

SOCIAL SCIENCES

INNOVATIVE APPROACH TO BUDGETING ACTIVITIES OF INSURERS IN THE
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Abstract. Traditional budgeting, despite the critical comments regarding this management tool, is widely used in many medium and large enterprises, including insurance companies. The authors propose an innovative approach to budget management in insurance companies, based on the hyperdynamics feature, permanent instability of today's business environment in the country generally, in the insurance market particularly, and specifics of insurance. In particular, it is a combination of traditional budgeting and non-budgetary methods of financial planning.

Keywords: financial innovation, traditional budgeting, financial planning, insurance market, non-budgetary methods of financial planning.

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Introduction

One of the major factors of business survival in the current crisis conditions of Ukrainian economy development and framework for achieving companies a sustainable competitive advantage in an aggressive external environment is the use of an innovative approach to financial management and in particular, such important aspects as the quality financial planning. An innovative approach to financial management provides using of new financial instruments or processes in ensuring the financial activities.

An important financial planning tool is the traditional budgeting. Despite criticisms regarding this tool, budgeting continues to be the most widespread method of financial planning for many corporations, enterprises and large and medium-sized businesses. Recent years have been the most difficult for Ukraine's economic development, due to the simultaneous combination of negative objective and subjective factors. Losses in individual markets ranged from 5 to 30%. There was no exception to the insurance market, that is not surprising given the extremely elastic demand for insurance services in our country. Most companies didn't have achieved the planned indicators on the results 2014-2017 years. This sets new requirements for financial forecasting, planning, activities of insurers, including the formation of budgets for revenue and expenditure items.

Specificity and innovative directions of budgeting in insurance companies

Today mistakes in financial planning have far more serious and quick consequences than ever before, as the competitive situation is constantly exacerbated in the insurance market and every company is experiencing a shortage of financial resources. As never before, the role of external factors for the success of the insurance business has increased. Most insurance companies do not apply an innovative approach to financial management processes in conditions of total market uncertainty and limited financial resources. Although the innovative improvement of financial planning would greatly contribute to solving the problem of financial resources optimization. As part of the formulation of the problem, it is necessary to review traditional approaches to financial planning, including drawing up budgets.

Determination of the entity's budget, provided by scientists who have studied this issue, are different, for example:

- *the budget* is the amount of funds that are available to perform certain functions and carry out specific activities within the corporate planning (*Tereshchenko, 2003*);
- *the budget* is a quantitative expression of indicators that are set centrally, according to the enterprise plan for a certain period (*Shcheborch, 2004*);
- *the budget* is a financial plan covering all aspects of the enterprise (*Bilyk, 2013*).

Despite the fact that there are many definitions of budgeting, but all who have studied the issue agree that the traditional budgeting, on the one hand, is a method of financial planning, on the other hand, the management process whose goal is the timely provision of financial resources.

The budgeting process is affected by industry or economic activity.

The main feature of the financial cycle (turnover of working capital) in industry is the existence of the production stage (transformation of material resources into the finished products). This lead to a complicated system of cost planning for an industrial company compared to other sectors of the economy. So, in the banking, insurance and trade sectors a big part of the value added is transaction costs, which are determined by the general conditions of the business' support activities (office premises, staff, etc.). Thus, the main objective of these companies is that the difference in "outgoing" and "incoming" value flows, that is, the margin (whether the difference of the purchase and sales value of the goods in trade or the difference of attracting and allocation of financial resources in the banking sector) cover the operating expenses. The optimization of the operating expenses, in general, is to ensure that, it performs as an intermediary with a minimum of expenses, which redistributes "incoming" commodity or financial flows.

This is much more complicated in the industry. So, there is a qualitative change of the "incoming" flows at the production stage, i.e., the "outgoing" flows value is determined not only by the market (external), but also by the internal enterprise (production) policy. The connection in industry between cost and structure of material resources purchases and income from sales of finished products is much harder than between credit interest and deposit interest of depositors in the financial sector. Despite that, the financial cycle of the industrial enterprise includes a stage of supply and the implementation phase, production accounting and planning determine the specificity and complexity of the budget process in the industry compared to other industries.

