

THE DEVELOPMENT OF THE INSURANCE MARKET IN THE REPUBLIC OF MACEDONIA

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Abstract

The aim of this paper is to measure the level of the development of insurance in Macedonia and reveal the factors that have influenced this insufficient level of the development of the insurance market compared to other Western Balkan countries and EU countries.

The deep political and socio-economic transformations in countries in transition since the 1990s within the framework of structural reforms imposed essential changes in the system of social insurance as the foundation of the insurance market in general. The successful implementation of insurance in life, economy, business and other public spheres based on the regulations of the market economy in countries with low development levels, imposes the need to understand and learn more the practices of insurance markets based on the most successful experiences from more developed countries of the region, which have already become members of the EU.

Financial instruments of the insurance market have great influence on the level of financial markets in developed economies and they also influence the performance of individuals, the business sector and the political sector. Such a conclusion could partially apply to Western Balkan countries and especially Macedonia as a candidate country for accessing the EU.

The period to be analyzed (2007 – 2013) is identified with the beginning and the ending of the global financial crisis as well as the period when the sector of insurance mainly owned by foreign shareholders in Macedonia was consolidated on the legal aspect.

The paper analyzes the performance of participants in the insurance market as part of the financial market with an insufficient development level in Macedonia compared to the EU countries.

The flaws of the paper are identified through the fact that the performance of the analyzed insurance companies has partially been compared to Croatia and to the EU average, but not to the insurance market in the majority of Western Balkan countries and other countries with similar economic development level, especially with regard to the financial and insurance markets.

Key words: *Insurance market, financial market, life insurance, Macedonia, the EU*

JEL Classification: *G22, G19, G20, I13, L10, O52*

I. INTRODUCTION

After two decades of implementation of intensive economic policies the countries of the Western Balkans between them and Macedonia have achieved macroeconomic stabilization but the results in reforming the economy, reforming the public sector and the public institutions are in insufficient level and continue to remain challenges for these countries in the future (Osmani,2016). In fact, the asymmetric development during the previous system and the low levels of economic growth in the first decade of the transition followed by increasing levels of unemployment, poverty, the large informal sector and fiscal evasion were the main obstacles in implementing deep institutional reforms and establishing a functional market economy in the Western Balkans (Osmani & Mazllami, 2014).

The insurance history begins at an early age, from ancient traders in Babylon. At that time, the insurance was mainly related to theft protection during the carriage of goods. Modern insurance currently offers a number of diversified products designed to protect the company's income and assets, the life of the individual, reduce the risks and other important aspects of the company and individuals in general.

The insurance market as an important financial market segment offering financial instruments that are traded as promises to reduce risk and to secure life, property and income is closely related to the perception based on solidarity as a precursor of the insurance process and of the trading of financial instruments of this market. Solidarity has evolved in that direction so that today it is identified with insurance as a social responsibility aiming at reducing risks to life, property and income for individuals and companies (Barbara&,Cortis,& Perotti,&Sammut andVella, 2017).

The experience of developed countries has proven that the contribution of the individual and/or the company to be protected and secured is the most efficient solution to any unpredictability in life (Insurance Bulletin, SC, 2012). The insurance market is continuously increasing, both in terms of the growth of active entities and in terms of product assortment, quality of services and distribution channels of financial instruments based on the insurance market.

The beginning of the liberalization of the insurance market in Macedonia started after the 1990s through the creation of a necessary legal infrastructure to establish and secure this market. In the framework of the financial market, the Macedonian insurance market participates with only 3.3%, which is marginal and represents a significant opportunity for the development of the insurance market with the aim of diversifying the financial instruments of the perspective insurance market. Rules on capital sufficiency and solvency are essential elements in the functioning of insurance companies for which there is no proper public information and adequate awareness of the risks of insecurity for most citizens and businesses in Macedonia unless they insure their property and lives.

