



INSURANCE OF BANKS' BUSINESS RISKS IN LENDING TO SMALL BUSINESS AND PRIVATE ENTREPRENEURSHIP

RUSTAM SODIKOVICH AZIMOV

Abstract. *The paper considers the practice of mortgaged property insurance when lending by banks of Uzbekistan to small business and private entrepreneurship (SB&PE) and the prospects for the development of this type of insurance. The consequences of incomplete property insurance and the absence of certain risks in standard insurance contracts are revealed. The tasks that need to be solved for the digitalization of insurance technologies are considered in order to promptly resolve insurance issues by the subjects of the SB&PE.*

Key words: *small business, private entrepreneurship, insurance protection, mortgaged property, insurance risks, digital technologies, insurance digitalization.*

Author correspondence:

Rustam Sodikovich Azimov

Candidate of Economic Sciences, General Director of JSC "Uzbekinvest Export-Import Insurance Company", Tashkent, Uzbekistan

Email: office@uzbekinvest.uz

INTRODUCTION

At the same time, the practice of lending to small businesses is questioned by banks due to their high level of risk. The reason is that small businesses are often under-represented in banks with old stereotypes such as lack of funds, insufficient own funds, insufficient assets as a defendant, inexperience in the market, high probability of closure, lack of management skills. But the pandemic has shown us that small businesses today are the most resilient in the market infrastructure, with their resilience that they can overcome the situation with quick resilience in the event of any crisis without negative consequences and catastrophic losses.

Moreover, it is also emerging as one of the most pressing issues today. In particular, in Uzbekistan, the poor are recognized as 12-15% of the total population, and 4-5 million of them are below the poverty line¹. In this process, a large number of low-interest, interest-free loans in the form of subsidies are allocated for the active involvement of the poor in business, earning income through entrepreneurship and business.

Taking into account the above, in recent years, "Every family is an entrepreneur", "Our youth future" and other social programs have been implemented to attract the general population to entrepreneurship and expand their sources of income. A total of more than 13 trillion UZS of soft loans have been allocated under the programs. More than 600,000 families have been reduced to poverty². Through these programs, entrepreneurship in the regions serves to improve the quality of life and employment, as well as to prevent future poverty among young people.

¹ <https://uza.uz/uz>

² Decree of the President of the Republic of Uzbekistan, dated June 27, 2018 No. DP-5466



It should be noted that the practical solution to these issues was the Presidential Decree "On additional measures to improve the system of involvement of the population in entrepreneurship and the development of entrepreneurship." According to the resolution, JSCB "Microcreditbank" has received a special certificate from non-governmental educational organizations: individuals with entrepreneurial initiative will be provided with microloans in the amount of up to 33 million UZS without collateral to start their own business. Microcredit in the amount of up to 225 million UZS will be provided to founders of micro and small enterprises on the basis of third-party guarantees, insurance policies, collateral for property purchased on credit, guarantees of the State Fund for Entrepreneurship Support and other types of security provided by law. At the same time, microloans are issued at a base rate of the Central Bank for a period of 3 years with a grace period of up to 6 months. The Reconstruction and Development Fund will provide the equivalent of \$ 100 million to provide financial resources to start a business by training young people and women in professional and entrepreneurial skills.³

From July 1, 2022, in the framework of the programs "Every family is an entrepreneur", "Our Youth Future" and other family business development, loans from the state target resources will be allocated to those who have completed relevant training courses in entrepreneurship on the basis of a single microcredit program.

It is also planned to establish a network of banking and insurance infrastructure in 2021 in all districts and cities of the country, including the possibility of providing microfinance services through the widespread introduction of digital technologies. In addition, it is planned to establish a system of electronic information exchange with non-governmental educational organizations on entrepreneurship training⁴.

It is expedient to continue the ongoing reforms to improve the system of entrepreneurship, reduce poverty and develop entrepreneurship. But at the same time, ensuring the independence of banks, the active participation of insurance companies in these processes, the protection of banks and business activities should serve to reduce risks.