Financial resources of the bank, insurance companies, other financial institutions, to a lesser extent, goods for resale of the trade organizations, are liquid assets, and quite easy to "overflow". If the situation suddenly changes on the financial markets, the Bank can relatively

painless “transfer” funds from short-term commercial loans to the stock markets. An industrial enterprise that has invested in the production of a specific product, will be in a much more difficult position.

The production stage presence determines the specificity of not only financial but also the investment cycle (cycle of renewal of fixed capital). Unlike other sectors, where the investment cycle is sufficiently standard in the industry most of the investments relate to the manufacturing of certain types of products, that is, it is highly individualized. There is a close connection not only between the profitability of the business in general and the return of investments, but also between the profitability of specific types of products and the return from specific investments in the production of these products.

Therefore, during the formation of budget management in insurance companies, it's necessary to consider specifics of financial management in insurance organizations, which are:

- funds for the provision of insurance services are received in advance;
- the insurance company can operate advance funding and receive additional profit;
- the profit can be obtained also due to the excess of insurance premiums are being over payments and operating costs associated with the insurance activity of the company;
- insurance companies, because of the high risk associated with their activities, must maintain the size of the insurance fund, that will provide them sufficient solvency (*Suprun, Zajvenko, 2009*).

Due to these, a row of the reference points can be determined that distinguish the budget process in insurance companies.

First, the receivables budget is determinative in many enterprises and organizations, while in insurance companies, commodity receivables is insignificant, accordingly, the budget of commodity receivables will not play any significant role.

Secondly, all budgets that are associated with the investment of free funds will be important. Their structure will be significantly different from those who are engaged in risky insurance, and those who are engaged in life insurance. Life insurance companies provide separate accounting for insurance reserves for each client, that causes the complication of the budgeting process.

Thirdly, insurance is based on the probability of occurrence or non-occurrence of events, which are defined by the contract as insurance cases. The main cost item of a stable operating insurance company is the costs associated with insurance payments. Accordingly, the process of budgeting is mainly based on actuarial calculations. Formed this way, the data concerning the anticipated costs of the insurance company are the basis for the formation of the budget of payments, and together with the forecast of income insurance premiums and other operating budgets the planned financial result of the insurer's activities are formed. Thus, in the field of operational activity, two types of budgets are formed. The first type is the budget, having a distinct probabilistic nature (the budget of insurance premiums incomes and the budget of insurance payments). The second type is the other operational budgets, that management has a direct impact on (budget for advertising costs, administrative expenses budget, budget of income from rent, etc.).

Fourth, the probabilistic nature of insurance payments of non-life insurance companies often generates significant fluctuations in the amount of cash payments in time. An array's formation of available cash for payments by type of insurance is important (considering the indicators of pays out and incurred losses ratio) and it is necessarily to create their insurance reserve (it can be defined as an equalization reserves).

The budget of insurance premiums incomes is a key indicator for planning an insurance company's activity. Formation of insurance premiums from income should include budget such as the number of concluded contracts, the amount of insurance amounts and rates of insurance tariffs. Even in a stable economic situation, the forecasting of insurance premiums in the dynamism of the external economic environment is a difficult task. The development of the budget for the receipt of insurance premiums in this regard should be based on the principle of making a "slippery" budget. That is, the budget is composed for the year with a quarterly or monthly adjustment depending on changes in the economy and in the market segments. It is necessary to structure the budget of insurance premiums from incomes.

Principles can be different at the same time. For example, it is imperative to allocate two main contractors (corporate clients and individuals) as there are fundamental differences in the acquisition work with them. Further distribution depends on the specifics of the insurer's activities. It is sufficiently effective to allocate in separate budgets the receipt of insurance premiums by the types of insurance, which have the largest share in the receipt of insurance premiums of the company with years.

Now the Ukrainian insurance market faces with systemic problems associated with the general crisis of the Ukrainian economy.

As of 30 June, 2016, the total number of insurance companies was 343, including the life insurance companies -45, non-life insurance companies - 298, (as of June 30, 2015 - 374 companies, including life insurance companies - 52, non-life insurance companies - 322). The number of insurance companies tends to decrease: as of 30 June, 2016 compared to the same date in 2015, the number of companies decreased by 31. There is now a crisis "cleaning" of the market. First of all, weak companies disappear, whose owners have no opportunities or they are not interested in their support.