II. LITERATURE REVIEW

The issue of the insurance market in Macedonia and the Western Balkans has in general been little researched due to the insufficient level of development of this market and the insufficient level of development of financial markets in general. At the international level, due to the growing importance of insurance markets, this market has been subject to research by many authors and scientific and professional institutions. Regarding the objectives of this paper, the following publications have been of particular importance:

- Hrechaniuk , Lutz and Talavera “Do determinants of insurers’ performance differ in the “old” EU, the “new” EU, and outside?” (2007)
- Barbara, Cortis,Perotti, Sammut and Vella ”The European Insurance Industry: A pest Analysis”, Basel (2017),
- Pervan, Ćurak, and Poposki “Insurance industry in Macedonia: A general overview”, (2014),
- Njegomir, Stojić “Does insurance promote economic growth: The evidence from Ex-YU region ”, Dubrovnik (2010),
- Marović, Njegomir, Purić “Development and competitiveness aspects of insurance markets of Former Yugoslavia: The emphasis on Montenegrin Insurance Market”, Dubrovnik(2014),
- Jeremić, Stojaković “Development of the insurance sector and economic growth in countries in transition” Belgrad (2016),
- Phutkaradze “Impact of Insurance Market on Economic Growth in Post-Transition Countries”, Warsaw (2014).

Similar to the findings of this paper are the findings of the authors Njegomir,Stojic(2010),Jeremic, and Stojakovic (2016), who have analyzed the level of development of insurance markets in the following countries of the former Yugoslavia: Croatia, Serbia and Montenegro. It is worth pointing out the positive impact of the development of the insurance market in the economic development of Poland as a post-transition country which, as a result of the rapid integration in the EU and NATO, was associated with large foreign investment flows in general and this had a very positive impact on the financial markets in general and on the insurance market in particular.

III. RESEARCH METHODOLOGY

During the realization of this research in the function of determining the level of the development of insurance markets in Macedonia compared to the EU countries, more statistical methods and techniques have been used which have produced substantial results for the analyzed period (2007-2013).

In the analyzed period (2007-2013), all insurance agencies that are currently active in Macedonia have been analyzed. These include the following: JS Macedonia, JS Triglav, JS Sava, JS Euroins, JS Winner, JS Eurolink, JS Insig, JS Uniqa, JS GKS, JS Albsig, JS Croatia and JS Gawe. The level of development of the insurance market in Macedonia has been measured by using the comparative analysis of statistical and financial

data of companies published in the financial reports provided by the official data of the Central Registry of Macedonia and regional and EU institutes and publications.

This was done by measuring the level of the premium, the level of penetration, the level of density and other important indicators that reflect the level of development of the insurance market in Macedonia compared to the EU and Croatia as a country from the Western Balkans that was recently accepted in the EU.

IV. THE HISTORY OF THE INSURANCE MARKET IN MACEDONIA

The insurance market in the Republic of Macedonia in the analyzed period witnessed partial increase in the aspect of the growth of active entities but also in the aspect of the quality of services and service distribution channels. The analysis and experience of companies and citizens in Macedonia prove that the only and most efficient solution towards any risk to life and economic activity is identified with the protection of property, economic activity and the insurance of the citizens' lives based on the free will of the parties in the insurance process, a will that depends heavily on the economic and social situation and the insurance culture.

Insurance in Macedonia functioned as an integral part of the insurance system of the Yugoslav Federation until the early 1990s. In 1974, under the legal provisions of the Yugoslav Federation, a community for insuring properties and people, ZOIL "Makedonija", was established. It functioned as such until 1991 (Ganchevski, 1995). With Macedonia's independence from the former Yugoslav Federation and the creation of a new legal framework and the application of the new socio-economic system, the foundations were set on which the development of a new insurance model began. The only insurance company, ZOIL "Makedonija" was transformed into a joint stock company and the first step to be undertaken under these new circumstances was to establish cooperation with external reinsurance companies. In 1993, the Law on Insuring Assets and Persons was adopted, which was the first step towards the liberalization of the insurance market in Macedonia, allowing for the creation of new joint venture companies (Ganchevski, 1995).

Until 2000, the insurance market operated as a monopoly market where 90% of the market was covered by only one insurance company. In 2002, the new Law on Insurance Supervision was adopted, after extensive consultations with domestic experts and relevant supervisory insurance authorities. This law created new rules for the establishment and operation of an insurance business in the country and the liberalization of the conditions for free movement of capital. These were the prerequisites for foreign insurance companies to invest in the domestic insurance market and to increase the competitive market.

