

IMPACT OF FINANCIAL SECTOR REFORMS ON THE PERFORMANCE OF INSURANCE COMPANIES IN NIGERIA

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ABSTRACT

The Nigerian financial system has been going through series of reforms to meet the global development all over the world. The insurance companies are not left behind to this ongoing dynamic change. The reform introduced in the insurance industry is to stimulate the industry's growth and stability. This study examines the Nigerian financial sector reforms and its impact on the insurance companies. The study is descriptive in nature and used secondary data contained in the annual reports and accounts of the quoted insurance companies for the years 2008 to 2014. Regression and correlation analysis was employed in analyzing collected data. The findings from the study revealed that financial sector reforms has impacted significantly on the performance of quoted insurance companies in Nigeria with 0.530 and 0.396 correlation on the share capital and reserves respectively. Despite the fact that, the significant effects of the global financial crisis on the operating results of companies during the 2008 and 2009, the study concluded that reforms has impacted significantly on the performance of quoted insurance companies in Nigeria and recommended that insurance companies should be more aggressive towards securing bigger and better insurance contracts so that the increased share capital base could be efficiently and effectively utilized, also, the Nigerian government should always consider the risks, uncertainties, and opportunities surrounding the insurance industry and employ scientific procedure in arriving at a particular reform policy.

Keyword: Financial Reforms, Insurance Companies, Performance, Share Capital, Cash Reserves

INTRODUCTION

Financial institutions for purposes of investment play the considerable role in mobilizing savings from the surplus economic units and directing same to the deficit economic units. The financial system especially market economy is seeing as the central nervous system of every economy. It comprises a number of separate but interconnected components all of which are essential to its effective and efficient functioning, Hamadu and Majekwu(2010). Basically there are three interrelated components of financial institutions. These are financial intermediaries such as banks and insurance companies, which act as principal agents for assuming liabilities and acquiring claims; the financial market in which financial assets are exchanged; and, the financial instruments which is necessary for the effective interaction of the intermediaries in the markets, Kama (2006). to the nominal need for operational improvement and growth of both the institutions and the general economy, Chinedu and Muoghalu (2004).

In Nigeria, the ability of the financial subsector to play its role has been periodically punctuated by its vulnerability to systemic distress and macro-economic volatility, and policy fine tuning inevitability, Kama (2006). Thus, the financial reforms were focused on further liberalization of banking business; ensuring competition and safety of the system; and proactively positioning the industry to perform the role of intermediation and playing a catalytic role in economic development. Insurance is one of the cornerstones of modern-day financial services sector. In addition to its usual role of risks management, insurance market activity, both as intermediary and as provider of risk transfer and indemnification, promotion of long term savings, and mobilization of domestic savings into productive investment, Arena, (1998).

Since the successful transition to civil rule in 1999, formulations of strategies for economic development have been introduced to stimulate the country's economic growth. Nigerian government recapitalization reform in the insurance industry is aimed at restoring confidence of the public in the market and enhances international competitiveness of local operators. It is believed that when the capital base of an organization is increased, the potentiality of achieving efficiency and growth could also be increased, Orea and Kumbhakar, (2004).

The main objective of this work is to examine the impact of financial sector reforms on the performance of insurance companies in Nigeria. The specific objectives are to find out whether insurance companies' performance had increased as a result of the financial sectors reforms and investigate the relationship between financial sector reforms and insurance companies share capital acquisition. Thus, it will test the hypotheses to find out if there is no significant relationship between financial sector reforms and insurance companies' performance in Nigeria and if there is no significant relationship between financial sector reforms, and insurance companies' share capital acquisition.

The paper is structured into five sections. The first is the introductory part while the second and third are review on literature and methodology respectively. The fourth and fifth section discusses on the finding and finally the conclusion and recommendations.

Review of Related Empirical Literature

To examine the relationship between property insurance propensity and premium as dependent variables, and leverage, growth opportunities, state and managerial ownership as explanatory variables in a Chinese property insurance market using a sample of thirty five (35) public liability companies from 1997 to 1999, Davies and Yuwei (2004) employed heterogeneity fixed effects estimation model on panel data. The results revealed that there is a tendency for companies that are highly leveraged or have physical assets intensive production to consume property insurance, while state ownership decreases the demand for insurance. The study was however credible but the result could have been different if it was carried out in a developing country like Nigeria.

Been stock, Dickinson and Khajuria (1988) studied the relationship of insurance and economic growth, a theoretical and empirical analysis applying a cross country panel data analysis using

annual insurance premium data from 29 European countries over the 1992 to 2004 period. The findings could have been different if specific country were chosen for the study.

data from 63 developing and developed countries. The result reveals education level to be significant. Furthermore the findings emphasized the importance of banking sector development and the results for the role of the income level are in line with the results of previous works. The panel data regression mainly confirms the results of the cross-section estimation. Different events in the developing and developed might have overcome the findings.

An examination of the impact of insurance practice on the growth of Nigerian economy was carried out by Eze and Okoye (2013) employing insurance premium income, total insurance investment and income of insurance development as determinants of insurance practice. Additionally, the study employed unit root tests, Johansen co-integration test and error correction model in data analysis to determine the short and long run effects of the model. The study found positive and significant relationship between insurance premium capital and economic growth in Nigeria.