According to the main indicators, the market is growing, as evidenced by the latest statistics. Compared to the first half-year 2015 the volume of gross insurance premiums increased by UAH 2861,5 million (21,3%), net insurance premiums increased by UAH 2150,8 million (19,9%). The increase in gross insurance premiums was made for almost all types of insurance, namely: auto insurance (CASCO, compulsory civil liability insurance for vehicle owners, Green Card) (increase of gross insurance payments by UAH 753,6 million (20,5%); life insurance (increase of gross insurance payments by UAH 374,8 million (39,9%); insurance of cargoes and luggage (increase of gross insurance payments by UAH 275,3 million (18,4%); property insurance (increase of gross insurance payments by UAH 265,7 million (16,2%); third party liability insurance (increase of gross insurance payments by UAH 227,3 million (40,8%); medical insurance (increase in gross insurance payments by UAH 147,6 million (14,9%). The growth of the absolute value of insurance premiums received for virtually all types of insurance took place in the crisis of 2015. But this growth was purely inflationary. To do so, we need to look at dynamics of the number of concluded insurance contracts.

Thus, during the first half-year 2016, the number of contracts decreased by 9534,0 thousand units (10,3%), while the number of the contracts of voluntary insurance decreased by 33970,7 thousand units (74,6%), including: the number of concluded insurance contracts on fire risks and risks of natural disasters decreased by 13247,6 thousand units (92,4%); the number of concluded property insurance contracts decreased by 12925,3 thousand units (89,9%); the number of concluded accident insurance contracts decreased by 5334,3 thousand units (63,4%).

During crisis period of 2008-2010, the market supported compulsory insurance.

Particularly, the number of compulsory insurance contracts increased in the first half-year 2016 by 24321,6 thousand units (52,5%) due to the growth of traffic accident insurance (vehicle insurance) contracts by 24407,0 thousand units (57,9%). From 2015 until 2016, the segment of compulsory civil liability vehicle insurance showed results of a steady increase.

To some extent, the inflation growth reserve has already been exhausted, therefore, it is important for the analysts of the company to make conclusions and form the budgets of insurance premiums income, it is important to conclude is the bottom reached in reducing the number of concluded contracts whether the process will continue. This uncertainty in budget revenue premiums creates difficulty in forming the operating budget expenditures in practically all areas of the insurance company.

Using traditional budgeting under conditions of such instability is difficult, sometimes impossible. In this context it is worth mentioning the criticisms that had place at different times and by different scientists on traditional budgeting.

Among critics who justify the ineffectiveness of budgeting as a managerial process, US professors Jeremy Hope and Robin Frazer. These authors do not deny the fact that with the help of budgeting as a method, operative financial planning and control over implementation of plans in the largest corporations of the world are carried out. However, the actual research suggests that in many corporations, budgeting, as a process, is causing more and more critical remarks, both from top managers and from the side of budget executives directly to the centers of responsibility.

The main criticisms given by these authors regarding the use of budgeting as a method of financial planning and control can be divided into three areas:

1. Budgeting is a long and expensive management process.
2. Budgeting is not suitable in a modern competitive environment.
3. Budgeting pushes to manipulate figures in financial statements.

In the case of formation sales budgets in insurance companies in crisis conditions, accordingly, budgeting is not suitable in the current competitive environment.

Since 1980, the level of uncertainty has grown in the business environment and the importance of effective corporative management has multiplied. Shareholders demanded a steady increase shares value, and competition increased in all markets due to increased cost of resources and implementation of new information technologies in the companies. Intangible assets of companies such as brand, permanent customers and an effective management team have become a crucial lever of stock price growth. A priority of companies has become ensuring a process of constant renewal through innovation in terms of reducing the duration of the production cycle. The constant trend towards lower prices and reduce margins made the company think about the need for a sharp administrative costs reduction and a management staff reduction. Frequent changes in customer preferences pushed the company to decentralize management so that local managers can quickly respond to them. For these reasons, many companies have introduced simplified budget management systems and began to develop a short perspective plans. So, instead of annual budgets, there were budgets for half a year or even for a quarter; at the same time there were so-called "slippery" budgets, which composed a year with quarterly adjustments.

