Review Article

Insurance as the First step in Financial Planning: A Review on Developing World

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Abstract: Sustainable development is hampered, especially in developing nations that heavily rely on agriculture, are susceptible to natural disasters, and lack effective coping mechanisms, by income swings brought on by socioeconomic, climatic, and other environmental risks. Over the past 20 years, emerging nations have seen a rise in the availability of financial services like credit and savings accounts. Nonetheless, many developing nations continue to have low rates of utilization of insurance services for financial protection against these risks. In order to study the financial services landscape, this article reviewed the insurance as the first step in financial services in developing nations. We go deeply into the elements that influence the likelihood that a household is protected by various insurance plans. Our ability to compare our findings with the very scant prior research on the factors influencing the demand for financial services, such as insurance, in developing nations is made possible by this. Future changes in federal income tax and estate tax policies may increase life insurance ownership, as decreases in cash value life insurance and other insurance products were not due to household characteristics. Insurance is crucial for financial planning, providing stability and protection against various risks. It helps people and families safeguard assets, care for loved ones, and work towards long-term financial goals. This study focuses on the financial services industry, particularly in Asian developing nations, and highlights the importance of understanding local needs and requirements for financial inclusion. Developing products that are most appropriate for economic, social, and societal resilience in the face of climate change is crucial.

Keywords: insurance, financial planning, developing world, life insurance

1. INTRODUCTION

A vital part of risk management and insurance planning, life insurance is also crucial for other aspects of financial planning such as estate planning, income tax planning, and employee benefits. Even well-laid plans may go wrong. You often have to deal with unexpected turns in life. That’s why you need a backup plan. Insurance serves as a backup strategy to assist a portfolio withstand unexpected financial shocks. The first step in financial planning is emergency preparation, which is made possible by insurance plans. Therefore, lay the foundation for insurance planning before creating complex savings and investment programmes. Create a solid financial plan that is impervious to emergencies. To put it simply, financial planning is the necessity of managing finances. This entails mapping out your goals for money as well as your earnings, costs, assets, and liabilities. After that, construct a financial portfolio and make investments in various sectors to achieve your objectives. Insurance is necessary given the impending high cost of living and anticipated inflation, particularly in developing countries where nuclear families are becoming more common. In the event that a spouse or partner passed away, the majority of families would have to lower their existing level of living if they didn’t have life insurance [1-4]. There are two primary types of life insurance: term and cash value. A cash value life policy offers savings in addition to insurance and is meant to cover the insured person for their "whole" life. Term policies, which are essentially insurance, are linked to a specific number of years, often 20 years, and can range from one to 40 years. The beneficiary will get the full face value of the policy if the insured passes away within the duration of the contract. The beneficiary does not receive any benefits if they pass away when the contract expires. One of the most popular forms of benefits offered by companies is group life insurance; in 2017, 60% of employers offered it, and 73% of eligible workers took advantage of it [5, 6]. Income variations brought on by socioeconomic and environmental risks are
a key barrier to sustainable development, particularly in developing countries that rely primarily on agriculture, are vulnerable to natural disasters, and lack adequate coping mechanisms [7, 8]. The World Development Report [5] states that unfavourable household shocks play a major role in pushing households below the poverty line. For example, [6] found that more than thirty percent of the variation in shifting poverty rates between nations can be attributed to cross-country differences in financial growth. Regarding this, a growing body of research suggests that formal risk management tools such as insurance, savings accounts, and loans can significantly affect the progress of economic development and the decrease of poverty [6–8]. Given this, it is believed that increasing access to financial services is essential to achieving the SDGs [9–11]. However, the impoverished world’s access to financial services and procedures is still uneven [12]. Unofficial savings and borrowing networks are the major ways that many households reduce the effects of fluctuations in income and spending. This is particularly relevant when thinking about rural populations: According to the UNCDF’s Making Access Possible (MAP) Programme, “more than 50% of economically active adults are farmers in most of the countries, supplementing their earnings from other work by engaging in the farming sector.” Living almost exclusively in rural areas and being impacted by climate shocks despite having little to no resilience mechanisms, they constitute the population’s lowest and most vulnerable segment [13]. Many people think that in order to help the most vulnerable people become resilient to the consequences of climate change, it is crucial to give them access to financing [14]. Through a process of evidence-based country diagnostics and stakeholder dialogue, the Making Access Possible (MAP) programme is a multi-country initiative to support financial inclusion. It has resulted in the development of national financial inclusion roadmaps that identify important drivers of financial inclusion and suggest action [15]. These initiatives are a part of ongoing initiatives to enhance data collecting on a large scale in order to gain a deeper understanding of financial inclusion. This initiative relies on having a deep understanding of low-income households’ wants and preferences in order to develop service solutions that better suit their requirements and reduce access inequities [16]. A “needs-based” approach to analysing financial inclusion can inform and assist in the development of business models and regulations that offer financial services that meet the needs of customers, especially those at the bottom of the pyramid [17]. This data allows us to investigate adult customers’ current coverage levels of different financial services. We go into great detail about the factors that influence the probability that a household is covered by different types of insurance. This emphasis on insurance is essential given the ongoing efforts to increase insurance penetration and the relatively poor success in doing so. Over the past 10 years, scholars and policymakers have paid close attention to the underutilization of insurance as a coping strategy in developing countries. This is especially true in view of the launch of sovereign risk schemes, innovative index insurance products, and micro-level products [18]. These strategies are based on the notion that they can help with risk planning and risk understanding development and offer more dependable and effective protection than post-disaster aid [19]. However, there is still a persistently low acceptance of insurance even in circumstances where it is subsidised, such as the InsuResilience programme, which appears to be impeding the growth of the commercial insurance markets. This is despite the insurance products being piloted and tested. There are a number of considerations depending on the kind of insurance. For example, the laws and policies controlling insurance at the macro, national level are not the same as those controlling insurance for private individuals. The use of financial products by households, including insurance, is the main topic of this article. Earlier research on the demand for insurance has mostly relied on willingness to pay (WTP) studies, case studies, and randomised control trials (RCTs), most of which were conducted at the national and regional levels to look at various facets of the supply and demand for insurance in developing nations. The dearth of micro-level data across nations has been one of the main causes in this regard. This essay fills in that void. The purpose of the current study is to examine insurance, which is the initial stage of financial services.

