Organizational Development of the Insurance Companies in Republic of Macedonia: Is There a Need for Creative Recombination?

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The role of the insurance in the modern economy is complex and multidimensional. The original and advanced functions of the insurance activity are crucial for financial system of any economy, allowing absorption, diversification and transfer of the general and particular risks, as well as their contribution in providing liquidity of the enterprises and households by the process of indemnification, thus securing consumption. Insurance companies are important in offering entrepreneurship incentives, growth of savings and micro and macro development by reallocating its assets in forms of premiums and technical reserves, in the economy. That makes insurance companies one the central parts of the capitalization of the economy. Their macroeconomic influence rapidly increased over the past decades, as a result of dynamic growth of financial markets and its products and insurance industry's role as one of the strongest institutional investor. Their capital supply generates highly qualitative, long-term orientated, patient, secure and anti-cyclical assets. Those issues appear to be one of the key challenges for the future. The SEE economies are having stable, dynamic but still in phase of development insurance markets. Basic insurance activity indicators are far below European figures, disabling greater role of the insurance industry in influencing higher rates of growth throughout insurance-growth nexus channels. Republic of Macedonia is not an exemption in that context. The insurance industry is a growing one, with high and dynamic growth rates particularly in the life insurance. However, insurance penetration and density remains low. The fact that the almost 98% foreign ownership of the companies, was not followed with higher growth rates and systematic implementation of new managerial know how, with regards to corporate governance and organizational development of the sector itself. The insurance culture in the country remains weak, as well as, insurance companies invested less resources in increasing their capacities for risk management and actuary, with weak ALM management, which creates difficulties in companies' profitability and their inter-connection within the financial sector and correlation to the economic growth. The core issue of the paper is to present analyses of the insurance sector of Republic of Macedonia, to offer findings of the correlation and regression models between insurance activity and GDP growth, and furthermore to test the role of the insurance companies management and models of organizational development as a variable for existing performance, as well to set and answer the hypothesis

whether there is a need for new organizational changes in form of creative recombination as a modern paradigm. The results of the paper are familiar for the insurance industry in most of the SEE countries.

Keywords: Insurance companies, organizational development, creative recombination, growth, SEE countries, Republic of Macedonia

Insurance, as an origin and unique process of absorption, diversification and transfer of risk and indemnification of losses is crucial for functioning the modern economy, in particular its financial system. Therefore, we can say that insurance is multidimensional and multiplicative process, both on macro and micro level. On micro level, insurance allows smooth, predictive and less volatile functioning of the business subjects, as well as it is the main source for financing their losses in case of material or financial damage. That indemnification mechanism is responsible for direct stipulation of the entrepreneurial activity and business recovery and dynamism, as well as, besides the side effects of moral hazards and adverse selection, the particular "state of mind" (Liedtke, 2007) that enables persons and business units to take more risky and profitable initiatives, important for growth and development of the economy. Furthermore, the insurance process is prevalent in its macroeconomic influence, directly or through out the improvements of the financial systems (Levine, 2005).

Primarily, with is stable, long-term and sustainable process of collecting small, but frequent and numerous cash flows, in form of premiums, insurance is a central part of the economies capitalization. In that sense, even though the insurance is still subordinated to the banking sector, the distinctive business model, increase of the risk by the growth and globalization of the world economy, and dynamic demographic changes that are converging with the growth of the savings instrument of live insurance, resulted to the fact that insurance premiums had larger growth than the banking savings in the past two decades, the same way that the financial crisis are stressing the necessity and importance of the insurance process for the global and national economies. The savings dimension of insurance is nowadays additionally emphasized, as a tool for stabilization of the national economies and their preservation of external and foreign crisis spill over, especially in terms of keeping the economic sound sovereignty. That puts the insurance companies as the leading institutional investors, in parallel with the pension funds, or the leading institutions for collecting and distributing the official risky capital.

