Mutual Insurance of Transport Infrastructure Construction Risks as an Inherent Part of Competitive Environment

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 Abstract:

In this article we introduce mutual insurance as an inherent part of competitive environment in the field of insurance of the transport infrastructure construction risks.

The competitive environment makes a great impact on the market behavior of the actors. The monopolization creates the environment, which does not prevent the negative steps of the firm in different directions.

The article shows, that mutual insurance is a significant factor which can prevent the monopolization of the insurance market. This is a specific factor that is inherent only to this kind of the market.

The competitive advantages of the mutual insurance organizations, their attractiveness to the clients (the insured) are conditioned with the specific relations between the insured and the insurance organization, such as the decision of the main questions of the financial activity of the insurer on the meeting of all the insured or their representatives, the possibility to insure the risks, which the commercial insurers do not insure and some others.

Keywords: Competition, competition environment, mutual insurance, insurance market, transport infrastructure constructions' risks.

JEL Classification Codes: G22, L74, H54, D41, D40.

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1. Introduction

In this article we introduce mutual insurance as an inherent part of competitive environment in the field of transport infrastructure construction risks insurance. Acting entrepreneurs in the field of insurance of transport infrastructure constructing risks defend their goals from the inevitable conflicts of interest posed by rivals via mutual challenges, threats, and risks. Therefore, each of them is ought to develop a unique form of competition communication with the opponents. Inquiry to the ordering of the fundamental ideas about companies' participation in competition is determined by an outstanding motivating conditions related to insurance. Despite mutual insurance have become the subject of numerous studies (Grijpstra, 2011; Logvinova, 2009; 2010; 2015; 2017; Mohd Kassim, 2012; Patel, 2012; Safuanov, 2009; Sherstiuk, 2017; Janova, 2017), research in participation of companies in competition that could entail mutual insurance consequents has yet been relatively silent. However, it should be noted, that risks belong to core identity of the competition process, as an art of interactions between rival companies. So mutual insurance reality could become inevitable outcome of rival's activity to mitigating risks.

The construction is one of the most capital-intensive fields of business activity. And transport infrastructure construction probably one of the most capital-intensive parts of construction business. At the same time this activity is connected with the variety of risks which can bring a sizeable disbenefit.

In their activity the construction firm have the risks of personal injury, entrepreneurial, financial, innovative, ecological risks etc. The construction risks always have a considerable volume and exist on all stages of the realization of construction project. Generally, this kind of risks include the technical risks, risks of third-part liability in the process of construction, risks connected with the low-quality contract execution.

In connection with this the insurance is very important to the construction firms. And as they pay a lot for the insurance, they are very much interested in the possibility to reduce the amount of insurance premium saving the level of quality of insurance. As it is known the competitive environment plays a big role in the formation of the level of the prices.

2. Materials and method

Competition is being studied now in various fields. It has become a special part of discussions in classic economic science building since Adam Smith's famous line about the invisible hand. In the twentieth century the theme of competition between market actors also gradually became the object of research attention in the study of management, entrepreneurship, sociology, psychology, political science. In the first half of the twentieth century, the image of competition as a set of actions taken by market participants began to develop. The need for research on patterns of competition

actions was been noted by Schumpeter (Schumpeter, 1950). Later, the perception of competition as a process of continuously performed competition actions that keep the market moving, creating advantages for some companies and depriving them to others, became typical for publications and helped to develop a traditional framework for the field of economics (Jacobson 1992), marketing, management and entrepreneurship.

The concepts of competition actions and competitive advantages were developed at M. Porter's Center for the Study of Competition (Porter, 1980; 1985; 1986). Porter used the term "competitive action" to describe the process of applying competitive advantages of the company and transforming them into competition results. The literature has referenced the structuring of competition (competitive) actions on "action and response" (Chen and Miller, 1994; Chen, 1996; Smith, 1991), formulated approaches to selecting the types of competitive actions to be taken (Nokelainen, 2010), functional characteristics of their classification (Ferrier, 2001), competition tactics in marketing wars (Rice and Trout, 2000) and in communication between partners in a competitive environment (Brandenburger and Nalebuff, 1995), the typology of competitive actions according to the criterion of belonging to a particular unofficial community of competitors (Hannan and Freeman, 1977; Geroski 2001; Yudanov, 2001), types of firms (Man *et al.,* 2002), industries (Turgay and Emeagwali, 2012; Emeagwali and Calicioglu, 2014), and the role of competitive action in the dynamics of creating competitive advantages (Chen and Miller, 2012).