At the same time, it requires the timely detection of outstanding non-performing loans and the development of mechanisms to insure against potential risks. It is desirable to increase the involvement of the population in entrepreneurship, improve the microfinance system and insurance activities, as well as the implementation of key areas of state support for entrepreneurship.

LITERATURE REVIEW

Small business is the most important indicator of the development of a market economy. In this regard, the question arises of supporting small and medium-sized businesses. One of the areas of such support is insurance. The level of small business development is one of the most important characteristics of the national economy, since it forms competitive, civilized market relations, improves the quality of goods, works, services and service culture; brings the production of goods and services closer to specific consumers.

³ Resolution of the President of the Republic of Uzbekistan, dated October 13, 2020 No. RP-4862

⁴ Resolution of the President of the Republic of Uzbekistan, dated June 7, 2018 No. RP-3777



According to Cailloux Jacques (2014) and others' analysis, bank financing of small and medium enterprises has improved somewhat in times of economic hardship. In general, in the context of financing small and medium-sized businesses, there are problems in financing to overcome the difficulties associated with cash flows. According to scientists, the best way to address these challenges is to develop specific measures to improve the functioning of credit markets in individual cases.

In particular, to reduce the risks associated with delays in payments by major contractors, including the elimination of cash flow difficulties through the use of reverse factoring; risk elimination through the rational use of insurance mechanisms, development of quality public credit information; advises on improving the capacity of financial firms to train in financial management [1].

According to Mirzayeva's analysis (2017) today, small businesses and private entrepreneurship face a number of problems - financial difficulties, sales of products, low level of staff qualifications, rising energy prices, shortage of premises, etc. In addition, small businesses are exposed to a high level of risk, which determines an unsustainable position in the market, dependence on large companies, shortcomings in managing one's own business, increased sensitivity to changes in business conditions, difficulties in borrowing additional financial resources and obtaining loans, uncertainty and negligence of business partners when concluding agreements (contracts), etc. [2].

Robert Sh. (2016) research shows that, entrepreneurial activity due to the risky nature involves the occurrence of material and financial losses. Insured risk for an entrepreneur is a probable event or set of events, in case of which occurrence insurance is carried out [3]. Nasretdinova Sh. (2014) reviewed that, it is necessary to identify factors that contribute to reducing the level of entrepreneurial risks. First of all, this is the improvement of state regulation of business and insurance. The first solves the problem of financing, reduces administrative barriers, and promotes the introduction of innovative technologies [4].

Shaxov V. (1997) examined the insurance, in turn, provides protection for enterprises in the event of damage when certain events occur, and in addition, it will be able to prevent bankruptcy due to the availability of a sufficiently wide range of insurance services [5]. Arxipov and others (1999) explored the principle of operation of insurance is based on the pooling or pooling of risks. Combining risks allows you to average, smooth out their negative consequences and use statistical patterns (the law of large numbers) to quantify risk. The more pulling, the more reliable risk management [6].

Entrepreneurship is a risk-based activity. Various scholars have commented on this in their research, in particular:

Martina Merkova and Josef Drabek commented on risk: "Risk is an inevitable part of any business". It is therefore important to analyze it, but at the same time, the paradox is that it is an invaluable part of the project until the very end [7].

According to a study by Staroverova G (2006), the transfer of risk, ie insurance - the entrepreneur puts the risk of risk on someone. Risk insurance, logically, means assigning certain risks to insurance companies. Its essence is that the entrepreneur gives up part of the income in order to avoid risk [8].



According to Balabanov I (1996), reducing the level of risk means trying to reduce the probability and amount of losses by the entrepreneur. Various methods are used to reduce the level of risk, including the most popular methods of diversification, limitation, insurance or self-insurance, reliable and complete information and data [9].

