



Influence of Risk Management on Financial Performance of “Uzbekinvest” Insurance Company

Sherkulov S. E. ugli

Fundamental economics department, Tashkent State University of Economics, Uzbekistan

Email: sherkulovshokhrukh@gmail.com

Abstract

Risk if not well managed could lead to collapse for most organizations especially those whose core business deals with day-to-day handling of risk. Risk management should, therefore, be at the core of an organization’s operations by integrating risk management practices into processes, systems, and culture of the entire organization. This involves identifying and analyzing risks, developing, and implementing risk handling techniques and monitoring the progress of these to avoid and/or reduce the impact of risk on the financial performance of the company. Furthermore, insurance company under concern should follow current international leading practice by adopting Enterprise Risk Management (ERM) which incorporates other insurance risk quantification models. This will ensure that the companies remain afloat during such times of strict regulatory regimes such as solvency 11 and Basel.

Keywords: Risk management; business, insuranc; business; risk exposure; financial performance; risk tools; future outcome; risk assessment; profitability, monitoring; return on equity; financial crisis; export-import.

1. Introduction

Risk management is an important discipline in business especially the insurance business. Recently, businesses put great emphasis on risk management as this determines their survival and business performance. Insurance companies are in the risk business and as such cover various types of risks for individuals, businesses and companies. It is therefore, necessary that insurance companies manage their risk exposure and conduct proper analysis to avoid losses due to the compensation claims made by the insured.

In risk management, a prioritization process must be followed whereby the risk with the greatest loss and greatest probability of occurrence is handled first and risks with lower loss are handled later (Kiochos, 2018, and Stulz, 2003, 2020b). There is, however, no specific model to determine the balance between risks with the greatest probability and loss and those with lower loss, making risk management difficult. Banks (2004, 2016, 2019a) notes that the key focus of risk management is controlling, as opposed to eliminating, risk exposures so that all stakeholders are fully aware of how the firm might be impacted.

Insurance services are one of the means to protect the economy from various financial risks. Therefore, the insurance industry is an integral part of the economy. Currently, 36 insurers operate in the insurance market of the Republic of Uzbekistan, including 28 in the general insurance network, 8 in the life insurance network, as well as 5 insurance brokers, 5 actuarial organizations and 22 assistants, adjusters and a surveyor. In 2020, The total authorized capital of insurers amounted to 782.4 billion sums (an increase of 138%), and the volume of investments

in the economy amounted to 2,834.9 billion sums (an increase of 137%). 55% of investments are in bank deposits, 30% in shares, and the rest in other securities.

Insurance payments in the amount of 176.9 billion sums were made in the first quarter of 2020, of which 141.2 billion sums were paid for non-mandatory types of insurance and 35.8 billion sums for mandatory types of insurance. The government provides aid and tax incentives to the insurance sector. However, as I see it, insurance companies' performance, information on new products, strategic plans for relations with customers and market actors leave much to be desired. The insurance market experience a high concentration of actors. In particular, over 55 percent of total insurance premiums are held by only five major companies of Uzbekistan, and 76 percent in case of 10 companies respectively (see Table 1).

Table 1: The shares of 10 insurance companies in the insurance market of Uzbekistan

Insurance company	Insurance market share, %
Uzagrosugurta	19.9
Uzbekinvest	14.5
Kafolat	10.5
ALSKOM	5.8
Asia Insurans	5.1
Alfa Invest	4.9
Kapital sugurta	4.9
Ozbekinvest Hayot	4
Temirjol-Sugurta	3.7
Agro invest sugurta	2.9

Source: Data of the State Insurance Supervision of the Republic of Uzbekistan

Export-Import Insurance Company "Uzbekinvest" operates in the field of "General Insurance" and provides services in all 17 insurance classes according to insurance business classification in Uzbekistan. "Uzbekinvest" Insurance Company was established according to the Decree of the President of the Republic of Uzbekistan N UP 745 dated by 21st January 1994 in April, 1994 and Resolution of the Cabinet of Ministers of the Republic of Uzbekistan N 206 dated by 13th April 1994. On July 1, 2020 according to the Decree of the President of the Republic of Uzbekistan "On measures to expand the mechanisms of financing and insurance protection of export activities" and in accordance with the Decree of the Cabinet of Ministers of the Republic of Uzbekistan "On measures to further improve the activities of "Uzbekinvest", the company was transformed into a joint stock company.

