The Social Sciences 11 (Special Issue 5): 6928-6932, 2016
ISSN: 1818-5800
© Medwell Journals, 2016

Conflict-Compromise Methodology for Resolution of Conflict in Insurance Relations

[1]N.N. Masyuk, [2]L.K. Vasyukova, [3]M.A. Bushueva, [4]N.A. Mosolova and [5]O.V. Kozminykh
[1]Department of Economics and Management,
Vladivostok State University of Economics and Service, Vladivostok, Russia
[2]Department of Finance and Credit, School of Economics and Management,
Far Eastern Federal University, Vladivostok, Russia
[3]Department of Economics, Plekhanov Russian University of Economics,
Ivanovo Branch, Ivanovo, Russia
[4]Department of Economic Theory, School of Economics and Management,
Far Eastern Federal University, Vladivostok, Russia
[5]Departmentof Finance and Credit, School of Economics and Management,
Far Eastern Federal University, Vladivostok, Russia

Abstract: The study explores the essence of insurance in terms of objectives of participants involved in insurance economic relations. These contradictory objectives, together with the dual role of the insurer in the processes of insurance and reinsurance are the fundamental factors influencing the development of the insurance market. The study analyzes the possibility of conflict resolution through the paradigm of conflict-compromise management. The researchers demonstrate the advantages of the conflict-compromise methodology in resolving conflict between the participants of the insurance market. The use of this methodology facilitates elimination of managerial dysfunctions in managing the risk of the policyholder and the insurer through achieving local compromises. The researcher of the study consider the insurance risk model as a logical conjunction of the policyholder's loss risk probability and the size of these losses caused by dangerous fortuitous events. The researcher consider risk prevention and adjustments in insurance rate structure as ways to eliminate contradictions for the benefit of the main insurance market participants.

Key words: Insurance market, insurer, policyholder, conflict-compromise methodology, managerial dysfunction, local compromise

INTRODUCTION

The present situation on the Russian insurance market is a reflection of all the complexities in the current financial market development. The increased concentration of the insurance market due to reducing the number of companies operating in the market has resulted in weakening the competition between the insurers. The insurance sector of the financial market is characterized by weak convergence arising from the information opacity of insurance markets, information asymmetry between the participants of insurance relations, the complexity of the insurance product and its intangible primary form (Belozerov and Pisarenko, 2014).

A quick analysis of the current situation in the Russian insurance market shows growing signs of economic decline. Since 2011, when the reorganization of the Russian insurance market was initiated, its market capitalization has decreased by almost a half. In 2015 the insurance market lost 69 companies and since the beginning of this year another 20 licenses have been revoked. Thousands of insurance contracts have remained unexecuted and bona fide policyholders have not been paid insured loss coverage. In order to tighten state control and supervision over the financial soundness of insurers, the insurance market regulator, the Bank of Russia is developing a set of documents governing the operations and investment activities of insurance companies. In the near future it is planned to tighten the requirements for the minimum ownership capital of Russian insurance companies, transfer the accounts of insurance companies to a new chart of accounts and industry-specific accounting standards, implement new reporting formats, adjust the deductibles

Corresponding Author: N.N. Masyuk, Department of Economics and Management, Vladivostok State University of Economics and Service, Vladivostok, Russia

of all insurance companies according to a number of agreements and establish a state reinsurance organization.

The capital concentration in the insurance market, accumulation of "associated" risks of the policyholder and the insurer will require the development of new approaches in the financial regulation of insurance companies (Nasyrova, 2015). The questions arise whether this will lead to the strengthening of financial soundness of Russian insurance companies and how it will affect the insurance market development.

The insurance market, being an organic part of the market in general has its own significant, or attributive, features (Ostanin, 2005). The main attributive feature of the insurance market is insurance product that is sold and bought in this market. Specific features or differencia specifica, of the insurance market can be revealed through the following essential components that define the economic content of the market:

- Participants of the insurance market, primarily insurers and policyholders
- Objectives of participants of insurance economic relations
- Means of embodiment of economic relations of the parties involved in the insurance market

It is to be recalled here that the key participants of insurance economic relations are the individuals that fulfill in the market their need to acquire insurance coverage against the risk of possible losses of material values or other assets (Vasyukova and Ostanin, 2011).

The objectives of the main participants, the insurer and the policyholder, at the stage of insurance contract conclusion are opposite, because one of them, namely the insurer is the seller of the insurance product while the other one, the policyholder is the buyer. Further, in the course of contract implementation, the insurer enters into a reinsurance contract, acting as the buyer of insurance product. This demonstrates the ambiguity of the insurer's status, since there is internal contradiction between the insurer's desire to reduce payouts to the policyholder and maximize the benefits from reinsuring his own risk. We shall consider in more detail the motivation of each participant of insurance economic relations, paying attention to the possible ways of resolving the above mentioned contradictions.