What is the most beneficiary, in fact is that in this process of investment, the insurance companies, with regards to their business model and obligations to the clients and shareholders, are positively transforming the capital maturity, thus extending the investment horizon, jointly with the broadening of the capital markets. The investment activity of the insurance companies contributes to the improved competition of the financial markets, and general productivity and efficiency of the economy, especially throughout "price tagging" the sectors, branches or enterprises by investing the large amount of medium and long term capital, part of its technical reserves. By accepting the risk and its

diversification, geographically and throughout different economy branches, insurance allows decrease of the global risk, and stimulates national and international business. In conclusion, undertaking the core mechanism of insurance and covering the loss claims, it supports the consumption, as a key GDP and growth component of every economy.

The positive role of insurance for the modern economy is inconclusive. The main issue of this paper is to analyze the role of the insurance companies as part of the insurance market, in Republic of Macedonia, as an economy in development, similar to the economies in SEE, in providing insurance service and accomplishment of the micro and macro-economic dimensions of the insurance immanent for the developed markets. In that way, we question the management issues and organizational development of the companies, with relation to the instruments of the change management, as a possible tool for improvement of the company's performances and influence to the national economy, trough the nexus growth channel. Bearing in mind the negative consequences of the last financial crisis of 2008, and in particular the rigorous solvency criteria imposed to the insurance sector, and especially the historically lowest level of the interest rates, that hit the premium rates and profitability margins of the insurance companies worldwide, yet, we put under scrutiny the management aspects of the Macedonian insurance companies, as a primary reason for continuous low ROA rates, in dynamic and growing insurance sector in the country. Finally, we apply the recent achievements of management of change, in concrete, the creative recombination, as a possible solution.

The insurance market in Republic of Macedonia

Insurance market in Republic of Macedonia evolved from the past, socialist model of insurance, common for the countries from former Yugoslavia, in part similar for the countries with the Soviet communist economic model. That model was characterized with the non-market, non-profitable and partially developed model of pooling the premiums for parts of the economy, and for few categories of insurance. The transition period for most of the countries, dominated with privatization and de-concentration of the economy, was different for the countries, and is not matter of subject of this paper. However, what is common is the architecture and consequences for the insurance market, as following:

Primarily, the insurance market in Republic of Macedonia is facing with low insurance culture. The old socialist past, tradition and culture, and prevalence to the "state paternalism", or what is said as "traditional societies" (Fukuyama, 1995:39; Hofstede, 1995), resulted with still dominant non market forms of insurance, such as family, friends, community and mostly the State.

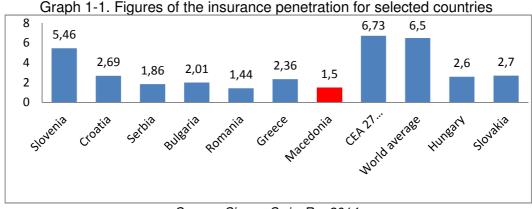
Secondly, the privatization process and financial scandals deprived the confidence in the alternative financial and savings channels, such as insurance, particularly life insurance, positioning the banking sector as a predominant one. That "aversion" to the rest of the sectors of the financial system, kept the insurance many years underdeveloped.

Thirdly, the key component for insurance demand, the income, was and is low, thus preventing people and companies to redistribute fraction of their

income towards the insurance products. Low growth rates and high unemployment are negatively correlated to the growth of the insurance activity, followed by high income and social inequality that creates the situation that the people and companies that most need insurance are not able to buy it.

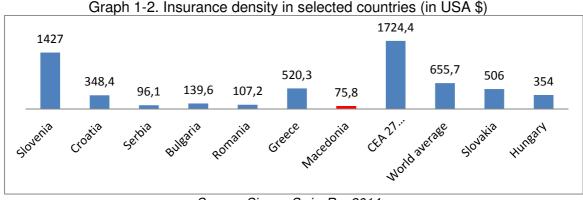
Fourthly, the supply was low for quite some time. The privatization of the state insurance company, happened, just on 2000, 10 years after the economic transformation, as well as the first investment in life insurance companies started in 2004. That situation, kept clients outside the competitive and functioning insurance market, without possibility for diverse and market insurance instruments.