All these elements have influenced the transformation of the structure of the Macedonian insurance industry (Pervan, Ćurak, and Poposki, 2014). Regulatory bodies of the insurance market in Macedonia are the Supervisory Agency and the National Insurance Bureau. In the insurance market in Macedonia there are 15 licensed insurance companies out of which 4 companies are engaged in life insurance; eleven others deal with non-life insurance, and only one of these companies has a license to carry out reinsurance activities, besides the non-life insurance activities.

In the analyzed period (2007-2013) there was a considerable growth of brokerage companies: from six brokerage companies in 2007 the number increased to 26 such in 2013 and they actively operate in the insurance market in Macedonia. The official reports of the Insurance Supervision Agency argue that representatives and insurance brokerage companies have an ever greater impact on the insurance market, recording 50.76% of product sales that were realized through mediation channels in 2013.

V. THE STRUCTURE AND TREND OF THE INSURANCE MARKET IN MACEDONIA

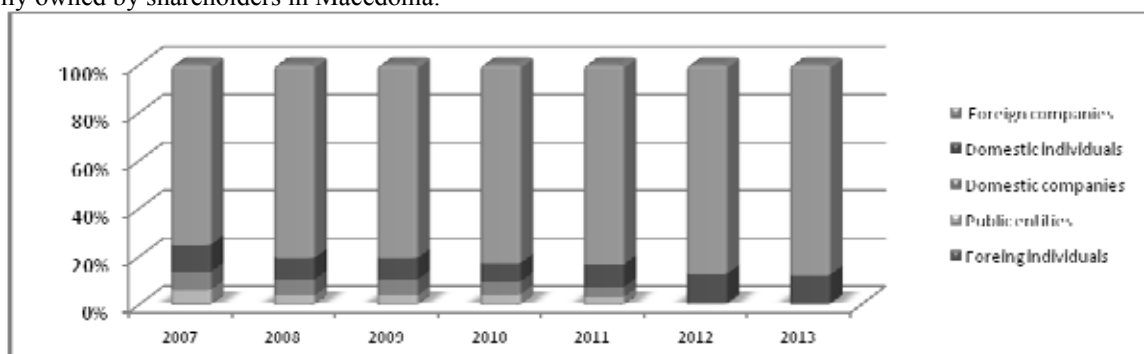
Our analysis argues that the main features of the insurance market in Macedonia are identified with the following:

- It is an average competing market, where 54% of the market is concentrated mainly in three insurance companies;
- A well-regulated market in a legal and liberal aspect with regard to competition and an overwhelming professional institutional supervision;
- A very liberal legal framework for new insurance companies to enter the market and free movement of capital both inside and outside the country (Law on Insurance Supervision, 2002);
- Continued growth of the insurance premium, which represents an opportunity for expanding the insurance market in the country in perspective.

5.1. The structure of ownership of insurance companies in Macedonia

Since 2013, insurance companies in Macedonia have been predominantly owned by foreigners, individuals and companies from the financial sector (87.76%), namely 14 such companies out of 15 have been

part of insurance groups having their main offices in any of the EU member states, whereas only one of them is fully owned by shareholders in Macedonia.



Graph 1: The structure of ownership of insurance companies in Macedonia (2007-2013)

Source: Annual reports on the insurance market in Macedonia (author's calculation)

Despite the fact that the dominant ownership of foreigners prevailed in 2007 by 74.8%, this ownership dominance of foreign shareholders rose by 17.4%, reaching an absolute share of 87.8% in 2013. It is worth mentioning that in the analyzed period (2007-2013) the domestic persons in the country sold 0.3% of the shares. This trend of sales of shares by insurance companies is also followed by domestic companies by selling the total shares, which in 2007 accounted for 7.5% of the portfolio of the shares. A similar trend was also noticed in the shares of public capital in insurance companies from 5.9% in 2007 to 0.3% in 2013.

It is worth pointing out that Macedonian residents increased their property in the portfolio of the capital of insurance companies from 5.3% in 2007 to 12% in 2013. Given that insurance companies in the analyzed period recorded positive financial results, with the exception of 2009, and tend to increase their property and investment performance, a withdrawal of this nature from legal entities and the state from an important economic sector is not in line with the theories and the economic practice of developed countries of the EU as well as those in Western Balkan.