The study spanned from the period of 1986 to 2009. The empirical result indicated that insurance sector growth and development positively and significantly affects economic growth. cultural, attitudinal traits and values in the economy. The findings might have been overcome by events.

Similarly, Wadlamannati (2010) employed ordinary least square (OLS), co-integration analysis and error correction models (ECM) to examine the effects of insurance growth and reforms along with other relevant control variables on. The study documented positive and significant influence between insurance sector and economic development. The study further reveals that while the reforms in the insurance sector do not affect economic activity, their growth has positive impact on economic development. However, the result could have been different if it was carried out in an African country with comparably less stable reforms.

Further, Ewedemi and Lee (2008) considered the adequacy of the increment in the share capital of insurance companies in Nigeria and relate it to risks and uncertainties in the industry to investigate the capital adequacy in the Nigerian insurance industry employing a population to comprise of five (5) quoted insurance companies that were in operation as at 31st December, 2009. They study reveals that the Nigerian insurance companies are now more equipped in their capital base, than before and hence would be able to attract more lucrative insurance contracts. Nonetheless, the study was not able to relate to insurance companies capabilities, ability to secure the contracts especially overseas, and the negative perception of insurance business to some local businessmen. These constitute the gap to the empirical literature.

Ibiwoye and Adeleke (2008) examined a movement of stock prices of insurance companies in Nigeria. The study was not directly related to the reforms of the insurance industry, yet the finding reveals that the market prices of the insurance companies' shares appreciated more soon after the reforms exercise. Thus, the study concluded that the insurance industry is fast becoming

the Nigeria's next capital market honey pot at that time. Their inference is in line with the conclusion arrived at by Omobola (2008) on the insurance growth in Nigeria. However, their findings might have been overtaken by events.

Theoretically, the research is linked to the theory of perfect competition. The fundamental basis of insurance operations lies with the assumption that buyers and sellers of insurance coverage have perfect information about each other before signing an insurance contract. While it can be argued that, this assumption may not be tenable in real world, the effects of information asymmetry can be organized in accordance with the temporal appearance of participants before an insurance contract is signed. This will give the consumer (the buyer of insurance coverage) the ability to evaluate all competing products within a perfectly competitive market situation. Consequently, the consumer may act as both a creditor (paying the premium) to the insurer, and as debtor (by paying in advance for future conditional payments). This dualistic characterization of signed contract makes the insurer's default probability highly relevant to product quality.

METHODOLOGY

Simple regression and correlation models were adopted in this study to establish the strength of relationship between the sector reform and firm performance of quoted Nigerian Insurance Companies. Data were sourced from published financial reports of quoted insurance firms in Nigeria and Nigerian Stock Exchange website for the period of seven (7) years (2008-2014). The population of the study is made up of all the quoted insurance firms in Nigeria as at 31stDecember, 2014. The sample size of the study was drawn from the quoted insurance companies in Nigeria scientifically using the Ralph, Holleran and Ramakrishnan (2002) formula as follows:

$$n = \frac{\log p}{\log \beta}$$

where:

- n = Sample size
- p = Level of precision (i.e 100% minus confidence level)
- β = Ratio of quoted insurance companies as at 2009 to the number of insurance companies prior to insurance reform.

In order to reduce the level of statistical error and attain the highest level of accuracy possible, 99% confidence level is selected, which gives a precision level of 1% (i.e. 0.01).

Therefore; $\beta = \frac{27}{71} = 0.38$

In view of the above values computed, the sample size of this study is computed as follows:

$$n = \frac{\log p}{\log \beta} = \frac{\log 0.01}{\log 0.38}$$

$$= \frac{-2}{-0.42} = 4.76 \approx 5$$

A mathematical model was developed based on the proxy specified for the dependent variable; Profit After Tax (PAT) as financial performance proxy, while Share Capital (SCH) as proxy for insurance reform which is the independent variables.

The simple regression and correlation values were calculated using the Statistical Program for Social Sciences (SPSS) version 16.

The regression equation is formulated thus:

$$PAT_{it} = \alpha + \beta_1SCH_{it} + \beta_2REV_{it} + e_{it}$$

Where:

- PAT = Profit After Tax
- α = Intercept (constant)
- SCH = Share capital
- REV = Reserves
- β = beta coefficient
- t = time
- I = firm
- e = Statistical error

RESULTS AND DISCUSSION

This part of the paper dealt with presentation of the statistical data on Profit After Tax, Share Capital and Cash Reserves of the selected quoted insurance companies in Nigeria from 2008 to 2014 result. The later part of the paper dealt with analysis, and interpretation of the data collected for the purpose of testing the model of the study as well as discussion of findings.

