Does insurance depend upon cultural values?

A controversial ad

Three people (an Englishman, a North European and an Italian) are watching TV when a commercial break begins. The first ad opens with a group of people dressed in ceremonial black, throwing another person in the air and singing "*For he's a jolly good fellow*". The shot is strangely low, focusing on the throwers rather than the person being celebrated, of whom we catch only glimpses of an arm or a leg. As the shot widens, the viewers realize, first, that the body is strangely devoid of reactions, and after some seconds – when a coffin appears – that what is being cheerfully tossed in the air is actually a corpse. Then the reason for the cheering materializes in the form of a life policy the departed had stipulated.

©youtube.com

What started as a joke is no such thing. The ad is for real, and can be seen on YouTube. The staging could be taken as a thought experiment. The ad in question might in fact spark very different reactions in the three imaginary people sitting on the couch in front of the TV, at least as far as clichés go. The Englishman is very likely to appreciate the black humor, while the North European would

pay more attention to the serious content of the ad: would my relatives and dependents be financially safe in the event of my death? Meanwhile, the Italian is probably already performing some colorful superstitious procedure to neutralize the "bad omens" represented by the ad.

Insurance decisions entail **unpleasant thoughts**, and not only in the case of term life: most property and casualty insurance is about protecting valuable assets from theft, fire or natural events, or the welfare of people from loss of their job, ill health or the consequences of accidents. In most cases, whereas the purchase of a lottery ticket represents a possibility as splendid as it is unlikely, stipulating an insurance policy involves thinking about things that could go wrong in life, and the consequences. While corporate decision makers are expected to be neutral in this respect, buying as much insurance as is needed for the safe and stable functioning of the business according to corporate finance theory, individuals purchasing insurance covers are human beings and therefore very likely to be **influenced by their personal vision of life**.

When insurance meets cultural values

But what do we know about insurance and cultural values? And how do cultural values influence the decision to buy insurance? The issue is multi-faceted, and open to **different interpretations**. Here is a brief insight into three possible views:

- The first is a **supply-side view**, which holds that insurance contracts are only partially understood by customers, who consequently place great value on the **reputation of the insurance company**. Influenced by the perceived competence of the salespeople and the care with which they manage customer relationships, customers basically put themselves in the hands of the insurance provider.
- A second, and related, viewpoint considers the **role of trust** in the insurance contract – the general tendency to expect that other people will behave correctly –, and the related subject of social capital: how a high level of social capital can benefit market agreements, in terms of both participation and cost-efficiency.
- The third view concerns **customer preferences**, specifically **risk aversion** preferences, and the tendency to protect household income and dependents subject to "national values": i.e., how the prevailing culture influences propensity to hedge against various types of risks by buying market insurance.

Insurance as a credence good

Many scholars view insurance, especially life insurance, as a **supply-driven market**, where highly active agents sell a complicated service to customers who are often unable to evaluate the service fully, and buy it essentially because of the reputation of the insurance vendor and their trust in the vendor. This view is still very much debated in the literature.

The traditional view of life insurance as a supply market, where, due to product complexity, customers buy what is essentially a **credence good**, is supported by authors such as Bernheim *et al.* (2003), who highlight the mismatch between protection needs and actual purchases. Bernheim *et al.* survey a large sample of elderly US couples, calculate their need for life insurance protection against the death of one member – also known as the ***protection gap*** – based on their contributions to household income and the financial position of the family as a whole, and basically find no relation between this and the amount of life insurance the couples actually hold. Nevertheless, a later and less widely known paper by Lin and Grace (2007) challenged these findings; the second study presents a different method to calculate the protection gap and its use to identify the missing link. Unfortunately, a comparison of the two studies is made difficult by the fact that, while Lin and Grace published the details of their calculations, the Bernheim *et al.* method has not been disclosed as the authors are marketing a planning software based on it…

A different line of research challenges the former study, starting from Crosby and Stephens' paper on consumer behavior (1987). This finds that, instead of simply inferring the quality of service from brand reputation and trust in the insurance seller, customers actually evaluate the performance of the service **to a certain extent**, both before and after the purchase. From their analysis of two extensive series of telephone interviews, Crosby and Stephens conclude that "[i]t may be naive to assume the consumer "buys" the contact person and firm without attempting to verify their performance in delivering core service benefits" and that "[t]hough **buyers may be confused**, they are not necessarily oblivious to what competitors and others in the market say. In general, [t]he agent's performance certainly affects satisfaction, but is balanced against the perceived performance of the **core service**."