5.2. The portfolio structure of insurance companies

In addition to risk taking, insurance companies collect funds, which they later invest in the capital market in the function of increasing their economic and financial performance. In order to realize these financial operations, it is important for these companies to comply with the legal regulations, which is very precise in the function of the optimal allocation of these financial or property funds. According to the legal regulations in force in Macedonia (Law on Insurance, "Official gazette of RM" nr. 64/11), insurance companies are obliged to invest financial funds in the capital market at the level of technical reserves.

Table 1: Funds which cover technical reserves in non-life insurance companies in Macedonia (in thousands of MKD)

Description	2007	2008	2009	2010	2011	2012	2013
Accounts and bank deposits	1.695.000	1.810.000	2.157.430	2.330.853	2.714.390	2.324.052	2.318.863
State securities	175.000	570.000	548.857	855.783	1.564.186	2.514.183	2.896.334
Shares	454.000	337.000	287.701	218.549	138.854	118.346	64.871
Corporate obligations	0	0	49.165	23.744	80.221	57.512	0
Investment funds	0	0	8.202	15.630	53.889	11.411	101.272
Other	0	0	116.728	140.732	411.910	208.255	0
Total	2.324.000	2.717.000	3.168.083	3.585.291	4.963.450	5.233.759	5.381.339

Data source: Annual report of the AMS (2007-2013) (author's calculation)

Table 1 shows the structure of the portfolios of non-life insurance companies that are active in the insurance market in the Republic of Macedonia. In the period (2007-2013) there was an increase of 130% of the funds that are in the function of technical reserves in non-life insurance companies. Of these funds, 53.8% have been invested in state bonds, 43% in bank accounts and deposits, 1.2% in shares and 1.88% in investment funds. During the investment of these financial funds, investors have given absolute advantage to the security of

investment (state bonds) and cash holding in bank accounts without any opportunity to raise these financial funds and only 3% of these funds have been invested in financial instruments with benefit possibilities.

5.3. Indicators of the development of the insurance market

The main indicators through which the rate of development of the insurance market is measured are as follows: the rate of density and the rate of penetration. The density rate represents the gross per capita income and is calculated as the gross income ratio and the number of citizens in the country (AMS Report, 2013).

Table 2: Indicators of the development of the insurance market in Macedonia (2007-2013)

Years	2007	2008	2009	2010	2011	2012	2013
Gross premium (thousands of MKD)	6.105.839	6.421.489	6.182.401	6.480.674	6.808.264	7.013.622	7.193.501
Penetration rate	1.72%	1.61%	1.56%	1.52%	1.50%	1.52%	1.52%
Density rate	2.988	3.135	3.012	3.151	3.305	3.401	3.487

Source: Annual report of the AMS (2007-2013) (author's calculation)

The penetration rate is an indicator that measures the gross premium income in the country's GDP, and is calculated as a ratio of the realized gross premium and the GDP. For the period 2007-2013, the rate of density recorded a minimal increase of 49 Euros in 2007 to 57 Euros in 2013. Compared to European Union countries, this indicator in Macedonia is very low and had a decreasing trend from 1.72% in 2007 to 1.52% in 2013.

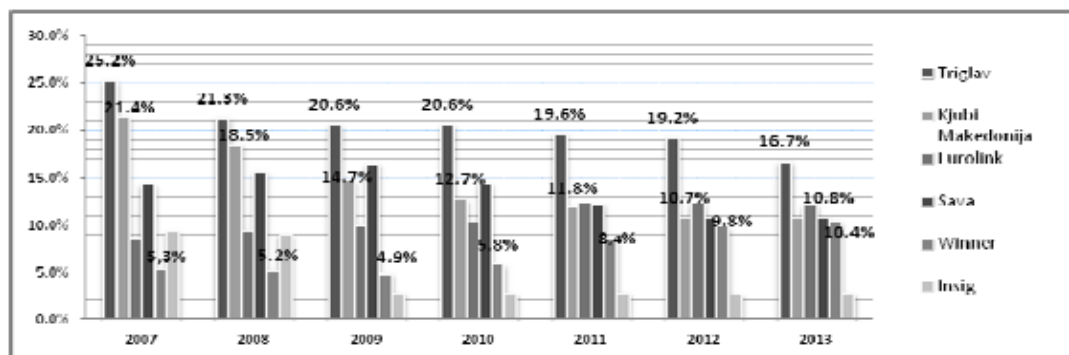
Table 3: Indicators of the development of the insurance market in Macedonia, Croatia and the EU (2013) (author's calculation)

