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OWNERSHIP TRANSFORMATION OF INSURANCE SECTOR IN THE REGION OF CENTRAL AND EASTERN EUROPE FOR THE PERIOD OF CRISIS

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Abstract: *Restructuring process refers to numerous activities by which insurance sector changes the existing ownership structure and business strategies in order to maximize the profits and improve business efficiency. Since in insurance sector in Central and Eastern Europe there occur changes, due to turbulent business environment, insurance companies, in order to survive in the market resort to the startegy of adaptation. The aim of this paper is to present the process of ownership transformation in the region of Central and Eastern Europe for the period of economic crisis, as well as to point to the fact that the growing share of foreign ownership in insurance sector has affected the recomposition of market structure, as well as growth of its share in the achieved insurance premium in the region.*

Keywords: *insurance sector, ownership transformation, countries of Central and Eastern Europe, economic crisis.*

1. INTRODUCTION

In developed financial systems, in a turbulent business environment, there comes to changes on daily basis which force financial institutions to rapidly adapt to the situation occurred. Since the subject of analysis in the paper is the insurance sector, the majority owners of the share package can be the state (or other form of collective property), foreign or national investors. The experiences of the countries that have gone through the transition show that there are differences in the level of business efficiency among the propriety types of ownership. According to the definition, private capital is primarily related to the increase of the manufacturer's surplus (realization of profit maximization), while that is not the case with state property. In addition, corporations in state, or other form of collective property, in addition to profit maximization, also have the aim to increase consumer's surplus. The practice has shown that by withdrawing the state from financial sector, the space for political interventions is reduced and the space for affirmation of responsable and competent management and competition strengthening is opened. [Shirley &Walsh, 2001]

In the beginning of the financial system restructuring process in the region of Centrala nd Eastern Europe there was recorded the domination of financial institutions with major state property. In addition, it was noticed that domestic owner (usually the state) has not taken adequate care of its property, which resulted in the change of onwership structure and increase of the share of foreign investors in financial sector of the region of Central and Eastern Europe. In one number of economic systems, particularly in cases of countries (all the countries) in region, we can observe the tendency to reduce the share of state financial institutions in the system, which is a consequence of: opening the national financial market for domestic and foreign private capital, extinguishing of the corporations burdened with losses in state property and implementation of privatization policy.

The adoption of these new Laws on insurance has initiated big changes in countries of Central and Eastern Europe and there were created the conditions for the arrival of foreign insurance companies to this market. The countries with a developed insurance market are for years now considered protected and thus big insurance companies search for new, primarily undeveloped markets. Region of Central and Eastern Europe provides the foreign investors a possibility of insurance development primarily due to low insurance premium per capita (insurance density) and low share of gross premium in gross domestic product (insurance penetration). Additionally, as the insurance premium per capita is lower and the share of gross premium in gross domestic product as well, the market is less developed and thus it is more interesting to the foreign companies. In addition to these two crucial motives, there is a series of criteria due to which foreign insurance companies decide to enter the new market: realization of profits, possibility of a monopolistic position, risk diversification, economy of scope (greater scope of production implies a lower price per unit), using the resources of the country that is being arrived at (land, employees, raw materials, technology).

2. OWNERSHIP RESTRUCTURING – THEORETICAL PRESENTATION

Restructuring process, as a constituent lement of transition refers to a great number of activities that change the existing ownership structure and business strategies in order to: maximize the profits, improve the business efficiency, create synergy 9additional value), company's growth (long-term increase of the company's size), increase of business activities, savings of costs, business risk reduction, entering to new markets, improvements in management of the company. The terms merger and consolidation are often used as synonyms, although there are certain differences in their meaning. Merger in financial sector occurs when an institution that is an integrated legal entity ceases to exist, while the corporation that executed the integration takes the property over, as well as the obligations of the company taken. On the other hand, consolidation (joining, merging) is aprocedure by which an entire property of one or several institutions is passed onto the new entity (C) voluntarily, where previous corporations (A and B) legally cease to exist. A s aresult of consolidation we have: A+B = C