©istock.com/wip.plus

Insurance, trust and social capital

Social capital is a sociological concept signifying the network of interpersonal relations that exists in a society and enables it to function effectively, complementing the legal system and the executive power of government in enforcing correct behavior. According to one definition (OECD insights): [social capital is] "the links, shared values and understandings in society that enable individuals and groups to trust each other and so work together". The concept, not new in itself, was revived by Robert Putnam in the early Nineties. The seminal book he wrote with Leonardi and Nanetti (1993) about democracy and civic traditions in Italy is a source of overwhelming evidence on the **relevance of social capital in social life**. In his later bestseller "Bowling Alone: The Collapse and Revival of American Community", Putnam takes bowling, and in particular the tendency of Americans to shift from competing against each other in local leagues towards literally "playing alone", as a metaphor for the **loss of community values** in ever-wealthier American society.

Apart from its obvious sociological relevance, social capital – however measured – is clearly also significant in facilitating economic activity, together with its close cousin **trust**, in a way that often makes the two concepts indistinguishable. Trust in one's counterpart, which will be more likely in a society imbued with common values and interpersonal relations, **can drastically reduce the need for contractual enforcement**, supervision and, in a worst-case scenario, **legal expenses**. In their work on the economic and financial relevance of trust and social capital, Guiso, Sapienza and Zingales (2004) found that both factors influence the preference of economic agents for payment methods other than cash, such as electronic money, checks and any form of payment based on trust in the other party to actually fulfill their future obligations. In related research, the same authors (2008) investigated the influence of trust on the asset-allocation choices of households. They found that the **subjective characteristics of the investor** have a significant influence on the decision to buy stocks; specifically, that lack of trust can explain the apparently irrational low degree of participation in the stock market in some countries with respect to the predictions of investment theory for fully rational individuals.

Trust matters in the insurance contract, both for the insured and for the insurer. As far as the insured is

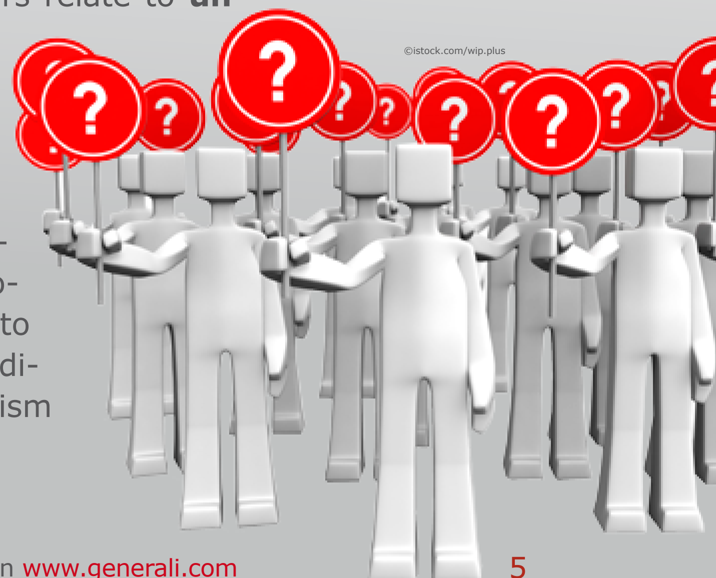
concerned, we return to the idea of insurance as a credence good discussed in the previous section: however financially literate and competent the customer may be, the reputation of the insurance company – in other words, the degree to which the customer trusts it to pay its dues in the event of a claim – is still a fundamental consideration. Yet the insurance contract is problematic for the supply side as well. Trust in the counterpart is a crucial aspect for the insurance company too. From the insurer's viewpoint, in a **society with a high level of trust**, contractual problems such as moral hazard, information asymmetries and, in the worst case, outright fraud are less likely to occur and therefore will have a lower impact on tariffs, allowing for more favorable terms and conditions on the supply side.

A possible role for social capital in economic models is to limit market inefficiencies when institutions fail to resolve them: family ties are frequently substitutes for inefficient institutions. Religious communities as well as other professional and voluntary associations help supplement the social welfare not provided by the state; assistance for the disabled and elderly or scholarships are some examples. In this sense, **social relations are a substitute for market insurance**, and may therefore be assumed to displace it. There is a more subtle level, though, at which market and non-market insurance interact, enhancing each other: **peer monitoring**. As Rothschild and Stiglitz have shown, informal insurance through social relations can effectively control an insured's behavior, limiting moral hazard and therefore proving complementary to the formal insurance market.

Insurance as a consequence of national values

This view traces part of the unexplained but systematic differences observed in life and P&C insurance consumption across **countries or regions** to the influence of cultural factors on the way customers relate to **uncertainty, ambiguity and the need for protection**.