And *finally*, political elite in the country is permanently introducing the robust social care system, that is to be understood as a crucial for alimenting the persons needs in comparison to the still less developed, known and visible system of insurance market products. In general, this factors, remained the two major insurance activity indicators, *insurance penetration(Gross written premiums-GWP/GDP)* and *insurance density(Gross written premiums per capita)* low in comparison to the EU and World averages, on the level or below the level of the most of the countries of the region (Graph 1).



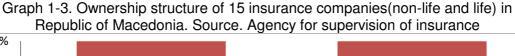
Source: Sigma, SwissRe, 2014

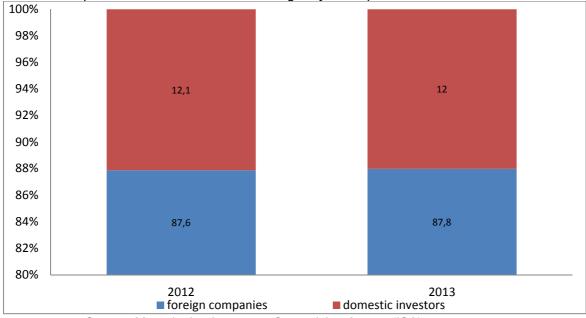
Similar attributes for markets in development, can be illustrated with the figures of the indicator of insurance density for the selected countries in the region (Graph 1-2), that, excluding Slovenia and Hungary, are far below the European average.



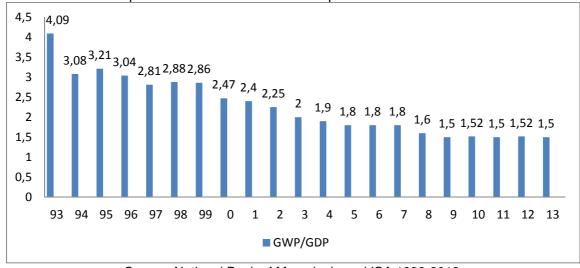
Source: Sigma, SwissRe, 2014

Besides pointing out the late liberalization of the Macedonian insurance market and enter of foreign insurance companies as a prerequisite for slow growth, we would like to stress other factors than already mentioned above. Precisely, regardless of entering 15 companies from 2000 till now, which are owned by foreign companies and personal investors by more than 80%(Graph 1-3), still, the insurance penetration over the years, surprisingly decreased and is remaining low, at 1,5% of GDP(Graph 1-4).





Source: Macedonian Insurance Supervision Agency(ISA), 2012-2013



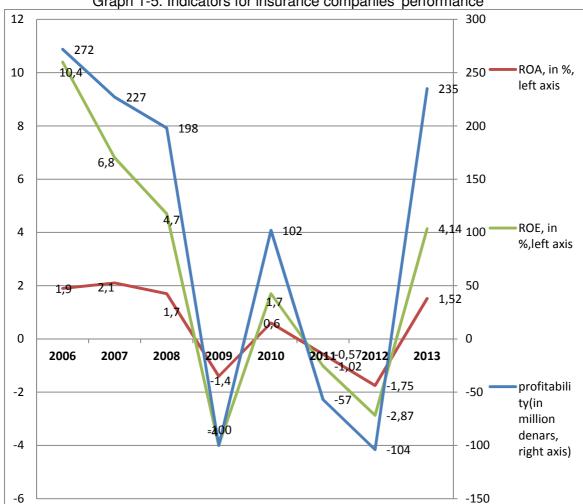
Graph 1-4. Evolution of Insurance penetration 1993-2013

Source: National Bank of Macedonia and ISA,1993-2013

So the basic question, as an analytical hypothesis, is why there is lack of adequate growth of the insurance industry. If we overview the absolute and relative data of the industry, we would find that there is growth, with exemption of the 2009, particularly in the figures of life insurance, that was non existing over the last decade. Previous researches made by various regional authors, showed that there are weak evidence for organizational development of the insurance companies as well as there is present, but partial and limited correlation dependency and Granger causality evidence between the growth of GDP and insurance premiums (Ivanovski, 2014), which results with the fact that the growth of GDP, i.e. income is not fully followed by proportional growth of insurance activity and performances of the companies remains poor regardless of their absolute or relative growth over the years. That underlines the Macedonian insurance market with different attributes that the developed markets, where the growth of the insurance activity is higher than the growth of GDP, and furthermore, the economic results of the companies are not following the growth of the premiums (Graph 1-5).