Porter also conducted the first detailed study on competition strategy. While its range was limited to competition actions themselves, this study provided subsequent authors with a foundation for considering the tactics of competition actions and situation-specific actions as a unique platform of constructive theory of competition (Rubin, 2017b).

A typical landscape of competition activity and comprehensive view on actor's day-to-day participation in competition process is formed by various competition strategies, tactical models and operations, and situation-specific actions as well as the focus of competition actions on results, resources, and business processes. At the present day, competitive dynamics researchers are generally of the opinion that the fundamental basis of strategic management discipline hinges on the dynamics of action-response based competitive interactions (Chen and Miller, 2012).

So all actors exist in the conditions of competition. Their day-to-day activity is made under the influence of the participation in competition process. In the economic science competition is recognized as a strong instrument against monopolism The competitive environment characterized by the presence of monopolists give the letter a possibility to rise prices without improving the products. This processes of competition taking place in different markets have some common features, but also have some peculiarities. We suggest to analyze the peculiarities of the formation of the competitive environment in the insurance market.

In our opinion the main peculiarity of this market is the existence two different methods of insurance products' creation. We determine method of insurance products' creation (*further –IPC)* as the relations between the actors that determine the way of formation of the fund of material resources, which will be used as an insurance fund, and the way of separation of the insurance products for the insured (Logvinova, 2010).

In the modern insurance markets of the states with the evolutional development (not the revolutional development as it took place in Russia) of economic as a whole and of the insurance market in particular, we can see two methods of IPC – method of mutual insurance and method of commercial insurance. Subsequently one can differ two types of the insurance organizations - mutual insurance organizations (they use the method of mutual insurance) and commercial insurance organizations (they use the method of commercial insurance).

The essence of this method is the following: each insured for the insurance of his material interests join his own financial resources with the resources of the other insured, who also want to insure his material interest. They join on the bases of the agreement between the participants that they join their resource for creating the insurance defense for themselves. The right of possession of every insured to the resources given to the fund transformed into the right of common property of all the participants to the resources of the fund. This conditioned the right of every member of the fund to take part together with the other insured in this fund to take part in the formation, management and disposal of the fund, and also his solidary liability together with the other members for the fulfillment of the insurance obligations (Logvinova, 2010).

In the far 1925 Russian scientist professor Voblij K.G. wrote, that in the field of insurance the entrepreneurs are not able to create monopoly, because the ensured can create the insurer by themselvs, they can create mutual insurance organization (Voblij, 1993).

The illustration to this statement can be found in the history of insurance in different countries. For example, in the year 1719 in Great Britain was adopted a law which gave two commercial insurers the monopoly right for marine insurance, and they increased insurance tariff. But the ship owners refused to buy insurance policies of these companies and created mutual insurance organization. The authorities had to reverse a law about the monopoly of that commercial firms (Logvinova, 2010).

In the history of Russia the examples about the antimonopoly backlash of mutual insurance also can be found. In the year 1875 eight commercial insurance societies made convention about the prices of insurance against fire and increased them for one third. In answer for this the house owners began to create mutual insurance societies against fire in different cities and towns. As a result the commercial insurers had to low their prices (Logvinova, 2009).

In connection with the existence of two methods of IPC it is possible to differ several varieties of competition in the insurance market. The outstanding Russian scientist Raiher (1993) in the middle of the XX century differed the following varieties (calling methods of IPC as "organizational forms of insurance"):

1. competition inside one and the same organizational form of insurance (for instance, competition between the commercial insurance companies);
2. competition between different forms of insurance (for instance, between commercial and mutual insurance) (Raiher, 1993).

The list made by Raiher can be added and modified according the types of insurance organizations which are present now on the developed insurance markets:

1. competition between commercial insurance organizations;
2. competition between mutual insurance organizations;
3. competition between commercial and mutual insurance organizations (Logvinova, 2010).

The competence between commercial and mutual insurance organizations took place in Russia in the years 1831-1917, when mutual insurance successfully developed in different forms simultaneously with the commercial. But then the fundamental economic changes took place in the economy of Russia in 1917, and competition in the field of insurance was liquidated. The participation in competition could be identified as a system of professional engagement and interactions of the actors in any kind of activity (economic, science, sport, creativity, domestic etc.) with the rivals, which includes the influence on the rivals, counteraction and collaboration within competitive environment, and consists of concrete actions of each of rival towards each other (Rubin, 2017b).