Acquisition is a term that refers to finding new jobs, purchase of the assets, acquisition of ownership share in other companies (B) and the like. As a result of acquisition we have: A+B = A

Berger [2007, 2007a] lists the advantages and disadvantages regarding the entrance of foreign financial institutions to new markets. Some of the comparative advantages are:

- Multinational activities of financial institutions in foreign ownership provide them to diversify the risks to several regions in which they do business and thus reduce the risk management costs.
- Financial institutions follow main corporate clients and found affiliations in countries where their clients extend business activities.
- It was shown that geographic diversification of multinational financial institutions contributes to the improvement of success and efficiency of business.
- Financial institutions from developed countries that enter the markets of developing countries are better in giving the loans based on information that are based on high quality and confidential information, as a result of their competence and economy of scope.
- When financial institutions from developed countries enter the developing countries, the transfer of capital, knowledge and experience of the best practice is enabled.

On the other hand, Berger [2007, 2007a] lists disadvantages in the aspect of efficiency of financial institutions in foreign ownership:

- Economic environment that has been significantly different in relation to home country can increase the management costs and reduce the business efficiency.
- Multinational companies give advantage to national financial institutions for certain types of services.
- If important decisions are made in the headquarters of a financial institution, which is rather remote in relation to the local one, this can cause the reduction of business efficiency.

Very often the issue of justification of foreign investors' entrance to insurance market in financially undeveloped countries is brought about [Dimić & Barjaktarović, 2017]. According to previous studies, there are several key advantages: development of life insurance, improvement of corporate management and risk management in business, improvement of service quality, introduction of new and high quality service packages, increase of health competition, strengthening of transparency in business, transfer of technological and managerial know-how, external funding sources.

We should not neglect the fact that foreign investors, when entering a new insurance market, are faced with a series of contraining factors: undeveloped financial market, limits in presentation of new funds, big founding stakes in relation to European Union, low insurance culture and lack of confidence of the citizens in insurance institution. In addition, the inflow of foreign investments also depends on financial stability of a country and its credit rating, inflation and exchange rate movement [Dimić, 2015].

Insurance companies with foreign ownership can increase the efficiency of local insurance market by providing high quality service of insurance, place new products and develop technological and managerial skills of business. Risk taking and making investment decision, based on international experience of insurer, can send useful signals to the market for efficient distribution of funds. Foreign insurance companies gain in market and financial strength in the region of Central and Eastern Europe which contributes to the improvement of financial situation of an individual, household and corporations.

The advantages of liberalization are numerous [Skipper, 1997]. However, many authors warn that excessive liberalization of insurance market can potentially cause domination of foreign investors (which happened in some countries of Central and Eastern Europe that are the subject of this analysis). Although Slovenia is not the subject of our study, we will point it out as a country that has managed to build a stable insurance sector (primarily in life insurance segment) and therefore avoided the domination of foreign capital (which has a share of 8%).

3. OWNERSHIP TRANSFORMATION IN FINANCIAL SECTOR OF EUROPE

In the last three decades, until the outbreak of economic crisis, in the global financial market (in the end of 2008) there was present the trend aimed at consolidation of financial markets. Global phenomena, technological innovations, liberalization, as well as deregulation of market were the factors that facilitated the process of mergin and joining the financial sector.

In Europe, this process was followed by the efforts to establish a unique financial market, with the aim to improve productivity and efficiency of the market. Moreover, during the last decade, financial sector of European Union was faced with the challenges of consolidation and integration of new member countries. There were two factors that affected the acceleration of the consolidation process of financial institutions in Europe. The first factor was the introduction of euro as a common currency, which contributed further integration of European financial markets. The second factor is new Basel Agreement, which motivated financial institutions to perform a more adequate capital formation and achieve greater economy of scope in business in order to strengthen their competitive positions in the market [Mašić, 2009].