At the same time, there are the most common measures to reduce credit risk in foreign banking practice, which are listed below.

a. Careful assessment of the borrower's creditworthiness. The method based on scoring the borrower is very common in foreign banking practice (scoring method). This method involves determining the customer rating. The criteria for assessing a debtor are strictly individualized for each bank, based on its position in practice, and reviewed from time to time.

b. Reducing the amount of credit given to a borrower. This method means that it is preferable to distribute a large amount of capital to several customers, rather than to one customer.

c. Credit insurance. Credit insurance assumes that the risk of non-repayment is borne entirely by the insurance company. All insurance costs are borne by the borrower.

d. Ensuring adequate supply. This method guarantees the return of the amount given to the bank and the receipt of interest. The focus of credit risk protection is not on attracting sufficient collateral to cover losses, but on analyzing the borrower's creditworthiness to prevent these losses. Because the loan is repaid in accordance with the loan agreement.

RESEARCH METHODOLOGY

The methodology used in this study used methods such as statistical analysis, analysis, synthesis, abstract-logical and critical thinking, induction, deduction, scientific experimentation, generalization to insure the entrepreneurial risk of banks in lending to small business and private entrepreneurship.

RESULTS AND DISCUSSION

Small business and private entrepreneurship (SB&PE) are one of the key elements of the economies in countries operating according to the market principles. The activities of SB&PE entities significantly affect economic growth rate, the economy structure, employment, gross national product volume and are a factor for the harmonious state development. The role of small business in the global economy is enormous. The place of small business in leading foreign countries can be seen in Table 1.

Table 1

Dynamics of economic development indicators of small business in developed countries

Countries	Share, in % to GDP	Number of employed, in mln people	Share of employed, in % to the total quantity
Great Britain	51.5	13.6	49
Germany	51.0	18.5	46



Italy	58.5	16.8	73
France	58.5	15.2	54
EU Countries	65.0	68.0	72
USA	51.0	70.2	54
Japan	53.5	39.5	78

Source: worldbank.org

It should be noted that only by stimulating the activities of small businesses and micro-firms, it will be possible to eliminate poverty in the economy in a short period of time. Such practical measures are yielding results. To date, the share of small business in GDP is about 56%, a quarter of industrial output, 98% of agricultural production and half of investment. In many regions, 70-90% of exports are to small businesses. In 2020, the number of small businesses was 14.4 units per 1,000 population. The dynamics of SB&PE indicators for 2010-2020 is shown in Table 2.

Small business solves many issues necessary for the sustainable development of any country's economy, including:

- smoothing economic environment fluctuations via mechanism of supply and demand balancing;
- developing healthy competitive environment in the economy, creating the system of incentives for mobilization and use of knowledge and skills, energy and hard work of the population;
- more rational use of the available material, personnel, organizational and technological resources;
- creating new jobs, forming the most important society class - middle class;
- developing innovative potential of the economy, introducing new forms of organization, production, distribution and financing.

Table 2

Dynamics of small business economic development indicators in Uzbekistan from 2010 to 2020

Year	Share, in % to GDP	Number of employed, in mln people	Share of employed, in % to the total quantity
2010	60.8	8 643.9	74.3
2011	61.9	8 950.7	75.1
2012	60.8	9 239.7	75.6
2013	60.9	9 604.0	76.7
2014	61.9	9 950.8	77.6
2015	64.6	10 170.4	77.9
2016	66.8	10 397.5	78.2
2017	65.3	10 541.5	78.0
2018	62.4	10 128.8	76.3
2019	56.0	10 318.9	76.2



2020

55.7

9 865.7

74.5

Source: www.stat.uz

The success of an entrepreneur depends on his ability to predict political and economic situation, calculate the project return, adequately respond to market changes and make effective decisions by the situation. Naturally, it is difficult to foresee and take into account all the factors related to entrepreneurial activity, therefore, there is always a risk of losses or failure to receive the intended profit.