In 2016 Uzbekinvest was the first company in Uzbekistan, which has passed re-certification and received certificate of its quality management system's conformity with the new ISO 9001:2015 standards issued by the SGS international certification body (Switzerland). On December 5, 2019, the international rating agency Moody's Investors Service (USA) officially announced an increase in the financial stability rating of Uzbekinvest insurance company from B1 to Ba3 with a Stable forecast. The Uzbekinvest insurance company became the first company in the banking and financial sector of Uzbekistan, which was assigned the International rating of financial stability "Ba3" by the International rating agency "Moody's". By the results of 2020, the rating agency Ahbor-Reyting assigned the Company a solvency rating on the national scale at "uzA ++" with a "Stable" forecast.

With the mentioned information about the company profile, we decided to study with this company. Because Uzbekinvest company has regional branches in all of Uzbekistan regions. the company also has a good financial capacity to study risk management under the concern.

2. Literature Review

Some empirical work understands risk management as an organizational and social practice, and has compiled sufficient evidence to suggest that risk management practices vary considerably across firms, even within an industry (Tufano, 1996; Mikes, 2011; Mikes, 2019).

In some firms, risk management takes the form of complex financial transactions (Tufano, 1996; Chacko, Tufano, and Verter, 2011); in others, it follows a more holistic assessment of financial and nonfinancial risks (Mikes, 2011; Mikes, 2019; Woods, 2009; Arena, Arnaboldi, and Azzone 2017), bridging functional silos.

From the literature, it is discovered that the desire to improve financial performance should be balanced with the risks associated with the operations of the firm. This then leads to the development of a risk management program to meet the strategies of an organization.

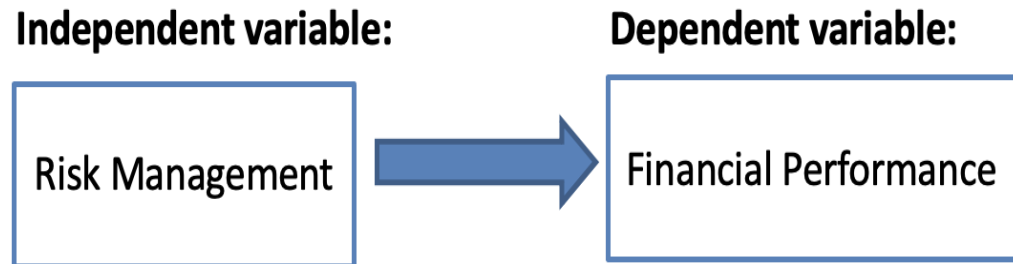


Figure 1: Independent and dependent variables

A population is the aggregate of all elements that conform to some general set of specifications (Paton, 2002). The study adopted a census survey of Uzbekinvest insurance company and all the registered branches operating in Uzbekistan and abroad as well. A census approach enables one to collect more accurate and reliable data.

3. Methodology

Both primary and secondary data was used in this study. Primary data was collected through the use of questionnaires. Questionnaires were picked and dropped to the risk managers in the Uzbekinvest insurance company and their branches.

Secondary data was collected from secondary data sources like insurance survey reports from company webpage and the audited financial statements of Uzbekinvest insurance company as presented to Ministry of Finance. Secondary data for the period 2016 to 2020 was used in this study. We used a regression model to determine the existing relationship. The following regression model was used for the study:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon$$

Where:

Y = Financial Performance (Measured using ROA)

X1 = Risk identification (Measured using inspection, financial statements analysis, establishing standards and risk rating and collateral.