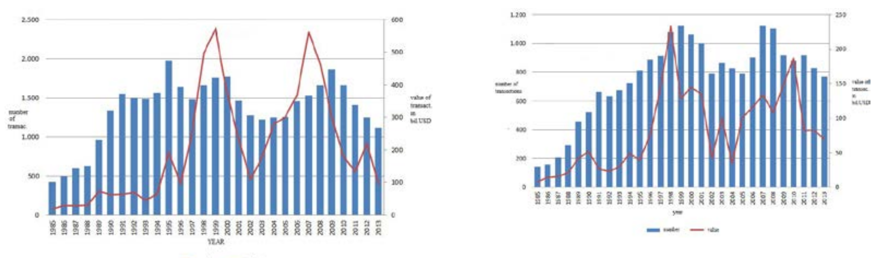

Fig. 1: Mergers and acquisitions in insurance sector in the worlds (banking sector, left side of the graph; insurance sector, right side of the graph)

Source: Made according to Institute of mergers, acquisitions and alliances (IMAA Institute), Statistics

When it comes to the restructuring of baniking sector in Europe, in the period from 1990 to 2005, the value of mergers and acquisitions has reached 794 billion USD (graph 2), where the highest value is recorded in 1999. (153 billion USD).

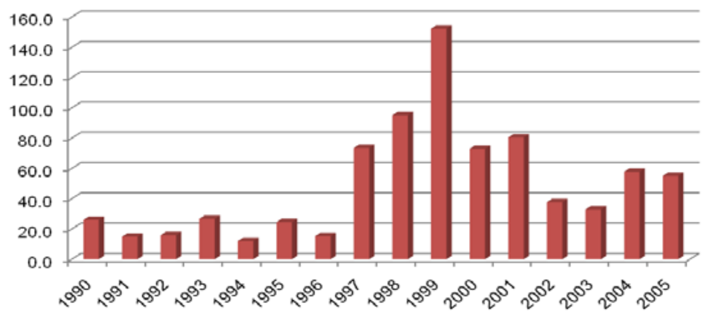

Fig. 2: Value of mergers and acquisitions in banking sector of Europe, in billions of USD

Source: Made according to Fritsch M., Gleisner F., Holzhauser M., Bank M&A in CEE, pp. 20

Just before the escalating of economic crisis, the level of mergers and acquisitions in European banking sector in 2008 has reached the level from 1999. Only a year later, there was noticed a dropping trend of investments in European banking sector which is continued until the end of 2012 when there were recorded five times less investments in comparison to the year 2008 although the number of transformations in banking sector was increased from 38 in 2011 to 51 in 2012 (graph 3).

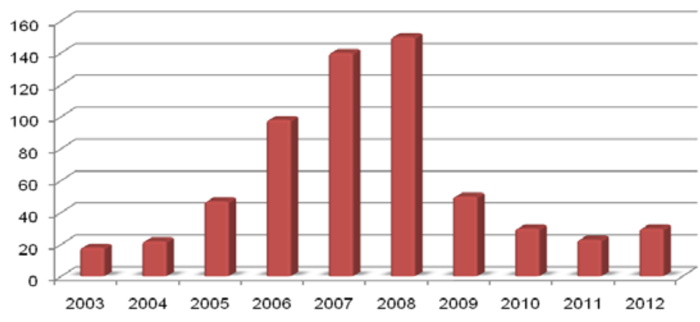

Fig 3: Mergers and acquisitions in European banking sector in the period 2003-2012. (in billion EUR)

Source: Made according to PricewaterhouseCoopers: European Financial Services M&A news and views, March 2013

After no so successful 2011., in Eurozone in 2012, the level of foreign investments was by 35% higher in relation to 2011. However, even four member countries of European Union have participated in rescuing financial institutions as lender of last resort. Thus Spanish Government in the first half of the year 2012 has prevented the bankruptcy of the bank Bankia with 4.5 billion EUR. In the second half of the year 2012, Belgium and France have intervened in Dexia, Spain in Banco de Valensia, Cyprus in Cyprus Popular Bank and Italy in Gruppo Sace&Simest. If we exclude these inflows of stocks, value of the investments of private sector in 2012 would be about 31 billion EUR, which is the lowest recorded level of foreign investments in previous ten years, 7% less in comparison to the year 2011. and only 15% of share in 2007. [PwC,2013]