According to this approach we can consider commercial and mutual insurance organizations not only as the rivals, but also as the partners. They can not only oppose each other, but also collaborate on the mutually beneficial basis. For instance, mutual insurers reinsure their risks in the commercial insurance organizations, as a rule. In the modern insurance market of Russian Federation as a whole (including the segment of construction risks insurance) the second and the third of mentioned above varieties of competition do not exist. All the insurance organizations in this market are commercial. Here exists the competition only between commercial insurers, because mutual insurance organizations (in RF the law permits only one organizational form of this kind of them mutual insurance society - MIS) have very small scale of activity and don't compete with the commercial insurers.
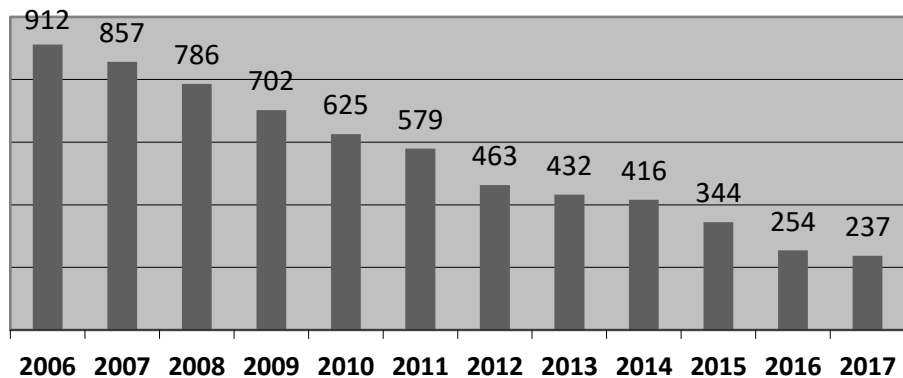
3. Results

In Russian Federation the insurance of construction risks began in the 70-s of the XX century. From that time till 1995 the insurance as a whole was the monopoly of the

state and there was now competition in this field. First insurance companies limited by shares, which began to insure the risks of construction, appeared in 1995. From the year 2002 they had very good conditions for development at that time, as the legislation permitted to the construction firms subsume all the expenses for the insurance to the cost of production. This situation took place till the year 2014, when the Ministry of Construction of Russian Federation canceled such possibility. Now the construction firms cannot include the expenses for the insurance in the cost sheet of the construction of any building unite. And the firms often don't want to spend their own money for the insurance which costs a lot.

One of the main reasons for existence of high prices for the insurance of the construction risks as a whole, and of the risks of transport infrastructure construction in particular, is the non-developed competitive environment in this field. The competitive situation in this local field is the reflection of the situation on the insurance market of Russian Federation. From year to year the number of the participants of the competence on this market reduces and the market share of each of the remained firm increases. It is possible to say about the tendency of limitation of competition because of formation of large universal insurance firms – leaders of the market.

Thus, according to the Central Bank of RF, the number of insurance organizations on the national market reduced during the last 11 years for 675 entities that is for 74%. At the end of 2017 there were 237 insurance organizations in Russia (fig.1).

Figure. 1. *The number of insurance organizations in Russia (by year)*

This reduction is the result of the impact of the following factors:

1. revocation of a considerable number of licenses for the insurance activity in connection with the requirement strengthening from the side of regulative and supervisory authorities;
2. persistent excess the number of revoked licenses over the number of released licenses;

3. mergers and acquisitions of the insurance companies and also joining them in the insurance groups;

4. complex struggle of the authorities with the co-called "pseudo-insurance schemes" (Tulentyi D., 2008), that is the operations aimed not at the creation of the insurance products, but at the optimization of tax, withdrawal of the financial resources from the company, embezzlement of the budget resources.

Because of the factors mentioned above the insurance market of Russian Federation considered by the specialists as concentration-prone. It is expected further reduction of the number of the insurance companies, that may in the long-term perspective form the situation when there will be only several dozens of huge insurers acting all over the country. The regulative and supervised authorities of Russian Federation consider such situation as positive (Central Bank of RF, 2017). In their opinion the reduction of the number of the insurance organizations on the market will give a possibility to make organization monitoring and audit more detailed. They are not afraid that several huge insurance organizations will be able to receive the monopole power.