Country	Density rate	Penetration rate	The share of the life insurance premium in the total premium
Macedonia	57 Eu	1.52 %	10.14 %
Croatia	287 Eu	2.76 %	27.96 %
EU (average)	1.524 Eu	7.8 %	56.8 %

The analysis of the rate of density, penetration and life insurance premiums in Macedonia compared to Croatia as a Western Balkan country – member of the EU, reflects a very low level as a result of low levels of GDP per capita, economic, political and security risks which the current and potential investors are facing because the perception of Macedonia is negative due to the fact that the country is not a member of NATO and the EU. Compared to the EU average, the insurance market in Macedonia has a rate of density that is 26 times lower expressed in absolute terms, the penetration rate is 4 times lower in relative terms, while the share of the life insurance premium in the total premium is five times lower.

5.4 The structure of participation of trade associations in the insurance market

The total number of companies operating in the insurance market in Macedonia in the analyzed period (2007-2013) increased from three companies to fifteen in 2013, of which eleven companies provide non-life insurance and four others offer life insurance. The growth of competition and the development of the insurance market in recent years have affected the gradual reduction of the dominance of the two insurance companies, which controlled up to 50% of the insurance market, imposing their own rules on the market. These monopolies in particular controlled the cost of insurance and compensation in disaster situations associated with many phenomena of information asymmetry and the agent theory that are characteristic of the functioning of financial markets always at the expense of the insured or in the benefit of the entities associated with political power.



Graph 2: The participation of non-life insurance companies which are above the 10% threshold in the gross premium

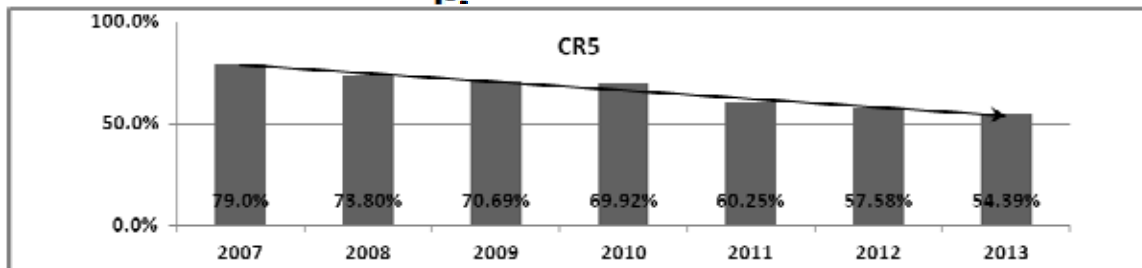
Source: Annual report of the AMS (2007-2013) (author's calculation)

In the analyzed period (2007-2013), the first dominant company "Triglav", with Slovenian shareholders, registered a decrease of market share from 25.24% to 16.7% in 2013. The second dominant company, Kjubi Makedonija, with dominant Australian shareholder, QBE Insurance Group, decreased its market share from 21.4% in 2007 to 10.7% in 2013. Other participants in the insurance market in the analyzed period underwent asymmetric oscillations, while the group that recorded the highest growth in the market is the Austrian Wiener - Vienna Insurance Group with a doubling of the share from 5.3% in 2007 to 10.4 in 2013.

5.5 The concentration level in the insurance market

The insurance sector in Macedonia is characterized by an average market concentration and continued competition growth. The Concentration Report (CR5) and the Harfindahl Index are the two main indicators for measuring market concentration. The Concentration Report (CR5) represents the market share of the *n* largest companies; the value of this indicator varies from zero (0) (in case of perfect competition) to 100 (in case of a monopoly) (Pervan, Ćurak, and Poposki, 2014).

