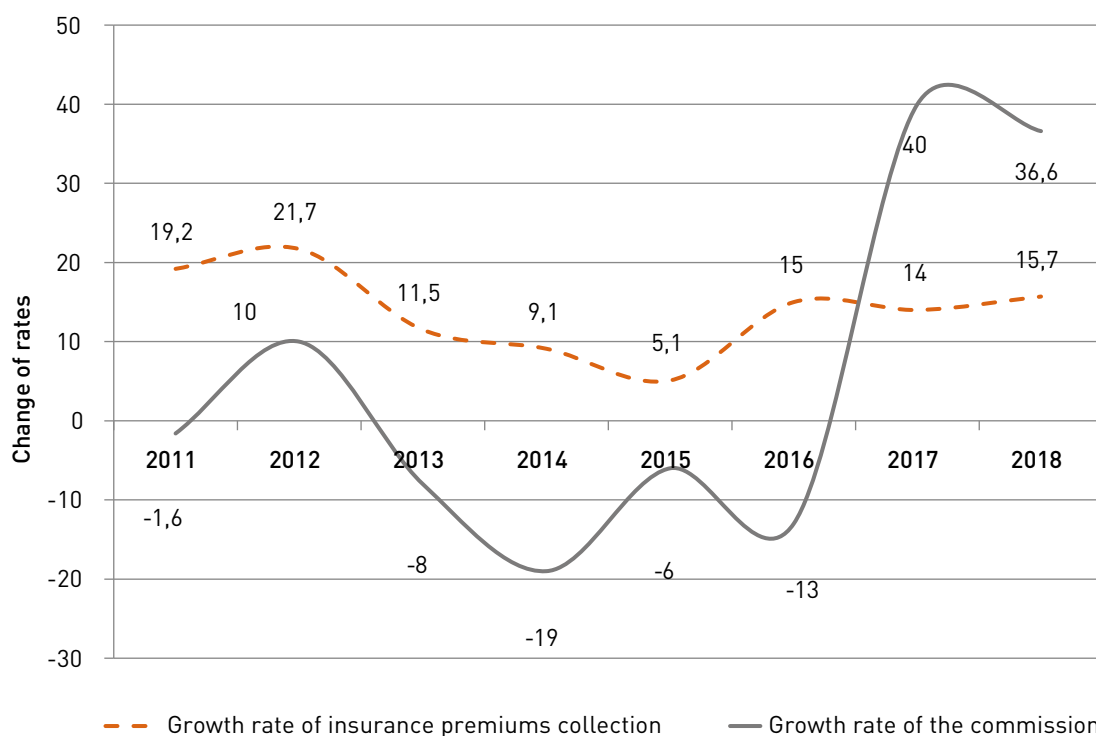
Going beyond the acceptable terms, as a rule, makes the exchange counterproductive for the "overpaying" or "receiving less than due" party. A conscious acceptance of this

situation by the "overpaying" buyer in order to maintain the sustainable financial result may be provided only by means of "underpayment" for another resource. In this case the purchaser of resources manipulates the amount of overpayment or underpayment for the used resources depending on the level of value of access to each resource from the point of view of the predetermined strategy. Providing reliability of communications with the resource suppliers – stakeholders – is the result of formulation of the optimal behavioural strategy of the insurance company in the market. The correctly defined price paid to each group of stakeholders means that the cost allocation for the resources is optimal and the communications due to which the exchange is organized will be strong enough [20].

**Figure 3.** Correlation of growth of the insurance premiums collection rates and the growth rate of expenses for conducting a case (calculated on the basis of [21-30])



**Figure 4.** Correlation of growth of the insurance premiums collection rates and the growth rate of the agency commission (calculated on the basis of [21-30])



Let's consider the situation of payment for resources provided by the insuring parties. Payment for their resources is provided by insurance compensations. So, the hypothesis of dependence of the dynamics of their receipt in the current year on the payment dynamics of the previous year is true. This hypothesis is considered to be true on the basis of analysis of the following diagram (figure 2).

Dependence of the chosen indicators is so obvious that a conclusion should be made that the insurance market has an extremely high risk of inequivalent payments to the

insuring parties. It is possible to cope with this risk only by a corporate policy of payments of insurance companies which will provide improving competitiveness of insurance services and result in growth of collection of insurance compensations.