The general objective for all participants of insurance relations is protection of property interests of the policyholder from the threat of fortuitous events (Gomellya, 2010a, b). At that, the policyholder, buying insurance coverage as a commodity which is sold in the insurance market, transfers to the insurer the risk of material losses which may be incurred by some hazardous events of probabilistic nature. In this context, the policyholder as any purchaser, tends to purchase high quality product for less money. And on this basis the policyholder whose primary purpose is to protect his own property against accidental hazards, builds his behavioral monostrategy. The issues of behavioral monostrategies of policyholders were studied by many researchers (Eeckhoudt, 2012; Forsstedt, 2014).

In addition to the general objective of insurance which involves into economic relations both policyholders and insurers, the insurer also has another objective of his own which is to make profit from his insurance business. Between these objectives there is a contradiction that must be resolved by the participants of insurance relations (Kolomin, 1997).

The contradictions that are found in the objectives of the policyholder and the insurer determine the behavior strategy of the parties involved in insurance relations in the insurance market. For further comprehension of our methodological reasoning let us consider in more detail the process of insurance contract implementation.

The insurer, when selling insurance coverage assumes the risk of material losses in case of hazardous events. For the insurer as for any entity engaged in entrepreneurial activity, the main purpose is to get profit from insurance activities. Therefore, the insurer wants to sell his product at a higher price (Ostanin, 2015). The goal of the insurer to maximize profits from insurance activities is not shared by the policyholder; moreover, it is contrary to his economic interests. The main income of the insurer comes from insurance premiums that the policyholder pays to the insurer in return for taking up the risk. Standard profit is part of any insurance premium payable by the policyholder under insurance contract. Thus, on entering insurance economic relations, the policyholder immediately generates the profit of the insurer by paying the insurance premium, regardless of the quality of the insurance product that he has bought from the insurer.

From the funds received from the policyholder as the insurance premium, the insurer generates actuarial reserves which are the means of materializing the goals of the parties involved in insurance relations (Mack, 2005).

The actuarial reserves are "the insurer's embodied liability for all applicable current contracts" (Vasyukova and Mosolova, 2013). The insurer, generating actuarial reserves and carrying out the payments of claims, commits acts aimed at achieving the main objective of insurance, i.e., protects the property interests of the policyholder. At that, the insurer bears a loss reducing his income, i.e., the insurer experiences a "commercial anti-interest" (Gomellya, 2010). For the insurer, actuarial

reserves are at the same time an investment resource. Investing actuarial reserves in the purchase of real or financial assets, the insurer receives income, thus, achieving his objective to increase profits. Consequently, there is a conflict of interests between the major participants of the insurance market.

MATERIALS AND METHODS

Meanwhile, the insurer, being a party of the insurance market, on the one hand, fulfills the function of the insurance risk acceptance from the policyholder and on the other hand, acts as a buyer of insurance coverage from another insurer in the course of reinsurance. The optimization issues of risk reinsurance model and exposure fee are discussed in the publications of several authors (Tan and Weng, 2012; Boyer and Courtade, 2015). The insurer insures his financial risk of loss which may occur if the losses of the policyholder caused by a dangerous fortuitous event exceed a certain threshold value (Herber, 1979).

In this case, the insurer protects his property interests related to the preservation of standard profit which he has already received as part of the insurance fee paid by the policyholder as well as the preservation of actuarial reserves as an investment resource and his own capital. In other words, the insurer, bearing the property interest of the policyholder during the term of insurance contract, protects his property interests through reinsurance. In this way, the main objective of the insurer, i.e., maximizing profits from insurance activities is supplemented by the general objective of insurance which is obtaining insurance coverage for property interests. This reflects the dual nature of the insurer: accepting the risk of losses from hazardous fortuitous events, the insurer himself becomes the bearer of insurance risk, i.e., financial risk of loss of profit due to the realization of loss risk of the policyholder.

Thus, the insurer simultaneously performs multiple functions in the insurance market he is a risk manager in the risk management system of insurers, financial intermediary, transmitting the insurance risk of the policyholder to the reinsurer and at the same time is a beneficiary of financial risk associated with the loss of his financial soundness in case of an insured event. Garven *et al.* (2014) explain the contradictions occurring between the primary insurer and the reinsurer by information asymmetry arising in the "insurer-reinsurer" relationships.

Therefore, the insurer forms his behavioral polystrategy because he pursues at least two or three conflicting objectives. The emergence of conflicting objectives in the strategy of the insurer is of internal nature and the insurer is trying to change the situation for the better by means of one or another managerial decision. Incorrectly taken decision cause managerial dysfunction which carries further the aggravation of the contradictions and consists "in violation of the functional state of the given system, that is determined by deviations from the set parameters" (Bushueva *et al*., 2014).