2. LITERATURE REVIEW

Even while it’s a valid objective of life insurance to replace lost human wealth, many households discover that their amount of insurance is insufficient, particularly given the present rates of ownership [20]. The decline in cash-value policies may be the product of sound decision-making given the expansion of tax-favored investment options and changes in tax laws; however, these trends may be impacted by adjustments to the federal estate tax and federal income tax. Durham’s [21] research indicates that households tend to overestimate the cost of life insurance quite a little. 25% of households overestimated the cost of a $250,000 20-year term policy by 250%, while 25% of households projected the cost to be less than $250,000. Financial consultants’ advice on life insurance is rarely taken seriously by families [22], which is why it’s important to prepare for life insurance. While we found that life insurance is more common in homes with financial planners, we are not sure if this is due to the financial planner’s advice or if families with life insurance were more likely to seek financial advice. Given the
downward trends in life insurance ownership, it should come as no surprise that households significantly overestimate the cost of life insurance while placing little importance on life insurance planning. If financial advisors and their customers saw term life insurance as a loss leader or breakeven product instead of a revenue stream, both parties might win. Term insurance is an excellent product to provide clients as a means of establishing rapport and confidence. The first step would be for planners to get an estimate from the client for the cost of a $100,000 20-year term life insurance policy, then compare that estimate with the actual amount. If the client is confident that, in the event of an early death, his or her family will get reasonably inexpensive financial support, then moving on to other planning areas may be possible. This tactic would likely be advantageous to financial advisors who follow or do not follow a fiduciary standard. When clients are recommended to purchase life insurance, recommendations for term life insurance that do not clearly provide a financial benefit may help to ease their concerns. Cash value life insurance may be addressed later in the financial plan rather than early if it is appropriate for clients with more complicated financial needs. It is widely recognised that households in developing countries are exposed to a wide range of risks, and that the coping mechanisms used to manage these risks differ significantly depending on a country's economic development stage and other factors [20–24]. More formal financial services are thought to be necessary for people to effectively manage risks and for economic progress in developing countries [25–30]. Previous talks on financial services and economic growth have emphasised the benefits of credit, insurance, and savings in risk management and increasing the economy's investment efficiency [31]. The relationship between financial development and economic growth has been explained in terms of possible development patterns between the two states, which have been called "demand-following"—in which a decline in demand for financial services is reflected in a decline in financial development—and "supply-leading"—in which financial development propels economic growth [32]. The increasing recognition of the importance of financial services has led to a plethora of national and international initiatives during the last ten years aimed at increasing the poor in developing countries' access to financial services. Even Nevertheless, developing countries have not historically had a high demand for financial services, and 1.7 billion people globally lack access to official financial institutions [33]. The demand for credit and savings [33–36] as well as the demand for insurance [37] are the main categories of demand analysis for financial services in emerging nations. In reality, households have access to a wide range of official and informal coping strategies (such as selling livestock, taking out loans from banks or money lenders S, using savings, borrowing from neighbours, purchasing insurance, or a combination of these). Research priorities continue to include figuring out what influences this decision [38–39]. The factors influencing the need for insurance in developing nations are among the least understood components of a household’s decision about coping mechanism(s). The demand for market-based insurance in emerging nations is not well understood [40]. A plausible explanation for this could be the challenge of disentangling the examination of supply and demand, given that a large number of families in developing nations do not have access to formal insurance products. Despite the last ten years of micro-insurance reform, formal insurance demand has remained relatively low in developing nations when compared to the demand for savings and credit. A growing amount of study has been conducted on the factors influencing the demand for insurance in developing nations as a result of the perplexing issue of the poor adoption of formal insurance in these nations [41, 42]. This discussion has benefited greatly from earlier research using household surveys, randomised control trials (RCTs), and choice experiments to examine the demand for index-based insurance in developing nations [43–46]. Numerous factors, including high premium costs, low income, trust in the insurer, prior insurance experience, education level, financial literacy, liquidity restrictions, and the impact of prior shocks, have been emphasised by these research as contributing to the poor uptake of demand for insurance. From a supply-side viewpoint, the current low demand for microinsurance services has also been examined by looking at the importance of basis risk, pricing, transaction costs, contract design, and service quality [47–50]. Few research have also examined the interdependence of the demand for formal insurance, credit, and savings among households in developing nations, and they have discovered that, in contrast to their counterparts in wealthier nations, the impoverished in these countries are less likely to use formal financial services. The importance of new technology, such as the usage of smart or mobile phones and its effects on financial services and inclusion in developing nations, is one of the most recent additions to the body of work now under publication. The significance of mobile phones in boosting financial inclusion in developing nations has been underlined by this research. The growing body of evidence is supported by a Finindex survey that indicates that, globally and in developing countries, between 2014 and 2017, mobile phones increased the proportion of account owners sending or receiving payments digitally from 67 to 76 percent and 57 to 70 percent, respectively [51]. Nonetheless, the majority of this research stream has concentrated on loan accounts, mobile savings, and financial transactions. The use of mobile phones has the potential to encourage the use of formal insurance, for example, by offering insurance advice services via mobile devices, however the research is still in its early stages and there is very little empirical data to support this claim [52]. All things considered, one of the factors influencing the uptake of insurance is its cost. The price of coverage,
a person's level of risk aversion, their income, and their perceived amount of risk all have an impact on how ready a person is to pay for insurance, according to theory and empirical investigations [53]. While studies have frequently overlooked the factors that affect the supply of insurance in developing nations, there is a growing recognition of important supply-side barriers, such as a lack of data or technical capacity (see, for example, Vivid et al. 2016). Important obstacles also include things like high transaction costs when providing commercial insurance to the underprivileged, moral hazards and adverse selection, and institutional obstacles, such as the nation’s regulatory and legal environment [56]. Factors influencing insurance demand and uptake have been a major area of interest for insurance research. Various variables that may be essential in understanding the demand for life insurance have been the subject of various studies. While factors influencing demand for insurance may vary depending on whether one is buying life or non-life insurance, the majority of research generally agrees that buying an insurance contract is primarily based on eight income levels, but it is also influenced by broader socioeconomic, demographic, and regional factors [57]. The amount of income has been one of the main factors influencing the life insurance market's consumption of life insurance [58]. To examine the role of income in industrialised and emerging economies, the relationship between insurance penetration and income level is sometimes depicted as the “S-Curve model.” Due to the two threshold values of income elasticity of demand for insurance, this model suggests that there is a nonlinear relationship between income and insurance demand. Consequently, compared to mature economies, emerging economies should have a higher income elasticity of demand for insurance. In a similar vein, it is anticipated that education level will have a significant impact on insurance demand. There has been conflicting prior research about the influence of education—which is frequently used as a stand-in for risk aversion—on the desire for insurance. There is conflicting evidence about the influence of education on life insurance demand, despite certain research demonstrating a strong positive correlation between education and demand. As a result, a substantial body of research indicates that the demand for life insurance is positively correlated with income and education levels, although these factors have little bearing on the demand for life insurance [59]. In contrast to the life insurance industry, there is relatively less data regarding the variables influencing the demand for non-life insurance at the cross-national level, such as crop insurance. While education and urbanisation are important factors influencing the demand for nonlife insurance, income is not relevant for the non-life market, particularly in Asian nations, according to recent studies exploring this phenomenon [60].