In particular, our profound analyses emphases two fundamental elements:

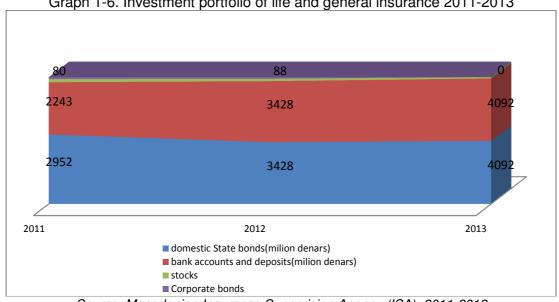
- The first one is the companies' profitability and financial results. Besides being relatively highly fluctuating, the profitability is still low, with negative or modest results for ROA and ROE.
- Additionally, as the second one, the insurance companies, still largely depend on the intermediaries (mostly brokers followed by dealers) in selling their products for high value of the premium, that is put on the financial results, thus decreasing the profitability, bearing in mind that the competition is putting pressure for downsizing the premiums as a price for the risk. In that direction, the companies profit suffers, as a consequence.



Graph 1-5. Indicators for insurance companies' performance

Source: Macedonian Insurance Supervision Agency (ISA), 2006-2013

Furthermore, insurance companies face a poor and low diversified ALM. Brief snapshot of their investment portfolios shows that they practice very poor investment management, dominated with the domestic investments in the state bonds and low profitable banks deposits. That situation, that resembles with the developed markets only in being the theoretical and actual investment portfolio as a conservative one, is directly influencing the profit rates of the companies, that are not exercising visible initiative in diversifying its technical reserves in more risky and more profitable assets at the capital markets world-wide, in compliance the supervisory regulations, that are still rigid, but sufficient enough for creating more profitable and vet stable and prudent investment portfolio(Graph 1-6).



Graph 1-6. Investment portfolio of life and general insurance 2011-2013

Source: Macedonian Insurance Supervision Agency (ISA), 2011-2013

Taking into account previous data, we can state that the insurance companies weak spots are in the areas of human resources, actuary and accounting which is crucial for achieving the actuary fair price and yet the competitive premium, ALM that is on the level of the establishing the market as well as the limited organizational development and poor strategic management. that results in limited number of products, without visible customization that still prevents higher demand for insurance instruments.

In summary, even though the GWP are rising in absolute terms, the new and foreign owned insurance companies, both in life and non-life insurance didn't influenced to higher growth rates of the activity, as well as significant number of clients. On a contrary, with exemption of the last 5 years of life insurance, that hasn't existed in the past, the main business perspective and initiative among the companies was not how to broaden the market and how to struggle for new piece of the cake, but rather to struggle for taking more from the actual piece of the cake. Briefly, instead of pure and sustainable growth, we are seeing only fierce competition for redistribution of the inherited market share, predominantly for the compulsory classes of the insurance, such as auto insurance. In addition, the industry remains dependent on huge network of intermediaries, who are working for substantially high provisions. Insurance sector also remains low connected with the rest of the sectors of the financial system, such as the banking sector and stock market, thus reducing in start the possibilities for macro effects on the economy.

In an initial conclusion, if analyzed from aside, most of the evolution of the insurance market appears to be by the book. Liberalization, foreign companies with experience, know- how and particularly with previous complex risk and investment portfolio, prudent solvency regulation that tends to slightly changes towards more liberalized investment criteria and what is important, relatively stable growth rates of the economy. So, what seems to miss? According to our analyses, main problem at this point should be located in the management processes and strategic positioning of the companies. Therefore, we view the

companies through the prism of changes and their evolutionary reshape something that should have already been done.

Function of Creative Business Recombination

Living and acting in a world in an excessive change, emphasizes the constant need to adapt and of course, change. Change management is the core essence of the developmental philosophy of every prosperous business or national institution, such as the insurance companies. However, if several decades ago, it was all about to determine, place, convince and implement the change, nowadays, after that theoretical and empirical process is common and ongoing, the fundamental issue and question arises as the detailed procedure, methodology, and not the necessity to change.