In this regard, the implementation of the following directions today will create a roadmap for the development and protection of business entities, including:

- Creating the necessary conditions and using the services of a wide range of government agencies and market infrastructure, business services in one place. By providing this opportunity, all-round support will be provided to business entities;

- assistance to business entities in access to engineering and communication networks, information support, use of public services (registration, permitting, licensing and other documents);

- development of business plans, as well as preparation of documents necessary for the use of leasing, insurance and appraisal services;

- assistance in the use of financial, commodity and natural resources, technological machines and equipment, production facilities, as well as land;

- taxation, employment, submission of statistics, financial, tax and other reports, banking services, rent of buildings and premises, advice on the purchase of state property at "zero" value;

- assistance in the implementation of international standards and certification systems, including the establishment of cooperative relations with foreign trade partners, as well as in the conduct of foreign economic activity;

- organization of bilateral and multilateral negotiations with market infrastructure entities, state and economic administration bodies, local state authorities on issues related to the organization and implementation of business activities for business entities.

Problems with bank loans are rising today. In particular, Table 3 provides information on the balance of the loan portfolio by type of loan. It is noteworthy that the balance of the loan portfolio in "loans for business development" as of March 2022 amounted to 10,676 billion UZS. In addition, microloans to individuals (10,970 billion UZS) and loans to legal entities (238,072 billion UZS) account for the largest share in the loan portfolio with the remaining amount.

Table 3

Information on the balance of the loan portfolio by type of lending, billion UZS (March 1, 2022)

Name of indicator	
Total	327 180
Loans to individuals	70 982
Mortgage	37 083
Microloans	10 970



Consumer loans	11 799
Education loans	402
Loans for business development	10 676
Other loans	51
Loans to legal entities	256 198
Loans granted to legal entities that are not credit institutions	238 072
Leasing and factoring	2 156
Interbank loan	1 452
Microcredits	10 124
Syndicated loans	4 394

Source: Central Bank of Uzbekistan. <https://cbu.uz/ru/statistics/bankstats/616689/>

Nowadays, the situation with lending to businesses is causing problem loans. The results of a quarterly analysis show that the share of problem loans is higher in state-owned banks. In particular, "Milliy Bank", "Xalq Bank", "Asaka Bank", "Qishloq Qurilish Bank", "Microcreditbank", "Uzagro Export Bank" are facing problem loans with high shares (Figure 1). This is due to loans allocated under government programs and low-interest unsecured loans to small businesses.

In this case, the situation shows the urgency of early identification of risks with insurance companies and the use of insurance protection mechanisms in order to avoid problems for banks. In this case, it is advisable for entrepreneurs to get out of bankruptcy, reduce risks, and in turn use insurance leverage to help.