This emerges with particular clarity when observing changes in broad forms of societal organization, with shifts in emphasis on individual responsibility. The move from a socialist system, where the State is supposed to provide for everybody, towards the greater individual responsibilities associated with capitalism



is reflected in the development of the private insurance sector in the countries of the former Communist Bloc, as discussed in Brokesova *et al.* (2014). Meanwhile, the uncertainty factor relates to the way societies deal with the fact that the future can never be known: should we try to control it or just let it happen? The seminal work in this field was developed by **Geert Hofstede** in 1984.

The key cultural dimensions cited in Hofstede's theory are as follows:

- *The extent to which the less powerful members of institutions and organizations within a country expect and accept that power is distributed unequally* = **power distance**.

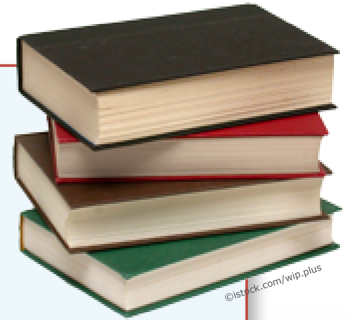
  This dimension is concerned with the fact that individuals in societies are not all equal – it expresses cultural attitudes to these inequalities.
- *The degree of interdependence a society maintains among its members* = **individualism**.

  The fundamental issue addressed by this dimension is the degree of interdependence among the members of a society. It has to do with whether people's self-image is defined in terms of "I" or "We". In individualist societies, people are expected to look after themselves and their immediate family only. In collectivist societies, people act as members of groups, which take care of them in exchange for loyalty.
- *Society driven by competition, achievement and success, where success is defined by the winner [or] best in field* = **masculinity**.

  A masculine score for this dimension indicates that the society is driven by competition, achievement and success, with success being defined by the winner / best in field; the value system starts in school and continues across organizational behavior. A feminine score means that the dominant societal values are caring for others and quality of life. In a feminine society, quality of life is the yardstick of success and standing out from the crowd is not admirable.

©istock.com/wip.plus

Based on Hofstede, and within a wider strand of literature on the influence of cultural factors in customer and financial behavior, Chui and Kwok (2008) examined the way "national culture'' affects consumption of life insurance. They found a significant and positive association between insurance density and individualism, consistent with the idea that social safety nets are smaller in individualistic countries and people will tend to look after themselves by buying private insurance. Symmetrically, a high degree of power distance – typical of societies where people surrender a large part of their authority to superiors but in exchange expect to be cared for by the State – is associated with lower insurance density. Feminine societies, where the emphasis is on caring for one's dependents, also show a greater propensity to insure. Lastly, the dimension of uncertainty avoidance, which should have the greatest influence on insurance purchases, is of only minor significance.



Do you want to know more?

If you would like to explore this fascinating question in greater depth, the following reading list is recommended:

- Bernheim, B. Douglas, et al. "The mismatch between life insurance holdings and financial vulnerabilities: evidence from the Health and Retirement Study." *American Economic Review* (2003): 354-365.
- Chui, Andy C.W., and Chuck C.Y. Kwok. "National culture and life insurance consumption." *Journal of International Business Studies* 39.1 (2008): 88-101.
- Crosby, Lawrence A., and Nancy Stephens. "Effects of relationship marketing on satisfaction, retention, and prices in the life insurance industry." *Journal of marketing research* (1987): 404-411.
- de Mooij, Marieke, and Geert Hofstede. "Cross-cultural consumer behavior: A review of research findings." *Journal of International Consumer Marketing* 23.3-4 (2011): 181-192.
- Guiso, Luigi, Paola Sapienza, and Luigi Zingales. "Trusting the stock market." *The Journal of Finance* 63.6 (2008): 2557-2600.
- Guiso, Luigi. "Trust and Insurance Markets." *Economic Notes* 41.1-2 (2012): 1-26.
- Kwok, Chuck C.Y., and Solomon Tadesse. "National culture and financial systems." *Journal of International Business Studies* 37.2 (2006): 227-247.
- Lin, Yijia, and Martin F. Grace. "Household life cycle protection: Life insurance holdings, financial vulnerability, and portfolio implications." *Journal of Risk and Insurance* 74.1 (2007): 141-173.

Conclusion

Clearly, we have simply scratched the surface of a vast subject of interest for the future development of insurance markets, but also, in a broader sense, for the way private insurance is perceived by customers.

As a general conclusion, it seems that the decision to buy insurance is based not only on the **rational need** to provide adequate protection for one's own risk portfolio but also on a number of **personal characteristics and idiosyncrasies** typical of each human being.
Analysis of the actual decision process among "real people in the real world" – with particular regard to breaches of the prescriptions of formal economic theory – is the domain of **behavioral insurance**: but that's another chapter of the story…

Giovanni Millo
R&D Department