Let's analyze the level of concentration in the market of construction risks insurance on the bases of the data about the number of the insurance organizations in the market of RF and the quantity of the insurance premium gathered by them (Table 1).

For this purpose can be used come indicators, which usually applied for the analyses of the product market. One of the most frequently used indicators is the market concentrated index (CR) (Rubin, 2003). This index is easy to calculate, it shows the percentage of huge insurance organizations from the whole analyzing market. It is estimated as a sum of market shares of the biggest insurance companies of the market.

$$CR_n = \sum_{i=1}^{n} Y_i, \tag{1}$$

where Y_i – market share of the i insurance organization; n – the number of all participants of the market

For the evaluation of the market share the three-level hierarchy is used: less 45% - non-concentrated market; 45 – 70% -medium-concentrated; more than 70% - highly concentrated.

Usually this coefficient is estimated for three (CR_3), four (CR_4), six (CR_6) and eight (CR_8) organizations-leaders. In the market of insurance of construction risks it has the following meanings: $CR_3 = 86,50\%$, $CR_4 = 88,66\%$, $CR_6 = 92,24\%$, $CR_8 = 94,71\%$.

Table. 1. *The leaders of the insurance premiums' fundraising among insurance organizations in the insurance of construction risks (1 semester of 2017)* [4]

The name of the insurance organization/ group of organizaions	Insurance premium (thousands of rubles)	Market share of the insuranc e organizat ion	The place of the organization in the list of the insurers of the construction risks in RF	The place of the organization in the list of the leading insurance organizations of RF
SOGAZ Insurance Group	11 892 351	79,20%	1	2
AlfaStrakhovanie Group	749 622	4,99%	2	4
OOO "Britanskij Strakhovoj Dom"	367 513	2,31%	3	48
OJSC "Reso-Garantija"	324 131	2,16%	4	5
JSC "VSK"	280 138	1,86%	5	8
"INGO" group	258 604	1,72%	6	3
Rosgosstrakh and Kapital	238 621	1,59%	7	1
VTB "Strakhovanije"	132 036	0,88%	8	7
PJSC-SAK "Energogarant"	109 159	0,73%	9	14
OOO-SK "ROSINKOR-Reserv"	102 958	0,68%	10	98
Other insurance organizations	559 798	3,88%	11-36	x
Total:	15 014 931	100%	x	x

These results allow us to make a conclusion that this market is highly concentrated. We can say that this characteristic of the market of insurance of constructed risks is absolutely coincide with the general tendency existed on the modern insurance market of the Russian Federation, that is the consistent trend of consolidation in the hand of several big insurance organizations (Figure 2).

Figure. 2. *The dynamics of market share of 6 top companies that are the leaders of the insurance premiums' fundraising in the insurance of constructed risks (by year)* [5]
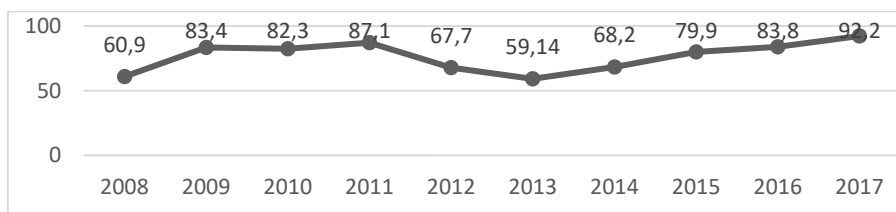
The main negative feature of the estimated coefficient is the fact that it ignore the structure of distribution of the market shares between the insurance organizations

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[4]Compiled by the authors on the data of EXPERT, 2018.
[5]Compiled by the authors.

which took part in the estimation. That's why it is necessary to estimate some more indicators.

Let's estimate the degree of concentration for the insurance of construction risks market on the bases of the data of the table1 and with the help of (Herfindahl-Hirschman index) (Ryizhkin, 2008).

The advantage of this index over the market concentrated index is that it allows to characterize the distribution of the "market power" among all the organizations – participants of the insurance market. This index estimates as the sum of squares of shares of all insurance organizations of the market.

$$HHI = \sum_{i=1}^{n} S_i^2 , \tag{2}$$

where S_i – market share of i- insurance organization; n – number of all participants of the market.