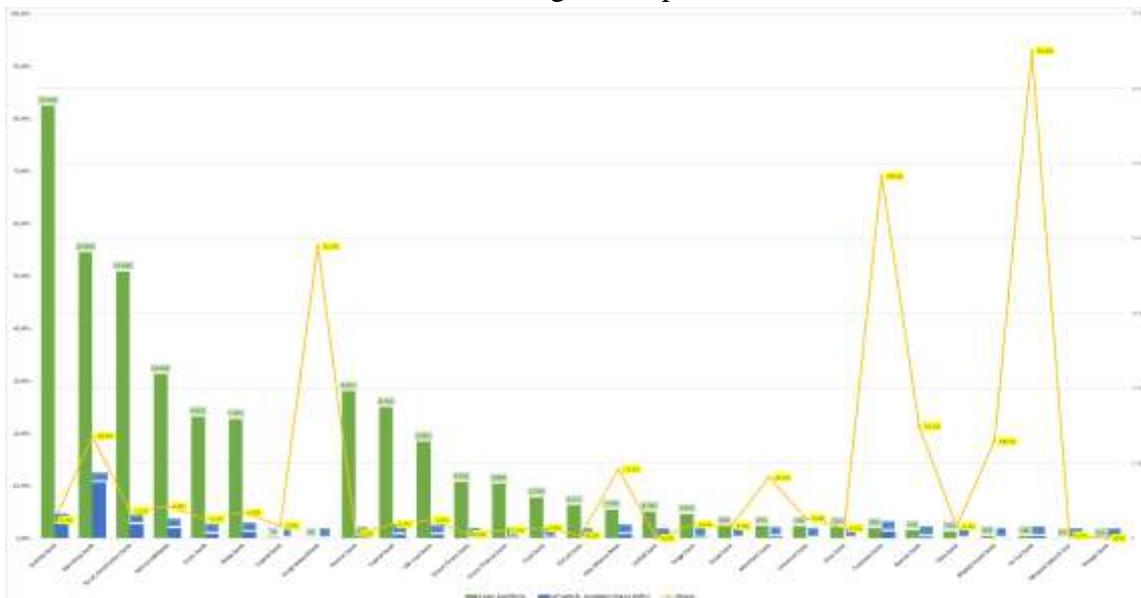


Figure 1. Information on problem loans of commercial banks (March 1, 2022)

Source: Central Bank of Uzbekistan. <https://cbu.uz/ru/statistics/bankstats/616691/>

*Loan portfolio in billion sum.

To protect entrepreneurs from adverse consequences of the risks arising, such a universal mechanism as insurance is used. Business insurance against risks is especially important for small enterprises which are primarily affected by any changes taking place in the market. After all, such organizations, as a rule, do not have free funds to compensate for



significant damage, and enterprise's shutdown even for a short time can lead to the bankruptcy.

Insurance companies in Uzbekistan might offer protection against many negative factors, depending on the client's needs and the scope of his activities: compulsory types of insurance; property insurance (mobile and fixed) against fire, natural disasters, accidents, theft, and etc.; third party liability insurance compensating for damage to the life and health, property and financial losses in case of civil liability; insurance protection against business interruptions, and etc.

There are 42 insurance companies in Uzbekistan, including 34 general insurance companies and 8 life insurance companies. In addition, the total authorized capital of insurance companies for 9 months of 2021 amounted to 1.51 trillion sums. These insurance companies concluded 7744.4 thousand contracts in both directions, during which time 2.6 trillion sums of insurance premiums were collected. Insured payments of 802.2 billion sums were paid to the insured. We can see that this figure has increased by 118 per cent compared to the same period last year. Today, the share of the insurance services market in Uzbekistan's GDP is only 0.48%. For comparison, the figure is 12% in the US, 11.6% in South Korea, 6.8% in Germany and 1.5% in Russia. One of the main reasons for this is that insurance services are not attractive enough. This indicates that the potential of the insurance market is not fully used and the investment activities of insurance companies are not taken into account. The solution of these issues is especially important.

What's more the obvious positive aspects of the insurance mechanism, it has not found wide use in the activities of entrepreneurs, especially voluntary types of insurance. Public opinion surveys show that the reasons behind disregarding attitude towards insurance are:

- insufficient information about insurance, except for mandatory types;
- lack of money for insurance;
- lack of insurance culture (insurance habits), even compulsory motor liability insurance is perceived by the majority as additional tax, and not as insurance;
- they have witnessed or are familiar with the unfair activities of the insurance company and now do not trust them;
- insurance is a means of ensuring only financial security and the risks protected by insurance are not the main ones in the list of risks significant for the population;
- insurance companies are not ready to make the services provided interesting, and most importantly, promptly solve issues in case of insurance event.

Entrepreneurs often face the issue of insurance when they need to get a loan from the bank. If property is offered as the security for a loan, then in order to guarantee the safety of the secured property, its insurance under the terms of the collateral agreement is carried out at the expense of the pledger by its full value against the loss or damage risks, and if the total value of the property exceeds the amount of the secured loan - for the amount not less than required (Article 12 of the Law of the Republic of Uzbekistan "On Collateral").

Usually, according to the loan terms the property is taken as collateral at 50-70% of the appraised value (insurance value) in order to exclude the influence of market fluctuations



and depreciation of the property over time. Here comes the first problem that has been on the market for many years. In the vast majority of cases, the pledgers (borrowers) conclude insurance agreements to insure secured property for 50-70% of the insurance value. The pledger insuring secured property against the agreed list of risks in order to save the insurance premium goes for incomplete insurance without thinking of the consequences. In case of insurance event with the collateral there is dissatisfaction with the insurance indemnity amount since it will be less than the damage caused to the property. This circumstance is due to the legislation of the Republic of Uzbekistan according to which if the sum insured in the property insurance agreement is set below the insurance value, the insurer upon the insurance event occurrence must compensate the insured for the losses incurred in proportion of the sum insured to the insurance value (Article 936 of the Civil Code of the Republic of Uzbekistan).