$$CR_n = MS_1 + MS_2 + MS_3 \dots MS_n = \sum_{i=1}^n MS_i$$



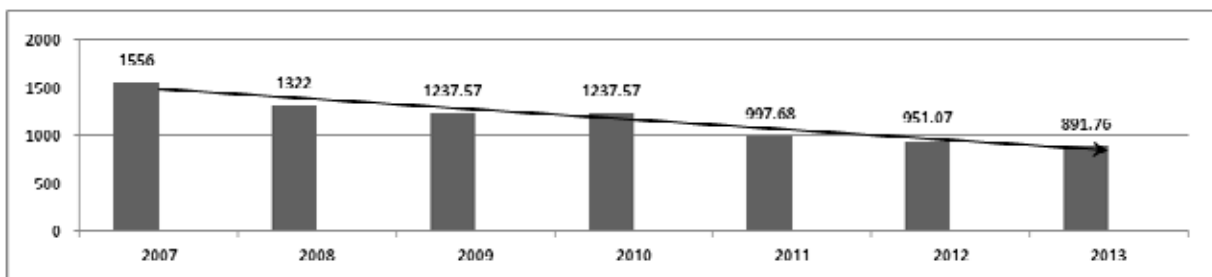
Graph 3: The CR 5 indicator and the linear trend

Source: Annual report of the AMS (2007-2013) (author's calculation)

In the analyzed period (2009-2013), the CR5 indicator for this insurance group fell from 70.69% to 54.39% as a result of the diversification of competition and the increase of participation by two dominant companies in 2007 in 15 competitive companies in 2013. The other indicator for measuring market concentration is the Harfindahl Index (HI) (AMS Annual Report 2013), which is calculated according to the formula:

$$HI = \sum_{i=1}^n S_i^2$$

where *S* is the participation of each insurance company in the realized gross premium, while *n* is the total number of companies. When the index varies in intervals from 1,000 to 1,800 units, the concentration level of the sector is considered as acceptable. The concentration level measured through the Harfindahl index for non-life insurance recorded a continuous decrease from 1,355.66 units in 2009 to 1,055.76 in 2013 or a high relative decrease of 22%.



Graph 4. The Harfindahl concentration index and the linear trend

Source: Annual report of the AMS (2007-2013) (author's calculation)

Analyzed by insurance groups, higher concentration can be noticed in life insurance, due to the small number of insurance companies operating in the market, while non-life insurance shows a continuous decrease of concentration shown through the Harfindahl index and CR5 indicators.

Table 5. Harfindahl index and CR5 index

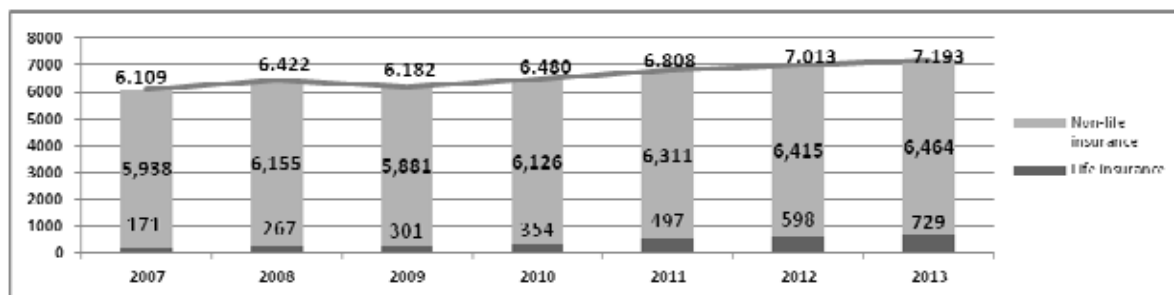
Gross premium	2009		2010		2011		2012		2013	
	HI	CR5	HI	CR5	HI	CR5	HI	CR5	HI	CR5
The whole sector	1.237,57	70,69%	1.237,57	69,92%	997,68	60,25%	951,07	57,58%	891,76	54,39%
Non-life	1.355,66	73,93%	1.249,90	74,21%	1.135,61	65,00%	1.104,32	62,95%	1.055,76	60,53%
Life	/	/	4.777,73	/	4.094,61	100%	3.723,22	100%	3.818,39	100%

Source: Annual report of the AMS (2007-2013) (author's calculation)

The low number of companies participating in the market is manifested through Harfindahl's index from 4,777 per unit in 2009 to 3,818.39 per unit in 2013.