With regards to it, the evolution of change management and its prevalent results puts the need to transform the very change management itself. Precisely, the transformation model implies to the revolutionary developmental tendencies, whereas the past and ongoing process of creative industry moderate constraints implies to a more modest and yet to see, more effective approach, well known as creative recombination. Better to say, there is a great necessity not to creatively obstruct revolutionary, but evolutionary industry, like insurance, features, but rather to build on its implementation faults and consequences foundations, in a more adaptive and resilient change management process.

It is quite evident that change would not and should not stop. However, the model of creative destruction showed its weaknesses throughout its symptoms of excessive change that ends with chronic syndrome of repetitive change, which if continued might provoke not just failures, but dangerous change fatigue. Instead of creating permanent cycles of creative destruction, for which relevant surveys showed that half (approximately 67%) of one hundred largescale CD cases didn't survived the initial phase, while the rest failed partially or completely afterwards, the process of creative recombination (CR) stipulates the use and certain modification, redeploy and recombination of the present assets, i.e. labor force, processes, structures, cultures and social networks. The need and determination to bring change, is achieved by "use what you have on the table" approach, compared to disruptive approach for creation of brand new model with shift to new organizational resources and assets in general. The influence of the creative destruction has raised the risk for corporate survival of the companies, while worsening their performance indicators of the analyzed industry, as a whole.

However, the general idea of creative recombination is not to eliminate the previous models. If that happens, it would be the same concept as creative destruction, which still is a favorable model for some business instances and situations. Above that, it is growing model of change that through discovering and pulling out existing organizational assets, their creative and unique redeployment and reconfiguration, creates possibilities for new ends, growth and success. Many scholars tend to give illustrative examples for such a change management processes.

There are many advantages derived from this evolutionary model, which can be put in *four key major advantages*:

Primarily, creative recombination does the change less costly, which is crucial in time of financial crisis and constant need for optimization of supply and raise of demand.

Secondly, by recombining the present assets it prevents additional processes and phases to be understood and learned in dimension of time, money and risk.

Thirdly, bearing in mind the previous, there is no need for significant and complex intervention in the old matrix of processes and organizational assets, through-out their termination, obliteration, redesign and start of the completely new system, as well, as *a*

Fourth advantage, it allows the employees in general to create a feeling and attitude of ownership of the process instead of reluctance and rejection, as if the creative destruction proves to influence.

This four element distinction, as introduced primarily in the process of software creative recombination, can be put in the main element - *Recombinant framework* as shown in the Figure 2-1.

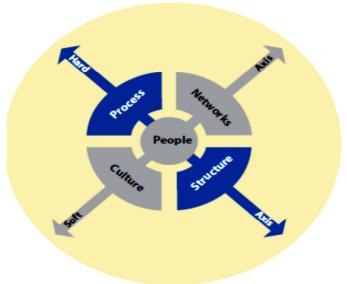


Figure 2-1. The Recombinant Framework

Source: Abrahamson E. (2004a)

Placing the processes and structures on the hard line is obvious and logical. It is very hard, expensive and outcome-risky to create new ones in an effective way. Turning again to the evolutionary and more adaptive manner of creative recombination, it allows handling and using the existing means for different ends. According to Abrahamson (2004a), several techniques might be implemented:

The first, initial one is the cloning, that means to identify the successful processes and structures and through-out cloning, or what the new production approach is called "Copy exactly" to place in another part of the company. By cloning within the system, effective structures and processes can be spread and grown.

Additionally, cloning has its own limitations, especially when brought outside the system or when should be cloned in rather different environment, culture and people. Therefore, the customization technique can improve the recombination. Import of effective structures and processes should not just replace the faulty ones, but they can be combined with the existing good ones. That, in fact, is customization all about. To create the same ends by modifying different and modified means, that represents the ultimate purpose of creative recombination. And finally, the whole process of change might be needed to conclude by "translating", whenever there is need for fine tuning of the change of the processes and structures.