In the Russian market realities the coefficient of payments to the insuring parties is the indicator controlled "from above", i.e. it is limited in order to release funds with a view to ensuring interests of other stakeholders. These tactics cause fall of collected amounts and decrease of



the revenues obtained from insuring parties which is the source of payment for all other types of resources necessary for conducting an efficient insurance business. Thus, insuring parties' dissatisfaction with the resource exchange becomes a significant risk of development of the insurance sector.

Another group of concerned parties is the staff. The resource exchange with it also bears the risks of inequivalence. As long as the insurance service over time, to a considerable extent, is provided in the course of communication between the insuring party and insurance specialists, involvement of employees in this procedure is the most important element of providing competitiveness of insurance and permanence of receipt of insurance compensations. Materialization of risk of the exchange inequivalence with this stakeholders' category will result in a loss of the company's human and entrepreneur's capital, decrease of its knowledge capital and deterioration of the market competitiveness.

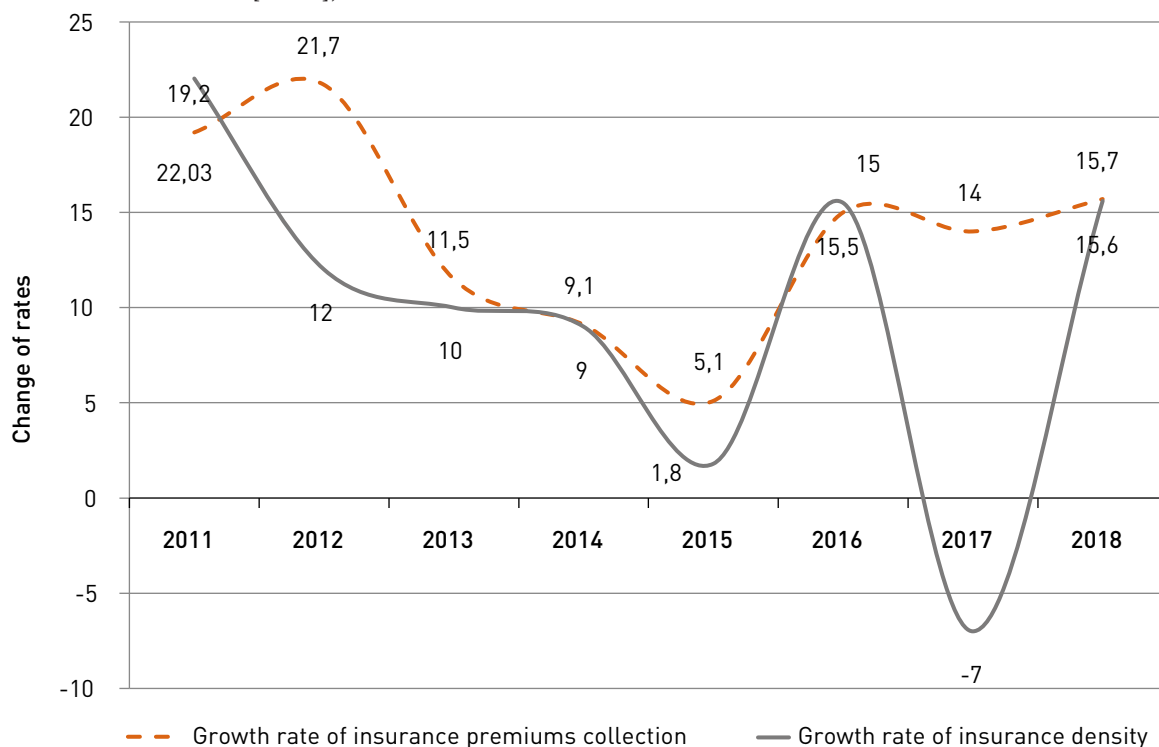
We have analyzed the Russian insurance market situation concerning acceptability of the resource exchange with the staff of the insurance company where we've considered the indicator of expenses for conducting a case as an assessment of payment. A high correlation of indicators of premiums growth rates and the growth rates of expenses for conducting a case (figure 3) is upset only in the period

of 2015 – 2016 due to implementation at the initiative of the Central Bank of Russia of expensive equipment for IT-solutions which provide for insurance reports. It did not cause growth of insurance premiums which is illustrative of inefficiency of these measures for insurance companies.