5.6 The structure of insurance classes in gross premium

Based on the realized gross premium, the insurance activity in Macedonia marks an upward trend in both insurance groups. In 2013, the total realization amounted to MKD 7,195 million representing a cumulative increase of 18% compared to the initial year of the analysis (2007). Analyzed in the structure, non-life insurance participates with 89.86% which represents a 7% decrease in structure compared to the initial year of the analysis when this insurance accounted for 97% of the insurance total. Even though it continues to be marginal with a share of only 10% in the insurance total in the analyzed period (2007-2013), life insurance has registered a rise of 326% as a result of increased competition in the insurance market that affected price reductions and increase of the culture of insurance among the population.



Graph5: Annual growth of the realized gross premium for the period (2007-2013) (author's calculation)

This positive trend as a result of increased competition and the growth of the quality and quantity of life insurance products in the country is also the result of the end of the global economic crisis and the positive macro economic trends that effect the further development of the life insurance sector.

VI. THE PROFITABILITY TREND OF COMPANIES PARTICIPATING IN THE INSURANCE MARKET

Profitability indicators are indicators that measure the overall performance and efficiency of commercial companies. They are usually considered indicators that measure the growth, success and earning capacity of the trading companies. The profitability of companies as an integral indicator integrates three sub-criteria: return on assets (ROA), return on equity (ROE) and return on investment (ROI) (Kabajeh, AL Nu'aimat, 2012).

Table 6. Profitability indicators (in % as a pondered average)

Return norms	Participating companies in the insurance market in Macedonia						
	2007	2008	2009	2010	2011	2012	2013
ROI		6,58%	9,29%	8,07%	5,35%	4,8%	3,7%
ROA	2,05%	1,66%	-1,40%	0,61%	-0,57%	-1,02%	1,52%
ROE	6,77%	4,65%	-3,99%	1,75%	-1,75%	-2,87%	4,24%

Source: Annual report of the AMS (2007-2013) (author's calculation)

The deterioration of the profitability indicators of the participating companies in the insurance market in Macedonia in the analyzed period (2007-2013) is a result of increased competition, underdeveloped insurance culture for citizens and companies, insufficient development of the insurance market and financial market in general mainly due to political, security and economic risks, as well as because Macedonia has a serious stagnation in the integration process in NATO and the EU and as a country situated in a generally unstable region in terms of political and security stability.

VII. CONCLUSIONS AND RECOMMENDATIONS

- The insurance market in Macedonia has a lower level of development in relation to other Western Balkan countries and an incomparably low level in relation to EU countries. The lack of interest of the largest insurance companies at European level to invest in the Macedonia is due to high political, security and economic risks deriving from the fact that Macedonia has a serious stagnation in the integration process in NATO and the EU.
- Insurance in Macedonia is more perceived as an emergency and compulsory service rather than an influential development industry across the country's economic sector. Macedonia has the lowest rate of insurance penetration in the economy (about 1.5% of GDP) and a density of 56 Euros.
- Greater representation of life insurance would have a greater impact on the development of the insurance market and in the development of the financial market as a prerequisite for impacting the economic development. In Macedonia, only 2% of the population possesses a life insurance policy, which is of the lowest levels in Europe. In Croatia, for instance, this percentage is 22%.
- The activity of insurance companies is largely oriented towards the race for awards in insurance products without providing a fair competition without having to account for a balance between profits and meeting the clients' requirements.
- Insurance companies in Macedonia need to reinvigorate their trust in their clients, improve their products and service quality in order to motivate their clients to increase their participation in the insurance market.
- From surveys conducted by different institutions, the citizens and the insured companies say that it is necessary to increase the pace of the realization of damage compensations caused by different factors, in order to increase the confidence of the potential clients in the insurance companies.
- Insurance companies, with the assistance of Macedonian government institutions, should apply well-coordinated information marketing campaigns to educate and inform citizens and companies about the necessity of insurances in the function of reducing risks and as an opportunity for pre-emptive investments.
- The Insurance Supervision Agency should undertake measures to increase the level of consumer protection similar to the practices applied in Croatia and EU countries, by lawfully banning insurance companies in offering non-viable products, ascertained by the decline in the trend of compulsory insurance, and to increase the consumption of life insurance services.
- Liberalization of mandatory insurance market and government tax relief in cases of investment in a life insurance policy along with a more functional collaboration between the banking sector and the insurance sector

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can be an additional contribution to the prospective development of the insurance market.

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