Table 1 provides a comparative analysis of the management of the insurance company on data of budget and on a non-budget basis (generally, it is called an agreement on relative improvements).

Table 1

Comparative analysis of insurance company management based on budgets and agreements on relative improvement*

| System Parameters | Traditional budgeting | Agreement on relative improvements |
|-------------------|---|--|
| Target tasks | Entirely fixed as at the income level so on the expense level | Possible options (for example, a reduction in insurance premiums leads to a reduction in operating costs or vice versa), but the overall result should be positive |
| Remuneration | It provides rigid fixation (e.g., % of the insurance premium or the fixed salary) | There are a lot of options and combinations, but the condition is the principle that improving of key indicators would increase remuneration, and vice versa |
| Plans | They have the character of clear scheduled tasks | It is very flexible, key indicators are planned with a certain level of variation |
| Resources | Fully booked among divisions | There is an opportunity of rapid change the resource base depending on the changing situation on the insurance market and in the contiguous segments |
| Coordination | Within the fiscal management system with a clearly-defined hierarchy | There are responsible persons, but in general the structure is more horizontal than vertical |
| Controlling | Monthly (quarterly) monitoring of performance of all budgets | Mostly, overall control of the situation within the limits of the indicators, the possibility of operating the changes in income or expenses depending on changes in the external economic environment |

* Composed by authors

When comparing the first and second models, the first is simpler and easier to use. This model has proven itself well in the conditions of traditional manufacturing with standardized products. The complexity of the second model is due to the flexibility and variability. Implementation of the insurance company's second model provides, first of all, the availability of highly skilled staff, which enable to implement functioning of such a model. Implementation of the management model based on the agreement on relative improvements and abroad it has proven itself in the financial sector, which has always been characterized by highly educated staff.

Despite the professionalism of the employees of Ukrainian insurance companies, the overall level of corporate culture remains insufficient for the full implementation of the model of relative improvements. Therefore, we can offer a combination of both approaches. Thus,

the first approach is used to form all administrative budgets and other non-insurance related budgets. This will allow the senior management of the company to have the idea of the necessary financial resources to manage and at the same time to avoid financial abuse from the middle managers. Budgetary tasks related to insurance activities need to be as flexible as possible. It is necessary to abandon the setting of strict targets in the field of sales, according to the specifics of the domestic insurance market (total demand drop due to the financial and economic crisis in the country). An agent or financial consultant who works on a net basis should be able to not sell services for a long time, since its real potential is uncertain and, with the improvement of the market environment, it can bring significant income to the company. The manager must have a budget for sales promotion and a budget for incentives without a clear cost indication. Of course, this approach may lead to finance abusive, but this practice is used in the leading Western insurance companies. It is also necessary to pay attention to the specifics of business, deciding about the configuration of the financial planning system in insurance companies. Thus, for a large retail company, at the current stage of the insurance market development, the elements of the traditional budgeting system will have a greater effect, as it will be very difficult to clarify the strategy and all the system's postulates of relative improvements to a big number of employees (among them are workers without the necessary education). The transition to comparative improvement methods is much simpler for a company with a small number of employees working in the Bancassurance system or concentrating on servicing legal entities.

Conclusions

The current business environment in Ukraine is very unstable and this instability is fully reflected on the insurance market. Overall during the Crisis 2014-2016, the market experienced a significant loss. According to the main criterion - the income of insurance premiums, the market has fallen to the level of 2015 in dollar terms. For insurance companies unable to predict and plan their activities in difficult circumstances. Using of the traditional budgeting methods becomes completely impossible for this. The researching of foreign experience on financial management and the planning of insurance companies' activities allows Ukrainian insurers to apply a combination of traditional budgeting and a method of planning based on relative improvements. This combination involves creating a more flexible financial planning system that allows the insurer to adapt to the rapid changes in the external economic environment. The proportions of traditional budgeting and management based on relative improvement will vary, depending on the scale, specifics and types of economic activity of the insurer. Formation of parameters for the determination of such proportions is the prospect of further research.

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