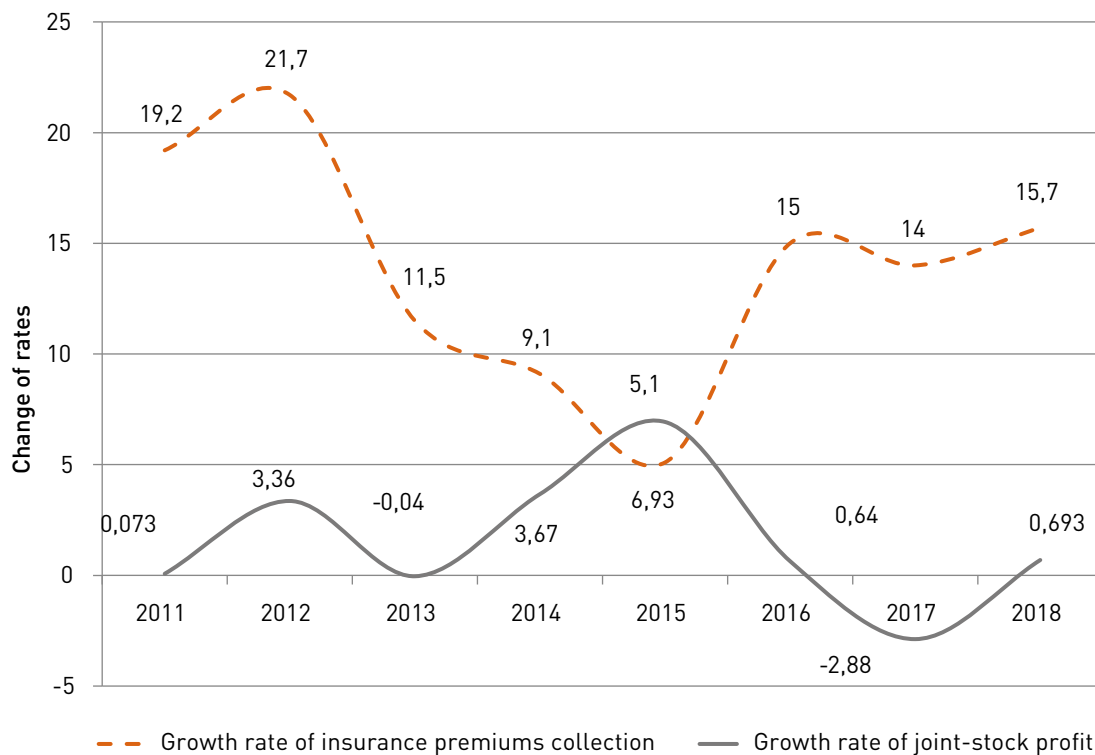
Change of the rates of collections' growth is significantly less than change of expenses for conducting a case. This means that such expenses are inefficient and insurance company's employees, especially the technical staff, get into the category of "incident fellow travelers" and at present their functions are actively transferred to IT-applications. In our opinion, correlation of the analyzed indicators is explained by existence of a highly qualified personnel of insurance professions. Representatives of the above professions ensure de facto the human and entrepreneur's capital of the insurance company. In this regard, it is reasonable to remunerate insurance specialists within the equilibrium price in the area of acceptable exchange [14].

One more supplier of resources for an insurance company is the group of insurance intermediaries who create communications with insuring parties who are traditionally meant to develop loyalty towards the insurer [31]. Remuneration to this category of stakeholders should be analyzed in accordance with dynamics of expenses for the agency commission.