The mitigation of these managerial dysfunctions and reduction of their negative consequences can be achieved employing the methodology of conflict-compromise management which is based on the achievement of local compromises between the policyholder and the insurer (Bushueva *et al*., 2013).

Continuing the reasoning within the paradigm of conflict-compromise management, it can be affirmed that managerial dysfunctions also take place in the whole insurance market which today is at low ebb.

The basic paradigm of conflict-compromise management methodology is based on the fact that the arising dysfunctions may be resolved through a local compromise which implies mutual concessions of the parties involved in the relations on order to achieve a balance of interests and to avoid conflict. This means that new kinds of relations emerge among the parties concerned. These new relations are based on the revision of certain goals and parameters of behavioral and functional strategies, namely, marketing, tariff, operating and financial strategy as well as the revision of the "redistributive model" of insurance market performance (Yuldashev and Tsvetkova, 2011).

RESULTS AND DISCUSSION

It is obvious that the insurer as a professional risk manager, has more opportunities to manage risks not only of the policyholder but also his own. Currently, the concept of "the culture of risk" is gradually being formed in the risk management system of insurers which is reflected in the insurance publications (Roeschmann, 2014).

To achieve the main objective of insurance which matches the objective of the policyholder and the insurer in case of reinsurance, it is necessary to make payments of claims as indemnity of losses from occurrence of insured event. But payments of claims are the main expense item of insurers which reduces their profit (Kolomin, 1997). The experts in the field of risk management, overcoming the one-sidedness in understanding risk as "valuation of damage", argue that risk is usually considered as a combination of expected

damage and probability of the expected outcome (Soane *et al*., 2001). Accepting the view of the basic risk model as the "logical conjunction of danger of the realization of an undesirable event and the probability of this danger", the main way to reduce payments of claims consists in reducing the probability of occurrence of insured event or reducing the severity of damages from insured events (Ostanin, 2011). The measures preventing the occurrence of loss event and limiting the amount of damage are a form of realization of the preventive function of insurance which is simply forgotten in today's model of the Russian insurance market development. Currently, the reduction in the amount of payments of claims by the insurer is achieved through ignoring the objectives and interests of insurance policyholders. Returning to the practice of funding the insurance risk prevention by the insurer in order to reduce the probability of occurrence of loss events is the local compromise that will result in implementing a fundamentally new model of economic relations between the insurer and the policyholder. The need for public-private partnership of insurance companies, policyholders and the government for the purpose of investing in the prevention of risks is explored by Kunreuther (2015). Risk managers, who came from the insurance industry, consider prevention of damage as their main mission (Butterworth, 2001). Funding preventive measures will allow the policyholder to consume not only the immaterial form of the insurance product in terms of obligations of the insurer to make compensation for damages in certain cases defined by the contract but also the material form of the insurance product in terms of risk prevention (Vasyukova and Mosolova, 2015).

Another local compromise can be achieved when forming the payment for risk, i.e., insurance premium. Insurance premiums as a source of actuarial reserve formation, are the main financial resource of the insurer. The insurance premium is determined by the usefulness of the insurance product which becomes a commodity on the market and is sold to the policyholder (Dickson and Waters, 1992). However, the insurance rate structure includes loading profit which does not depend on the quality of the insurance product purchased by the policyholder on the market. The policyholder will only be able to determine the quality of the product after the occurrence of loss event and on receiving the payment of claims from the insurer. And even if the product turns out to be of poor quality or simply not useful because the insurer has ignored the insurable interest of the policyholder, the insurer's profit has already been paid. The cost value of the insurance product is determined by the net premium of the insurance rate and the costs of the insurer's policy administration (Mack, 2000). The policyholder is not interested in paying extra expenses in the form of additional premiums which ensure the profitability of the insurer's activity (Vasyukova and Ostanin, 2012). A compromise between the objectives of the insurer and the policyholder in determining the price of insurance product can be achieved only if the cost structure of the insurance product will not include additional premium in the form of loading profit. The policyholder should not satisfy the economic interests of the insurer by means of advance payment of his profit. The insurer should earn profit by operating effectively in the insurance market.

The harmonization of the objectives of the insurance market major participants will inevitably lead to changing the model of the insurance market performance. The elimination of managerial dysfunctions by identifying the causes which generate contradictions as well as search for local compromise will help overcome the crisis in the insurance market.

It will then be possible to understand that the measures of tightening control over individual parameters and performance indicators of the insurer, along with the increase in the cost of insurance products do not contribute to resolution of contradictions in the relations of the main participants of the insurance market. Subsequent repressive control over the participants of insurance relations is quite expensive and as practice shows, ineffective.

CONCLUSION

To eliminate the downfall symptoms of the Russian insurance market it is necessary to overcome the contradictions between the participants of insurance relations. The contradictions in the objectives of the insurer and the policyholder give rise to managerial dysfunctions in the policyholder's insurance risk management and the insurer's financial risk management.

