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Globalization, political institutions, financial liberalization, and performance of the insurance industry

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ABSTRACT

This paper investigates the impacts of globalization, political institutions, and financial liberalization on the performance and risk-taking of insurance firms covering 1324 individual firms in 30 selected OECD countries. We find that greater globalization and a stable political institution lead insurance companies to exhibit a better performance—i.e., insurers adjust their strategies while being aware of institutional changes. By contrast, financial liberalization has an inverse impact on insurance company performance. Thus, greater globalization and a stable political environment both drive less risk-taking for insurers. These findings are particularly important to insurance markets' competitors and national policy-makers.

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1. Introduction

Measuring the performance of insurers has gained importance in the literature, because a strong performance not only increases the market value of that firm, but also leads towards growth for the whole industry, which helps the overall prosperity of the economy. Life insurance has indeed become an increasingly important part of the financial sector over the past 40 years, providing a range of financial services for consumers and becoming an essential source of investment in the capital market

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for developed economies (Beck & Webb, 2003). In fact, insurance companies are now providing the mechanism of risk transfer and helping to channelize funds in an appropriate way to support business activities in the economy (Haiss & Sümegi, 2008). Due to the increased importance of life insurance in the financial market and economy, our study's goal is to recognize previous works related to the life insurance development issue in terms of the impact of the insurance market's structure on growth in the market.

Another motivation of this article is to complement prior studies—i.e., with respect to risk-taking and profitability under certain operating environmental characteristics, previous studies discussing these effects mainly focus on the banking sector (Kaminsky & Reinhart, 1999; Laeven & Levine, 2009). They find that bank regulation and structure ownership significantly affect bank risk-taking and/or performance. Cubillas and Gonzalez (2014) also analyze the effect of financial liberalization on bank risk-taking. Conversely, only a few studies target the insurance industry (Cummins & Venard, 2008; Fields, Gupta, & Prakash, 2012; Pasiouras & Gaganis, 2013), and they argue that the quality of the environment plays an essential role in affecting insurer profitability/performance and risk-taking differently. On the other hand, changes in insurance firms' risk-taking or performance may potentially influence stakeholders and shareholders—for example, stakeholders benefit from an increase in profitability.

Given the importance of insurer profitability and risk-taking for stakeholders or shareholders in the insurance industry, our study examines both the impacts of environmental factors and firm-level internal characteristics on the performance and risk-taking of life insurance firms at the international level. We employ a dynamic panel data framework on 1324 individual life insurance firms across 30 OECD countries covering the period 2004–2011. We analyze how globalization, political institutions, and financial liberalization influence the life insurance sector among these countries.[1] Using a wide range of environmental proxies allows us to examine how they work within the life insurance sector.

This paper contributes to existing relevant studies in the literature through three primary points. First, we investigate the impacts of the operational environment (globalization, political institutions, and financial liberalization) on the performance and risk-taking of life insurance firms from an international perspective. If environmental characteristics play an essential role in the OECD life insurance sector, then we expect our findings to have significant policy implications for insurers and policymakers in those developed countries. We identify that greater globalization and a stable political environment result in better insurer performance and less risk-taking for insurers, whereas financial liberalization harms the life insurance industry.

Second, the earlier empirical literature has mostly relied on a pooled OLS estimation in analyzing the effects of environmental quality on the performance and risk-taking of insurers across countries (Fields et al., 2012; John, Litov, & Yeung, 2008), but the empirical pooled OLS estimators may be biased and inconsistent due to potential heterogeneity. In this study we employ the dynamic panel Generalized Method of Moments (GMM) approach to generate consistent and efficient parameter estimates.

Third, unlike previous studies that have adopted an aggregated institutional variable, we apply different measures in terms of globalization, political institutions, and financial liberalization that enable us to distinguish nine different dimensions of operating environments. For the risk-taking dependent variable calculation, we compute the firm-level coefficient of variation (CV) of the solvency ratio and leverage ratio by their average value under a three-year rolling time window. The coefficients of variation in the solvency ratio and leverage ratio make risky measurements more available.[2]

It is quite beneficial for policymakers, insurers, and investors to understand the influence of globalization, political institutions, and financial liberalization on firm performance and risk-taking in insurance markets. For policymakers, globalization, political institutions, and financial liberalization are associated with the insurance firm's development, and any policy settings related to a change

[1] We pay particular attention to the sample period 2004–2011 due to the restriction of available data for life insurance companies.

[2] Fields et al. (2012) use all information to average value at a certain time period; for instance, for a firm with information from 1990 to 2010, the CV for 1993 will use information from 1990–1993, while the CV for 2010 will use all the information from 1990 to 2010.

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