Insurance companies usually take the pledged property for insurance in case of direct physical loss or damage as a result of: flood, storm, hurricane, shower, hail, heavy snowfalls, landslide, ground subsidence, landslide, groundwater, mudflow, lightning strike, earthquake, accident, fire, explosion, burglary, intentional misconduct of third parties, i.e. 18 risks. In this regard, the second problem arises when the risks related to the state bodies actions are not covered. Many cases are known from the media when the real estate of entrepreneur was demolished by local authorities' decisions. There is no such risk in the list of risks under collateral property insurance agreements.

It should be noted that such risks related to the pledged property can be accepted for insurance in accordance with the Law "On Collateral" which defines: "The agreement or legislation may impose on the pledger the obligation to insure against government bodies actions and acts adoption interrupting its economic activity or hindering it or adversely affecting it (confiscation, property requisition), as well as liquidation or declaring it as insolvent debtor" (Part 2 of Article 12).

Thus, in order to solve these two issues, it is advisable for pledgers and banks to conclude collateral insurance agreements for the assessed property value, and also to provide for risk coverage in case of the local authorities' actions to demolish the secured property.

Under conditions when many public services are concentrated in one place and are provided with a wide use of information and communication technologies (ICT), the insurance companies procedures in concluding insurance agreements and, in particular, in considering insurance events do not fully meet the expectations of their clients - SB&PE entities.

Insurance development trends analysis in the leading foreign countries with a fully functioning insurance markets shows that in the financial sector insurance companies follow the banks in digitalization of their activities. In this direction, the insurance market of Uzbekistan is at the initial stage of its development. This can be explained by undeveloped market, lack of insurance culture, low demand for insurance in general, and for innovative insurance products in particular. Some insurers successfully implement ICT tools for their internal procedures, there are online insurance opportunities, but most insurers continue to work with clients on "paper" basis, not on the digital database analysis. Interest in the



insurance activities full digitalization, including the claims settlement procedure, is emerging. In the sphere of introducing digital technologies in Uzbekistan, banks turned out to be the most technologically advanced, the first digital banks have appeared.

Insurance of SB&PE entities according to the bank requirement when their lending issue is being solved, takes significant share in the insurance portfolio of domestic insurers. Therefore, during the process of introducing digital technologies for SB&PE entities insurance, cooperation between insurers and banks could give positive results for working out mechanisms and procedures at all stages: accepting insurance object; servicing insurance agreements during their validity period; settling claims. The legislation of Uzbekistan allows for such cooperation on a commercial basis.

CONCLUSION

Insurance companies in order to meet the requirements of today and in the near future, will have to solve the following:

1. For digitalization, it is not enough to simply organize or open innovative department without constant cross-functional communication with other divisions and external partners of the insurance company. If insurers introduce innovations by ways they already understand— without changing their underwriting and claims policies, insisting on superficial improvements—they will face further sales reductions.

2. Introduction of digital technologies requires the unification and standardization of insurers activities, i.e.: standard insurance coverage, standard data exchange protocol with banks; standard insurance terms. The standards will also need to cover the actions that must be carried out during the pre-insurance object examination, as well as the claims settlement, keeping sight on possible fraud attempts. Standardization will allow to take different look on the business processes customary to insurance companies, optimize them or exclude some wrong approaches.

3. Embedding insurance in ecosystems created by the banks or leasing companies. Provision of individual insurance rates and services, automated track of client risk situations, as well as provision of additional non-insurance services (assistance services).

4. One of the main tasks in implementing new technologies is the right focus of the insurance company's employees to create competence in working with innovations, in their quick launch and change in activities.

With appropriate strategies, tools and leadership in place, insurers will be able to modernize their business to meet future market needs.

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