Finally, whatever technique is applied for the hard axis of the framework, integral adaption of the elements of the soft axis must be undertaken. Better to say, the "perpetual" wheel would move only if the consequent and consistent steps are implemented with improved re-use of the existing social networks and people that should put in function the already recombined processes and structures.

Secondly, it must have its own context and qualitative frame-the culture, of course, the recombined one. The existing people and their networks must be used, instead of creating new ones. The corporative and social culture must be the base for that, regardless whether it's going to be just slightly of seriously reconfigured. We should emphasize that the most effective organizational models in the past lies exactly in the model of reviving, reshaping and modification of existing in the internal companies' system culture, or in the imported, customized and afterwards cloned elements of the recombinant framework. Again, its effectiveness is connected with the optimal and efficient use of the existing, upgraded with the new organizational assets.

In conclusion to this part, creative recombination as an actual change management tool should preserve its fundamental feature. Change for a better change, not change just for the sake of a change. It should not be understood as the ultimately new and only management instrument for change, as it was the nowadays criticized, and previously in the decades, widely spread creative destruction model of change management. As it has been always clear, there has to be a balance between the change models, as a clear obligation and responsibility of the managers.

Creative recombination of the Macedonian insurance companies

Macedonian insurance companies surely do have a need for creative recombination. Actual growth of the insurance sector is primarily results of fulfilling the gap with the new companies, as well as of using the mainly aggressive brokers and dealers selling campaign. However, those results are far from the optimal ones. In that sense, using the Abrahamson (2004b) Recombinant Framework, changes might be implemented on both axes, with combination of all of the three recombination techniques.

Firstly, the change is placed within the structure. Even though, corporate management is introduced as legal and supervisory criteria, still, its full potential

has not been used. The insurance companies are dominantly owned by foreign regional and European established insurance players. Their corporate structure might be cloned, with possible customization at some levels. By introducing existing functional and effective corporate structure, Macedonian insurance companies would be systematically organized as a fully capable mechanism to deal with the core and advanced elements of insurance. In that architecture, primary incentive should be given for strengthening the following two major departments:

The first department is the actuary. This is the change hotspot for the insuring business entities. By investing in skilled actuaries and upgrading the knowledge for the actual ones, the insurance companies would have objective possibility to offer a fair premium, sufficient for covering the risk at the right level, at the same time, to cope with the competition at the market. We would mention only one actual negative example. Macedonian life insurance companies still do not have a contemporary life tables, as a basis for their business, and are still using the old former Yugoslav life tables from 1950's, created on the foundation of the even older Austro-Hungarian life tables. Even more, the companies in the non-life insurance do not use academically and scientifically backed instruments in premium calculation, thus offering for some classes of insurance, too low sums for the premium, which results in indemnification process when damage and claims occur.

The second department is the investment management. As shown above, Macedonian insurance companies hardly deal with the advanced, risk orientated ALM. Connection with the Macedonian, regional or European stock market is missing, and the portfolio is low diversified, accepting the majority of the risk on the balance sheets from the domestic economy. Taking into account sound levels of solvency, cloning the experienced and skilled human resources form the mother companies and creating the connection with the stock markets in Europe, would increase the profit margins for the companies, and allow additional space for new premiums. In conclusion, this structure recombination should be followed by establishing the proper department for reinsurance as further risk dispersion for the companies, something that is hardly used in the past.

The second element of the Abrahamson hard axis, processes, is also a matter of prompt recombination. In this direction, the insurance companies should implement sustainable system for broadening the business, and introduce better, customized and new products, particularly in the classes of non-life insurance, such as property, liability and micro insurance, and within the life insurance, more diversified life savings and health insurance. That would increase the level of written premiums, as a factor for market growth, reshape the risk portfolios that are by 50% consisted of obligatory auto insurance. By recombination of the actual resources, the actual processes of the insurance companies would evolve towards complex unit that puts accent for strategic planning, organization and implementation for business strategies. Primarily, companies would have system for creating competitively sustainable offer, for most of the classes of insurance, and would focus on raising the demand by lower cost. The bank assurance, as a selling channel for life and non-life policies would definitely cut down the enormous cost for intermediaries that

amount to 25% of the premium values sold through this channel and would raise the insurance demand, additionally influencing the limited insurance culture in the country. The marketing activities mainly orientated in the life insurance, should cover the promotional activities for long-orientated reshape of the insurance demand and acceptance of the insurance based instruments for risk cover. Changing for the future means that the life companies, for example, should more actively deal with the offer of "private pensions", as a process for payment of the pensions from the compulsory fully funded schemes would start in ten years-time. In the recombination of the processes, customization and translation is needed, as an adaptive mechanism for change of the actual less functional processes.