3. CONCLUSION

It is conceivable that future changes in federal income tax and estate tax policies could result in an increase in the ownership of life insurance given our conclusion that the decreases in the ownership of cash value life insurance and the ownership of any life insurance were not caused by changes in household characteristics. Insurance is essential to financial planning because it provides stability and protection against a range of dangers. Life insurance, health insurance, retirement plans, property insurance, equity markets, and other insurance products give people and their families' financial security and the capacity to deal with unforeseen circumstances. People can safeguard their assets, care for their loved ones, and work towards their long-term financial objectives by including insurance into their financial planning. To make well-informed selections, it is crucial to carefully choose insurance products based on unique needs and speak with financial counsellors. When paired with appropriate insurance, sound financial planning may give people and families the self-assurance to take on upcoming obstacles and create a secure financial future. This study looked at the financial services industry, with a particular emphasis on the demand and coverage for formal insurance from Asian developing nations. Our examination of coping strategies for shocks shows that, whereas borrowing and savings are significant coping strategies for shocks to one's health, depending on insurance and savings is more typical in the case of environmental shocks like droughts. In order to promote financial inclusion, our analysis emphasises how critical it is to comprehend the demands and requirements of individuals who are exposed to shocks. Although financial services and products were not created with local needs and requirements in mind, there are numerous examples of unsuccessful attempts to combat poverty that highlight the importance of having access to finance. Therefore, it is crucial to think about the kinds of products that will be most appropriate from
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