X2 = Risk assessment (Measured using approximations & projections)

X3 = Risk mitigation (Risk control and risk financing measures)

X4 = Risk management implementation and monitoring (Controls, responses, reporting & review)

ε = the error term

The Y value is an average for the 5-year period, 2016-2020.

4. Results and Analysis

The study targeted Uzbekinvest insurance company and their 14 registered branches in Uzbekistan out of which 14 responded contributing to a response rate of 100%. To determine the extent to which risk management practices were adopted by the insurance company, the respondents were requested to indicate their level of agreement with statements that point to the extent to which the various risk management techniques were used in their respective branches. The responses were rated on a 5-point Likert scale where: 5-Strongly Agree, 4-Agree, 3-Not Sure, 2-Disagree, and 1-Strongly Agree. The findings were as shown in Appendix 2 & 3.

Ratio Analysis of Financial Performance:

Table 2 Descriptive statistics for return on assets

YEAR	N	MIN ROA	MAX ROA	MEAN	STD DEV
2016	14	0.61	6.18	2.175	1.47478812
2017	14	-11.65	6.83	1.94682	1.39528427
2018	14	-11.75	8.79	2.64614	1.62669492
2019	14	0.78	10.73	3.08841	1.75738701
2020	14	-2.46	11.64	3.56727	1.88872251

ROA=Net Income/Average Total Assets

The findings as depicted in Table 2 shows the lowest value for ROA as -11.75 in year 2018 and the highest as 11.64 in 2020. In addition a low standard deviation is a sign of lower variation in financial performance of the insurance company. On the other hand, a steady rise in ROA values from 2018 indicates that the Uzbekinvest insurance company has been performing well financially over the last three years.

Regression Analysis:

Table 3 Model Summary

Model	R	R ²	Adjusted Square	Std Error of the Estimate
1	0.846	0.7157	0.679	0.5382

Coefficient of determination (R square) explains the extent to which changes in the dependent variable can be explained by changes in the independent variables or the percentage of variation in the dependent variable (financial performance of insurance company) that is explained by all the four independent variables (risk management practices).

Table 3 above reveals an R² of 0.7157 which implies that the four independent variables studied explain only 71.6% of the variations in financial performance of insurance company. Consequently, this means that other factors not studied in this research explain 28.4% of the variations in financial performance of Uzbekinvest insurance company.

Table 4 ANOVA of the regression

MODEL		SUM OF SQUARES	df	MEAN SQUARE	F	Sig
1	Regression	2.534	6	1.267	9.475	0.0031
	Residual	9.307	8	2.327		
	Total	11.841	14			

The significance value is 0.0031 which is less than 0.05 thus the model is statistically significant in predicting how risk management practices affect the financial performance of insurance company. The F critical at 5% level of significance was 2.1646. Since F calculated is greater than the F critical (value = 9.475), this means that the overall model was significant, and hence, it is good for prediction.

Table 5 Coefficient of determination

MODEL		UNSTANDARDIZED COEFFICIENTS		STANDARDIZED COEFFICIENTS	t
		Beta	Std Error	Beta	
1	Constant	1.147	0.2235		5.132
	Risk identification	0.668	0.1102	0.1032	7.287
	Risk assessment & measurement	0.348	0.1828	0.0937	4.685
	Risk mitigation	0.454	0.2156	0.1178	4.626
	Risk monitoring	0.398	0.3164	0.1425	3.418

The data findings analysed also show that taking all other independent variables at zero, a unit increase in risk identification will lead to a 0.668 increase in financial performance, a unit increase in risk assessment and measurement will lead to a 0.348 increase in financial performance, a unit increase in risk mitigation will lead to a 0.454 increase in financial performance while a unit increase in risk management program implementation and monitoring will lead to a 0.398 increase in financial performance of insurance company.

5. Interpretation of the Results

With regard to the various risk management practices adopted by the insurance company, the study found that risk identification contributes the most to the financial performance of Uzbekinvest insurance company followed by risk mitigation, risk management program implementation & monitoring and risk assessment & measurement in that order. At 5% level of significance and 95% level of confidence, risk identification, risk mitigation, risk management program implementation & monitoring and risk assessment & measurement all significantly influenced the financial performance of insurance company.