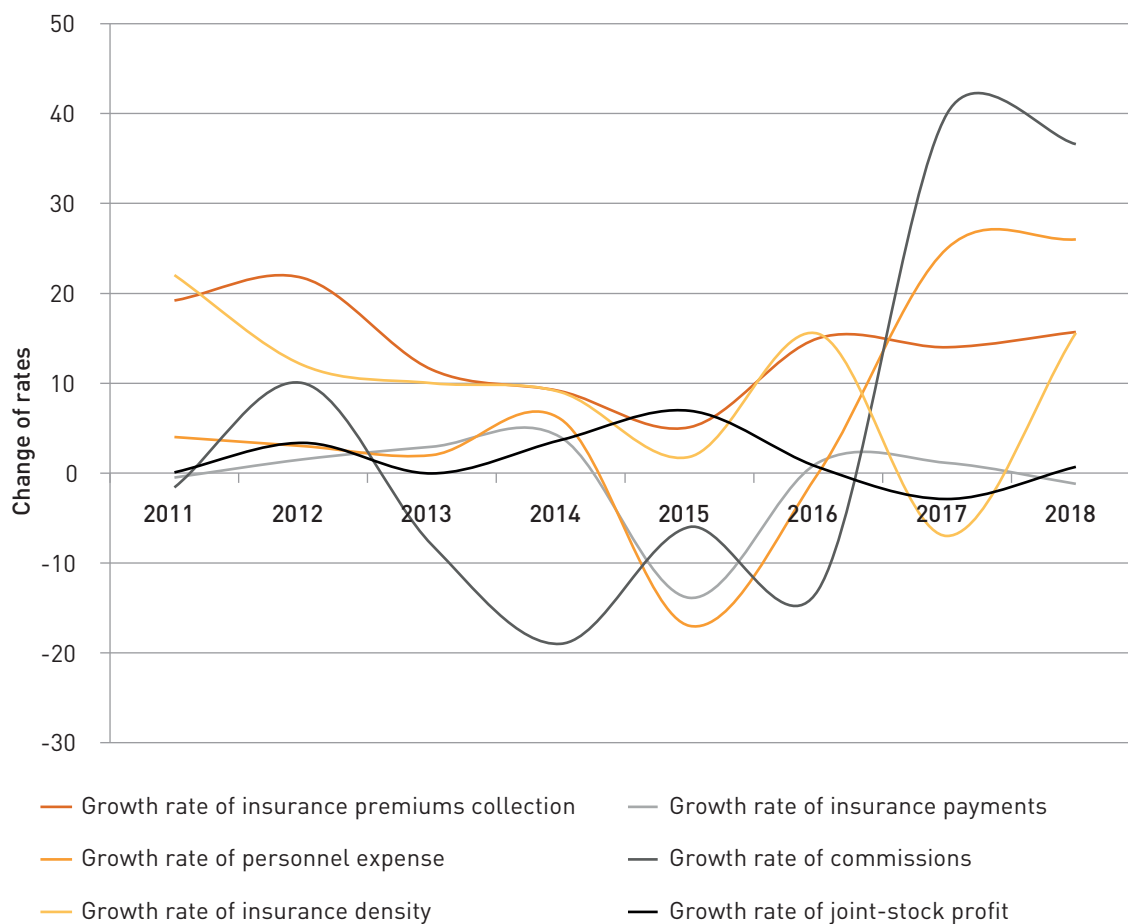
**Figure 5.** Correlation of growth of the insurance premiums collection rates and the growth rate of insurance density (calculated on the basis of [21-30])



**Figure 6.** Correlation of growth of the insurance premiums collection rates and the growth rate of joint-stock profit (calculated on the basis of [21-30])



**Figure 7.** Correlation of growth of the rate of payment for the resources of all groups of stakeholders of an insurance company (calculated on the basis of [21-30])





On the basis of figure 4 we may define that there is an inverse dependence between the insurance premiums collection and paid agency commission. A sharp growth of the rates of its change is related to an unparalleled increase of commissions paid to banks in the course of “bancassurance” [32]. In 2016-2017 it amounted to 49% of the collected premium. The reason for the inverse dependence of the collections increase and the percent of the agency commission is the agents’ claim to an increased payment rate in the cases when the customers’ interest in purchase of insurance protection decreases. This market phenomenon indicates inefficiency of the agent intermediation because the communication with insuring parties is considered to be more important than the resource of the insuring parties themselves. Strengthening of the tendency of decrease of the rates of payment for the insurance services’ consumers’ resource may cause falldown of the indicator instead of increase of the number of contracts in the stable portfolio.

The state holds a special place among the insurer’s stakeholders. The state’s interest in development of the insurance sector manifests itself in growth of the indicators of penetration and insurance density. We have analyzed how Russian companies provide for the growth of the insurance density indicator which illustrates the level of insurance of property interests of citizens and companies (figure 5).

The growth rates of the insurance density slumped up to 2018. There is an intrinsic reason for that: population increase in 2015-2016 related not just to integration of Crimea into the Russian Federation in 2014 but also to rise in births in Russia. Nevertheless, a steep downfall of the growth rate of insurance of economic entities indicates a low popularity of insurance as a tool for providing stability of their financial standing with families from Crimea and families who had newborns within the above period. This state of affairs may be explained by the fact that the state pays no attention to the insurance sector as a tool for maintaining stability and safety of households and small enterprises. As a result, the sector (as a complex of economic entities and communications among them) is unable to solve large-scale tasks. A mutual dissatisfaction means that for the insurers the state is in the category of “incidental stakeholders” which are mutually indifferent to exchange of the existing resources. The lack of the state support resource, insurers increases the possibility of degradation of the sector and losing by it of the status of an item significant for development of the national economy [33].