Table 1: Interventions of the countries of European Union in rescuing financial sector

Period	Government	Institution that needs financial aid	Value (in billion EUR)
1H2012	Spain	Bankia	4,5
2H2012	Belgium and France	Dexia	5,5
2H2012	Spain	Banco de Valencia	4,5
2H2012	Cyprus	Cyprus Popular Bank	1,8
2H2012	Italy	Gruppo Sace&Simest	3,8

Source: Pricewaterhouse Coopers: European Financial Services M&A news and views, March 2013

Of the total of 51 billion EUR of the achieved transactions in European financial sector, in the year 2012, top 20 financial transactions have with 41,6 billion EUR made more than 80% of the total transactions. The greatest number of mergers and acqisitions in the year 2012 were executed in the banking sector. It is interesting to mention that in the top 5 financial transactions in Europe there were three banks, one leasing and one insurance company. In that way, the second place, right after the acquisition of the leasing company RBS Aviation Capital (with 5,5 billion EUR) was taken by the Governments of Belgium and France that have taken over the ownership of the Dexia group last year in November. The third and the fourth position are occupied by the Government of Spain which has taken the ownership of Banco de Valensia and 45% of ownership of Bankia with 4,5 billion EUR each, while the fifth place is occupied by financial institution Cassa Depositi e Prestiti which has taken over 76% of ownership over the insurance company Gruppo Sace, Simest for 3,8 billion EUR.

4. PRIVATIZATION PROCESS OF INSURANCE COMPANIES IN THE COUNTRIES OF CENTRAL AND EASTERN EUROPE

The process of privatization of insurance companies in the region was carried out differently in the analyzed countries (Serbia, Croatia, Bosnia and Herzegovina, Montenegro, Macedonia, Romania, Bulgaria and Albania). In that way, Croatia and Serbia have carefully entered this process and retained the ownership of the national insurance companies, which was not the case in Montenegro and Macedonia [Dimić, 2015].

The share of foreign ownership in insurance premium above 80%, in the period 2007-

2012, in insurance market was recorded in Macednoa, Romania and Montenegro, which is a consequence of privatization of the national insurance companies. Thus, in Macednoa and Montenegro, insurance companies with national ownership have a share of 15%, mainly in the segment of non-life insurance.

In Serbia the share of insurance companies with national capital in the total premium from 2007, when it was 41,4%, records a continuous drop, so in the end of 2012 it was only 25%. In ownership structure of insurance companies since the World War II until 2007 there dominated national majority capital. With the privatization of DDOR Novi Sad (second by the size insurance company according to the achieved insurance premium), which was in major social ownership, by the insurance group Fondiaria Sai, insurance sector in Serbia has transferred into major foreign ownership.

In the last few years in domestic insurance market there can be felt a strong impact of foreign insurance companies (such as Generali, Uniqa, Triglav and Fondiaria Sai) which have entered the domicile insurance market through portfolio investments, i.e. purchase of majority share packages of the existing insurance companies.

Table 2: Privatization of insurance companies in domicile insurance market

Company	Buyer	Package	Selling price (in EUR)
Delta insurance	Generali	50%+1 share	30 million
Zepter	Uniqa	>80% capital	16 million (with the possibility of price revision after a few years)
Kopaonik	Triglav	95% capital	17,5 million
DDOR	Fondiaria Sai	96% capital	240 million