6. Conclusion and Recommendations

6.1 Summary of Findings

Company had adopted the four risk management practices that were the focus of this study. Of the four risk management practices, risk identification was found to be the most significant in influencing financial performance with a unit increase in risk identification leading to a 0.668 increase in financial performance.

A unit increase in risk management implementation and monitoring led to an increase of 0.398 in financial performance with risk assessment and measurement having the least influence on the companies' financial performance, at 0.348 increases in financial performance for a unit increase in risk assessment and measurement.

Generally, from the results of this study, adoption of risk management practices was found to have a significant influence on the financial performance of insurance companies, as explained by an R² of 71.6%. This implies that better risk management by company leads to improved financial performance.

6.2 Conclusion

The study concludes that risk identification and mitigation play the most significant role in influencing financial performance of insurance company. Hence, risk identification can essentially be said to be the key starting point of any risk management program as companies cannot manage what is unknown.

The study results, also show that all the four risk management practices were of some significance in influencing financial performance and hence the conclusion of this study is that insurance company need to adopt a multifaceted approach in their risk management efforts that includes all the practices that were the focus of this study in order to realize the full benefits of their risk management programs.

Therefore, concludes that there is a strong relationship between adoption of risk management practices and financial performance of company under investigation. The study further concludes that there are other factors that influence financial performance of insurance company and that this explains the remaining 28.4% of the variation in financial performance of the company

6.3 Recommendation for policy implication

From the project, risk identification and mitigation were found to have a huge impact on the financial performance of insurance company. The study therefore recommends that the management of insurance company should put in place cost-effective measures for timely risk identification and effective risk mitigation so as to ensure that their financial performance is not impacted negatively.

The study also recommends that the management of insurance company should continuously assess their risk management practices to see if they are still practical in the face of a continuously changing operating environment, for instance the new regulatory pressures of solvency 2 and Basel regulatory regimes.

Lastly, the study recommends that the management of insurance company should put in place risk management frameworks conform to international best practice. This will ensure that Uzbekinvest insurance company achieve international standards and, therefore, become globally competitive.

References

- [1] Froot, K., Scharfstein, D. & Stein, J. (1993). A Framework for Risk Management,
- [2] *Journal of Applied Corporate Finance*, 7, 22-32.
- [3] Gold, G. (1999). The Valuation of Risk Assets and the Selection of Risky
- [4] Investments in Stock Portfolios and Capital Budgets. *Review of*
- [5] *Economics and Statistics*, 47 (1), 13-37.
- [6] Iqbal Z. & Mirakhor A. (2007). *An Introduction to Islamic Finance: Theory and Practice*, 2nd , Edition.
- [7] Kadi, A.M. (2003). Basic Conditions and Procedures in Insurance. *The Accountant*, 13 (3), 16-19.
- [8] Magezi, J.K. (2003). A New Framework for Measuring the Credit Risk of a Portfolio. *Institute for Monetary and Economic Studies (IMES)*, 1-45.
- [9] Merton, R.C. (1995). A Functional Perspective of Financial Intermediation, *Financial Management Journal*, 24 (2), 23-41.

- [10] Mikes A. & R.S Kaplan. (2014). Towards a contingency. Theory of Enterprise Risk Management. Working Paper 13-063.
- [11] Pagach, D. P. & Warr, R.S. (2010). The Effects of Enterprise Risk Management on Firm Performance. Available at SSRN: <http://ssrn.com/abstract=1155218>.
- [12] Pagano, M.S. (2001). How Theories of Financial Intermediation and Corporate Risk-Management Influence Bank Risk-taking Behavior, Financial Markets, Institutions and Instruments, 10 (5), 277-323.
- [13] Warner, J. (1977). Bankruptcy Costs: Some Evidence. Journal of Finance. 32, 337-347.
- [14] Weiss, L. (1990). Bankruptcy Resolution: Direct Costs and Violation of Priority Claims. Journal of Finance and Economics, 27, 285-314.