Shareholders remain the most important stakeholders of any commercial undertaking. If we remove from analysis payment of revenues to the shareholders, which have been earned by investment activities of insurance companies, the source of payment of the share capital (taking into consideration the risk imposed on it) is also insurance premiums which ensure generation of the joint-stock profit. A joint analysis of change of the indicators of the growth rate of joint-stock profits and insurance premiums

leads us to the conclusion that since 2013 their dynamics is in the reverse phase (figure 6).

Collection of insurance premiums and their growth rates are the main indicator of increase of the company value as its marketing capitalization. This indicates efficiency of management and becomes its key indicator of efficiency. In this regard in the period of the market revival top managers of corporations increase maximally the expenses which promote growth of revenues. It should be noted that bonuses for the managers in these periods are also calculated on the basis of the collections amount, thus, increasing the company aggregate expenditures. So, in spite of a quantity increase of revenues the growth rate of the generated profit under the conditions of a rising market is dropping.

In the periods of a market downfall the management is focused on a prudent policy of cutting expenditure, and this results in a growth of the rate of the profit increase. We think it is reasonable to state the following hypothesis: by manipulating the shareholders’ interests top managers of insurance companies, first of all, ensure payment for their own management resource.

Figure 7 represents changes of the growth rate of the key indicators which show payment for resources of each group of stakeholders of insurance companies.

Analysis of diagram (figure 7) reveals the direct dependence of the growth rate of insurance premiums collection on the growth rate of the level of payment for the resources of all insurance activity participants, except for the shareholders and insurance agents. This confirms once again their special place as stakeholders’ groups in the relational system of the insurance company.

## Conclusion

The companies should consider the category of insuring parties as key stakeholders and accordingly organize payment for the resources provided by them at the upper limit of the acceptable exchange zone. A low activity of insuring parties dissatisfied with the non-equivalent exchange aggravates the situation where the insurer has an opportunity to pay for the necessary intellectual, organizational, communication resources by decreasing the pay-out coefficient below the fair one in the prejudice of the consumers, or by decreasing the amount of the revenue due to the shareholders in the prejudice of the latter. In this case a frequent corporate practice is the focus of the insurer’s top managers, who dispose of the financial flows, on their needs as the ones of the highest priority. Little interest of public authorities, the state’s voluntary non-participation in the insurance market as a key stakeholder prevents from providing of meeting the requirements of the equivalent exchange for resources of various types and, as a consequence, from fulfilling the potential of extensive development of the insurance niche. Such distortions in the equivalent exchange model bear the risks of degradation of individual corporations as well as of the insurance sector in general.

A strategic state program of the insurance sector development may become the factor which can normalize the situation of non-equivalent exchange of the insurer with the stakeholders. The program should lay the foundation not just for implementation of obligatory insurance types, but also for the statutory regulation of their imputed types, all the more so because the imputed insurance is increasingly widely replaced by a membership in self-regulating organizations. As long as the main problem of insurance resides in its “non-transparency” for the consumer, apart from the program of development of the population financial literacy it is necessary to stimulate creation of such products the solutions of payment for which are indisputable and amounts of payment are fair in relation to the paid contributions. The interest in creation of new insurance products with participation of the state should not concern only insurance interests of the global value. In practice it is widespread in the agricultural insurance system. The need in mass insurance products of interests’ insurance characteristic of individual homogeneous population groups using electronic means of communication with a simple way of concluding a contract and claims settlement is observed among the players. Taking into consideration the cheapness of insurance offers they are unlikely to be interesting for large insurance companies or their local dependent branches. This in its turn will be a motivation for small companies to increase their market share.

In case of existence of a “proportional” regulation, i.e. the requirements of capitalization of insurance companies in accordance with the specific character of the territory where the companies conduct their principal activities the corporations are able to create and service the products targeted at the local market because they know better the specifics of the market situation in their region. Interest of the local authorities in solving the regional problems and their broad understanding of territorial problems as well as the possibility of creating the systems using electronic and phone communication when concluding an insurance contract and claims settlement ensured within a private-public partnership may be the foundation for the practice of making by the companies of a stable corporate insurance portfolio and to show the state importance of insurance when ensuring the stability of public production, decrease of social risks and creation of additional budget revenues.

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