Source: National Bank of Serbia

Having in mind that in the year 2012 the share of Dunav insurance in the insurance market in Serbia was above 30%, if the Government of Serbia made the decision to sell this insurance company and if (which is more likely) it would be bought with foreign capital, there would be no reasons to mention domestic capital in insuranec activity since that share would be reduced to a few percents only [Smiljanić, 2013]. From 2004. Until the end of 2012., in Serbia there was even 13 foreign insurance companies (last among them was Gasprom insurance). With the successful process of privatization in the past period, as well as entering to the market of foreign companies by obtaining greenfield licenses, insurance companies in foreign ownership in 2012 record, starting from the year 2007, a prevailing share in the premium of life insurance with 90,8%, premium of non-life insurance with 57,6%, total property with 68,8% and the number of employees with 65,5% [NBS, 2012]. At the moment, there is no one interested to enter the domicile insurance market. Explanation for such a situation we can find in negative effects of the crisis that caused the slowdown of economy in the region, as well as in the assumption that Serbian market at the moment is not particularly interesting to foreign insurers (graph 4).

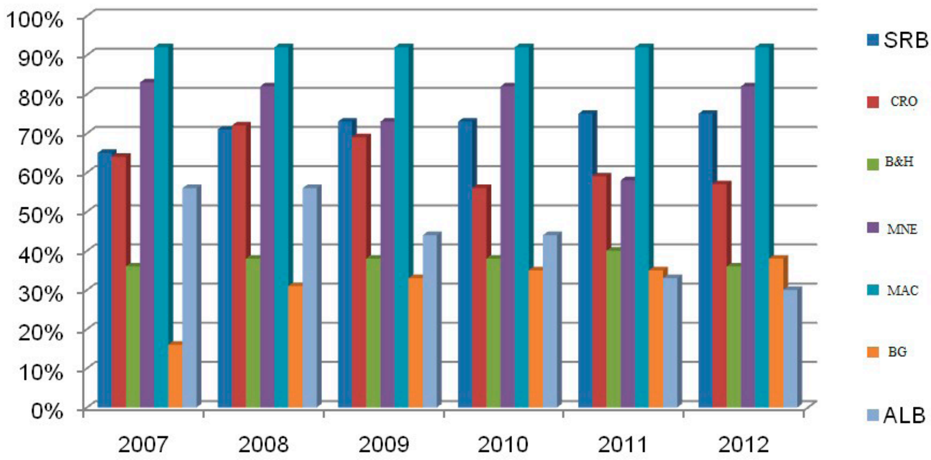

Fig.4: Market share of insurance companies in majority foreign ownership in countries of Central and Eastern Europe

Source: Websites of Central banks of the countries of Central and Eastern Europe

In Croatian insurance market in the period observed there were no greater deviations, and thus the relation of foreign towards domestic capital in 2012 was close to the one from 2007 (about 40%). Croatian insurance market is specific by the fact that in addition to a higher market share of insurance companies in majority foreign ownership, domestic insurance companies in the period observed manage to keep a greater share in total capital or, however, to be equalized with foreign investors. The greatest individual share is achieved by insurance company in majority state ownership Croatia insurance (31%).

When it comes to the insurance market in Bosnia and Herzegovina, in the period observed there were no oscillations recorded when it comes to market share of insurance companies in majority foreign ownership (up to 40%). Statistical data confirm that insurance companies with domestic ownership are more dominant in number in the market. In addition, this group of insurers records a growing trend of shares in insurance premium (with an exception in 2008 and 2011).

In Montenegro in the market there dominate insurance companies in majority foreign ownership with a market share above 80% and the share in capital higher than 65% (with an exception of the year 2007.).

The greatest market share of insurance companies in majority foreign ownership was recorded in Macedonia (92%) and it was not changed in the period observed. Of the total of 12 insurance companies, only one insurance company in domestic ownership with the recorded share in the capital which was in the range from 16,5% to 25,0%.

Romanian insurance market was in the group of analyzed countries the most developed since it includes about 40 insurance companies. The highest market share of insurance companies in foreign ownership was recorded in 2010 (twice as in comparison to the year 2007), as well as share in capital which was above 90%.