For the evaluation of the concentration ratio the five-level hierarchy is used: less than 500 – low level; 500 – 1000 – relatively low; 1000 – 2000 – medium level; 2000 – 6000 –high level; 6000 – 10000 – very high.

The calculation for our data is:

$$HHI = 79{,}2^2 + 4{,}99^2 + 2{,}31^2 + 2{,}16^2 + 1{,}86^2 + 1{,}72^2 + 1{,}59^2 + 0{,}88^2 + 0{,}73^2 + 0{,}68^2 + 3{,}88^2 = 6333{,}31$$

The results of calculation show that the market of construction risks insurance has a very high concentration. In comparison with the year 2016 in 2017 concentration has increased significantly (Figure 3).

Figure 3. *Herfindahl-Hirschman index (by year)*
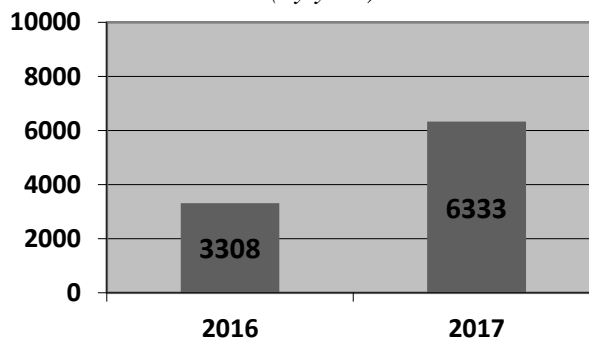
The highly concentrated insurance market can be characterized with the following peculiarities:

- the existence of the dominating insurance organizations which have the digest
  volume of gathered insurance premium;
- the control over the prices by the dominating insurance organizations;
- high prices for the insurance products;
- the absence of orienting to the demands and wishes of the insured in the big insurance
  Companies;
- the high entrance barriers for the new insurance organizations.

It is possible to identify the core of concentration with the help of Lind index. The core of concentration of the market is the number of business entities which supposed to be able to dominate together in the market and to make concerted actions aimed at the limitation of the competition from the side of their common external environment. Lind index is broad-used in the EU, and was created by the officer of Eurocommision in Brussels – Remo Linda. Index is calculated as follows (Ryizhkin, 2008)

$$L = \frac{1}{k(k-1)} \sum_{i=1}^{k} Q_i \, , \tag{3}$$

where k – number of big insurance organizations (not less than two);
$Q_i = \frac{\frac{A_i}{i}}{\frac{A_k - A_i}{k-i}}$ – ratio of medium market share i insurance organization to the share of k-i organizations*;*
i – the number of leading insurance organizations among k big insurance organizations;
Ai – the general market share of i insurance organizations;
Ak – market share of k big insurance companies.

The index is calculated gradually: at the beginning – for two biggest organizations, then for three; four and so on until the tendency of lowing of the index changed for the tendency of its growth. The merge of the concentration core considered to be estimated, when the last added to the estimation insurance organization will have the significantly lower market share than all previous organizations.

For this estimation let's numerate the market shares of the organizations from table 1 in the lowering order: A_1 – market share of "SOGAZ" insurance group (79,20%), A_2 – market share AlfaStrahovanie Group (4,99%), A_3 – market share OOO "Britanskij Strahovoj Dom" (2,31%), A_4 – market share OJSC "Reso-Garantija" (2,16%) ect. For the two biggest organizations Lind index is equal to the percentage ratio of their market shares.

$$L_2 \ = \frac{A_1}{A_2} \text{x } 100\% = \frac{79,20\%}{4,99\%} = 15,87$$

For the three biggest insurance organizations Lind index is equal to the arithmetic middling of two ratio:

$$L_3 \ = \frac{1}{2}\text{x}\left[\left(\frac{A_1}{\frac{A_2+A_3}{2}}\right)+\left(\frac{\frac{A_1+A_2}{2}}{A_3}\right)\right] == \frac{1}{2}\text{x}\left[\left(\frac{79,20\%}{\frac{4,99\%+2,31\%}{2}}\right)+\left(\frac{\frac{79,20\%+4,99\%}{2}}{2,31\%}\right)\right]$$
$$= 19,96$$

Thus the tendency of increase can be seen after adding third organization to the estimation. This means that two first organizations ("SOGAZ" insurance group and "Alfastrakhovanie" insurance group) form the core of concentration of the insurance market. These two organizations have more than 84% of insurance market and is proposed to dominate on this market and to counterwork the free competition. It is important to pay attention to the fact that in the year 2016 the core of competition consisted of five organizations, which had 80% of market share.