The changes made for the structure and processes, should be compatible with the convergent changes for the networks and culture in general. as third and fourth element. Macedonian insurance companies count more than 1600 employees that are more than 600 insurance dealers and brokers. That is significant number of people that should be used for re-organization but also for promotion of the new services and processes. Insurance companies' human resources should be knowledge based, rather than purely working based. training. integrated strategic planning and organizational Continuous development should be the priority for he companies. In this instance, changes should begin from the Managing and Supervisory Boards from the companies. Last relevant surveys for the European insurance companies, after the last financial crisis, shows that lack of knowledge and expertise in the top position holders, which is correlated with the negative financial results of the companies, as well as, there is lack of business ethics, integrity and credibility.

Extensive survey over pension funds in Australia, New Zealand, Canada, USA and Europe, in relation with insurance companies that provide pensions through-out life insurance policies, showed that management of the funds and the companies directly influences the level (growth or drop) of the rate of returns by at least 1%-2% (Ambachtsheer et al., 2006). The human resources should be leading bearer of transferred know how form the mother companies, in parallel with use of the knowledge and past networks of the retired insurance workers, with regards to the concept of "silver workers" introduced on the insurance and pension market in the European developed markets. In conclusion, insurance companies should create demand for insurance products. They have to inform and educate the clients for the insurance advantages and beneficiaries. Prior to that, they have to educate and train their labor force.

Finally, Macedonian insurance companies should decide to start changing. Permanently, instead of being satisfied with only higher position in the market, for the cost of profit and development, they must concentrate on sustainable organizational development based on change, while they can do it by its own decision and its own concept.

Conclusion

Macedonian insurance market is in development. It is fastest growing sector of the financial system, particularly the life insurance segment. It due to the fact that the insurance market was liberalized late compared to the markets in the region of SEE. However, absolute and relative growth is not following the pace of growth of GDP, which implies that growth of income is not channeled into the market oriented instruments of insurance, thus remaining low figures of insurance penetration and density and still low insurance culture in "traditional" society and State-governed economy.

In this paper, we questioned the management and organizational development of insurance companies in the process of creating and raising the supply and demand for insurance products. Therefore, we apply the Abrahamson (2004b) recombinant Framework as a tool for permanent management of change. Precisely, we found there is great need for creative recombination of existing structures, processes, networks and culture of Macedonian insurance companies. They suffer weak management, not clear defined organizational structure, with limited sectors for actuary and ALM, as well lack of broader, diversified and customized offer and still dependence of intermediaries in distribution channels.

Creative recombination is growing model of change that through discovering and pulling out existing organizational assets, their creative and unique redeployment and reconfiguration, creates possibilities for new ends, growth and success. We oppose existing strategies for "grabbing" more from the existing market share, and suggest creative recombination for growth and sustainable development, as a result for creating new market and sub-market shares, especially in the insurance classes that are underdeveloped so far, and have large potential. Therefore, the insurance companies should implement sustainable system for broadening the business, and introduce better, customized and new products, particularly in the classes of non-life insurance, such as property, liability and micro insurance, and within the life insurance, more diversified life savings and health insurance.

Last relevant surveys for the European insurance companies, after the last financial crisis, shows that lack of knowledge and expertise in the top position holders, which is correlated with the negative financial results of the companies, as well as, there is lack of business ethics, integrity and credibility. The companies must initiate systematic process of know how transfer, permanent HR education and training and sustainable development. Macedonian insurance companies should finally start to strategically plan, act and function creatively. It's about time to start changing, creatively.

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