The mitigation of these managerial dysfunctions can be accomplished by employing the methodology of conflict-compromise management which is based on the achievement of local compromises between the policyholder and the insurer. The prevention of insurance risks in order to reduce the probability of occurrence of loss events is a local compromise which results in implementing a fundamentally new model of economic relations between the insurer and policyholder.

If the loading profit which forms the standard profit of the insurer is excluded from the insurance rate structure, it will contribute to overcoming managerial dysfunction in the definition of the policyholder's payment for risk.

REFERENCES

Belozerov, S.A. and Z.H.V. Pisarenko, 2014. Testing Russian insurance market for convergence. Regional Econ., 3: 198-208.

Boyer, M.M. and D.T. Courtade, 2015. The structure of reinsurance contracts. Geneva Papers Risk Insurance Issues Pract., 40: 474-492.

Bushueva, M. A., D.I. Korovin and N.N. Masyuk, 2013. Local compromise as a basis for financial decision-making in a cluster (evidence from textile cluster). Bull. Higher Edu. Institutions Textile Ind. Technol., 6: 35-41.

Bushueva, M.A., N.N. Masyuk and Z.V. Bragina, 2014. Evening-out managerial dysfunctions as a basis of conflict-compromise methodology. Econ. Entrepreneurship, 12: 430-432.

Butterworth, M., 2001. Integrated risk management special interest group. Mastering Risk Concepts, 1: 31-35.

Dickson, D.C.M. and H.R. Waters, 1992. Risk Models. Heriot-Watt University, Edinburgh, Scotland,.

Eeckhoudt, L., 2012. Beyond risk aversion: Why, how and what's next and quest. Geneva Risk Insurance Rev., 37: 141-155.

Forsstedt, S., 2014. Asymmetric Information on risky behaviour: Evidence from the automobile insurance market. Geneva Papers Risk Insurance Issues Pract., 39: 104-145.

Garven, J.R., J.I. Hilliard and M.F. Grace, 2014. Adverse selection in reinsurance markets. Geneva Risk Insurance Rev., 39: 222-253.

Gomellya, V.B., 2010a. Essays on Economic Theory of Insurance. Finansy I Statistika Izdatelstvo, Moscow, Russia,.

Gomellya, V.B., 2010b. Insurance. Market DS Publishing, Moscow, Russia,.

Herber, H.U., 1979. An Introduction to Mathematical Risk Theory. University of Pennsylvania, Philadelphia, Pennsylvania,.

Kolomin, E.V., 1997. Economics and psychology of insurance. Financial Newspaper, 2: 27-33.

Kunreuther, H., 2015. The role of insurance in reducing losses from extreme events: The need for public-private partnerships. Geneva Papers Risk Insurance Issues Pract., 40: 741-762.

Mack, T., 2000. Credible claims reserves: The Benktander method. Astin Bull., 30: 333-347.

Mack, T., 2005. Mathematics of Risk Insurance. ZAO Olimp-Business Publisher, Moscow, Russia,.

Nasyrova, G.A., 2015. Regulation of insurance company's performance on the basis of prudential approach. Effective Anti Crisis Manage., 4: 60-68.

Ostanin, V.A., 2005. Will in the Structure of Sense. Vladivostok Branch of the Russian Customs Academy, Vladivostok, Russia,.

Ostanin, V.A., 2015. Insurance in terms of providing economic security of commercial enterprises. Customs Policy Russia Far East, 3: 80-86.

Roeschmann, A.Z., 2014. Risk culture: What it is and how it affects an insurer's risk management. Risk Manage. Insurance Rev., 17: 277-296.

Soane, E., F.O.M. Nreevy, N. Nicholson and P. Willman, 2001. Psychological theory and financial institutions: Individual and organisational influences on decision-making and behavior. Mastering Risk Concepts, 1: 36-40.

Tan, K.S. and C. Weng, 2012. Enhancing insurer value using reinsurance and Value-at-Risk criterion. Geneva Risk Insurance Rev., 37: 109-140.

Vasyukova, L.K. and N.A. Mosolova, 2013. The mechanism of actuarial reserves formation as means of improving the efficiency of the insurance market performance. Russian Entrepreneurship, 15: 96-108.

Vasyukova, L.K. and N.A. Mosolova, 2015. On key risks in the Russian insurance market. Issues Econ. Manage., 9: 72-77.

Vasyukova, L.K. and V.A. Ostanin, 2011. Methodological approaches to insight into insurance. Bull. Khabarovsk State Acad. Econ. Manage., 6: 35-37.

Yuldashev, R.T. and L.I. Tsvetkova, 2011. Practice of Insurance Business Development a Handbook for Insurance Company Owners and Managers. Ankil Publisher, Moscow, Russia.