The leader of the market is "SOGAZ" insurance group. This organization in 2017 increased its market share from 55,49% to 79,20%. "SOGAZ" insurance group has the competitor advantages which is conditioned by the character of preferences of the potential insured connected with the sources of construction's funding. This advantage is created as a result of cooperation with big clients, for instance Moscow Department of construction, "Metrostroy" of St.-Petersburg, "Avtodor" state company, "Gazprom" and some others. Significant number of big construction projects is insured in "SOGAZ" insurance group" (Annual statement of "SOGAZ" insurance organization for 2016). Because of the following factors:

- the big construction products have the state investments, as a rule;
- "SOGAZ" insurance group" is closely connected with the state authorities or the enterprises with the state participation.

So the competition of the insurers for the big construction projects is practically absent. Theoretical investigations and historic practice show that the peculiarity of the competitive environment of the insurance market is the presence of mutual insurance organizations. These organizations have a number of competitive advantages for the insured:

1. Orientation to the maximum in satisfaction of the demands of the insured as the mutual insurance organization is ruled by the community of the insured. Every insured person enters this community not to receive a profit but to create the insurance defense for his material interests. Meanwhile the commercial insurance organization is ruled by the share owners, and their main goal is receiving profit from the investments into the insurance company.

2. The possibility for the insured persons to receive the insurance product for the lower prices than in the commercial insurance organization.

3. The possibility to use the part of the insurance fund, which has not been used for the insurance payment, for the reduction of the price of insurance and even setting it to zero in some cases (according to the decision of the meeting of all members of mutual insurance organization or their representatives).

4. The possibility to insure the specific risks for the price which is lower than in the commercial insurance organization or the risks which are not insured by the commercial insurer.

5. The possibility for the insured to receive some resources from the mutual insurance organization for taking preventive measures lowering the probability of the insured risk and the size of damage from it.

6. Transparency of information about the activity of mutual insurance organization for the insured.

All these competitive advantages will be able to attract the interest of the organizations of transport infrastructure construction to the mutual insurance.

4. Conclusion

This manuscript recognizes that mutual insurance is an inherent part of the competitive environment of the insurance market, that is proved by the theoretical conclusions and by the examples from the history of Great Britain and of Russia in the XIX century. The peculiarity of the formation of competitive environment in the insurance market connected with the existence of two different methods of insurance products' creation was cleared out. Studying the nature of mutual insurance as the method of insurance products' creation has enabled to show its competitive advantages in comparison with the method of commercial insurance.

The authors also explored the competition process on the insurance market of the Russian Federation as a whole and a segment of insurance of construction risks of transport infrastructure in particular. It was shown that both the whole market and its segment have a high level of monopolization. Due to the high demands of the regulative and supervising authorities the number of the participants of the market permanently reduces and market shares of three biggest firms grow. The core of the concentration, consisted of tree commercial insurance organizations have been highlighted. Now all actors of this market are commercial insurance organizations.

The authors consider the appearance of mutual insurance organizations on the insurance market will influence the competitive environment for all the insurers. The list of the risks which can be insure, the potential insured actors to some extend are common for the commercial and for the mutual insurers. That's why the competition between these two types of organizations will develop and give a positive influence on the structure of the market, on the level of the prices etc. The commercial insurance organizations will have to pay more attention to consumers' satisfaction by creating

new insurance products and improving services. Presence of mutual insurance on the market of construction risks insurance of Russian Federation have to become a good countermeasure against the monopolistic tendencies. Appearance of mutual insurance organizations in this segment will make a positive influence both on the insurance market and on the market of transport infrastructure construction. This influence will take place because of:

- reduction of the expenses of construction firms for the insurance and thus the reduction the price of the construction of the transport infrastructure entities without the reduction of insurance defense;
-development of competition on the insurance market of Russian Federation. According to the estimation of the authors of the article at the first stage of the activity of mutual insurance organizations of transport infrastructure risks the concentration will reduce for 9,6%;
-creation of financial interest for the fair play for the constructing transport infrastructure entities.

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