Market share of insurance companies in majority foreign ownership in Bulgaria was in comparison to the year 2007 doubled in 2008. (31%) where the growing trend is recorded until the end of the period analyzed.

In Albanian insurance market in the period 2007-2008. There was present a dominant share of domestic insurers according to the criterion share in capital (above 80%), while market share of this group of insurers was approximately equalized with the share of foreign investors. In 2009. one insurance company in majority foreign ownership exits the market, which has caused the reduction of market share to 44%, while on the other hand the share in capital was increased by almost 4 times (to the level of 75%). Until the end of 2012, with the reduction of market share of insurance companies in majority foreign ownership, there is a growing trend of share in capital.

In scientific references there are divided attitudes when it comes to ownership transformation in financial sector. Thus one group of authors believe that high share of foreign ownership in total balance sum and insurance premium (or capital) can represent a great problem to the development of economy in the analyzed region of Centrala nd Eastern Europe. In addition to the growth of concentration level caused by merging of financial institutions, it is reqied to monitor the concentration level of each financial institution individually, as well as „mother" companies that affect the business policy of financial institutions in region through the administration and supervisory board. On the other hand, group of authors concludes that entrance of foreign insurance companies to financial market of the analyzed region has a positive effect on competition. In that context, entrance of foreign financial investors increases competition pressures (because it carries along new technologies and new knowledge) to the domestic financial system. Taking that into consideration, it is no wonder that in the last twenty years the share of foreign ownership in insurance sector was increased in the region analyzed. Although the increase of market concentration is the most frequent sign of dropping intensity of competitiveness, some studies [Beck et al., 2003] point out that greater presence of foreign financial mediators mitigates negative aspects of greater market concentration.

We predict that in the next years there will come to more significant changes in insurance market in analyzed countries in the region of Central and Eastern Europe when it comes to concentration level. However, there remains the question whether big foreign insurance groups will decide to enter domestic markets, through mergers or acquisition of insurance companies in majority domestic ownership or they will resort to the strategy of enlargement, by merging with other insurance companies in order to strengthen their market position? Higher concentration level in insurance market in analyzed countries of the region (in relation to banking sector) is a consequence of market development in the past and significant role of big social and state companies, as well as market size, since there is no space for development of a great number of insurance companies. Since the countries with lower share of premium per capita, as well as lower share of premium in GDP can achieve a more rapid growth and thus encourage the development of financial sector, we can expect for the insurance market in the following period to have a potential to develop.

5. CONCLUSION

In case of all countries analyzed in the region of Central and Eastern Europe in the period observed we have determined that the share of insurance companies in majority foreign ownership in premium/capital was by many times higher (even up to ten times) in relation to domestic insurance companies. Thus:

- In Serbia there were seven insurance companies in domestic ownership in the market in this period, which have a market share of about 25% and share in insurance premium about 30%.
- In Croatia, market share as well as share in insurer's capital in domestic and foreign ownership is almost equalized in the period 2010-2012.
- In Bosnia and Herzegovina, more present in the market are domestic insurance companies with market share above 60%, while according to the criteria of share in insurance premium, foreign and domestic insurers are equalized.
- In Montenegro, the insurance companies in majority foreign ownership ae dominant in the market and their market share, as well as share in capital exceeds 80%.
- In Macedonia in the period observed there were no changes when it comes to the number of insurance companies. In that way, in this insurance market of the total number of twelve insurance companies, even eleven were in majority foreign ownership with a share in capital above 80% (the exception is the year 2007.).
- In Romania, the insurance companies in majority foreign ownership are dominant in the market with a market share as well as share in capital of 80%.
- In Bulgaria, the situation is different having in mind that domestic insurance companies have 2/3 of market share.
- In Albania up to the year 2010, the number of domestic and foreign insurance companies was equal, where in the year 2009 there was expressed three times higher share in capital in case of insurance companies that are in majority foreign ownership. Albania is an example from the practice that shows that, although market share of foreign insurers is reduced, insurance companies in majority foreign ownership realize a greater share in the capital in relation to domestic insurers.

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