Table 4.1: Presentation of Statistics of Variables Used

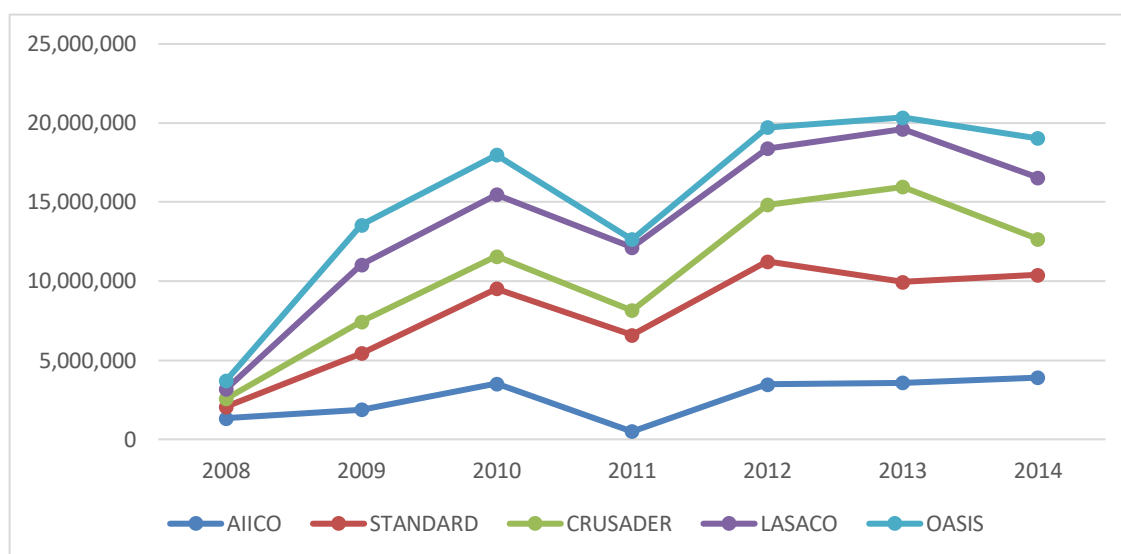
Companies	Year	Profit After Tax N'00	Share Capital N'00	Cash Reserves N'00
A I I C O	2008	483,702	1,332,765	4,537,199
	2009	304,709	1,873,757	4,437,220
	2010	231,347	3,520,082	7,609,170
	2011	277,783	492,234	1,365,737
	2012	544,051	3,485,337	7,143,092
	2013	614,639	3,580,000	7,155,257
	2014	764,931	3,901,717	2,320,027
STANDARD	2008	262,381	735,000	906,118
	2009	333,576	3,571,587	2,766,865
	2010	864,196	5,996,587	17,069,182

	2011	866,234	6,108,501	10,435,981
	2012	906,118	7,764,931	17,276,823
	2013	910,538	6,378,870	17,548,354
	2014	953,402	6,501,341	18,946,798
CRUSADER	2008	315,057	498,679	5,656,254
	2009	1,446,931	1,994,710	6,378,870
	2010	-208,253	2,054,822	2,566,361
	2011	1,113,548	1,545,415	2,589,614
	2012	1,332,765	3,571,587	3,601,717
	2013	1,873,757	5,996,587	3,661,894
	2014	-27,183	2,260,304	2,333,696
LASACO	2008	171,531	604,910	910,538
	2009	678,111	3,601,717	2,484,380
	2010	764,931	3,901,717	2,320,027
	2011	786,931	3,994,710	2,378,870
	2012	487,638	3,571,587	2,385,548
	2013	525,440	3,661,717	2,385,548
	2014	583,702	3,873,757	2,501,753
OASIS	2008	113,548	545,415	189,614
	2009	138,165	2,501,753	958,224
	2010	-49,677	2,501,753	620,977
	2011	277,783	492,234	1,365,737
	2012	483,702	1,332,765	4,537,199
	2013	662,381	735,000	906,118
	2014	-95,537	2,501,753	525,440

Source: Annual Reports and Accounts of the Selected Insurance Companies in Nigeria and Nigerian Stock Exchange Fact Book 2008 to 2014.

In table 4.1 above, the years captured are considered as period after reforms and presented based on company by company basis. From the research data, cash reserve of sampled insurance companies increased from 2008 to 2010 by 32% and decreased from 2010 to 2011 by 15% but has a steady increase from 2011 to 2013 by 68%, these indicate that the insurance companies made successive progress in the years under review and have very good capital based as showed in figure 4.1.

Figure 4.1: Share Capital of Sampled Quoted Insurance Companies ,Source: Author's Computation, 2017



Data Analysis

To empirically determine the relationship between financial sector reforms and performance of insurance firms under review, correlation matrix and regression analyses were used. The following sub-section outlines the results of the data analysis.

Correlation Analysis

Table 4.2 below presents the degree of relationships between the variables of financial reforms and performance of insurance company. The result reveals that there is positive correlation between variables after the sector’s reform. The Pearson Correlation Coefficient between profit after tax and share capital is 0.530, while between cash reserve is 0.396. Thus, correlation coefficients indicate weak power of relationship between cash reserve and profit after tax at < 0.05 significant while a strong power of the relationships between share capital and profit after tax on < 0.1 significant. Also, there is positive and strong relationship between share capital and cash reserve. This further indicates the reform has positive impact on the insurance companies.

Table 4.2: Pearson Correlation co-efficient between Variables

	Profit After Tax	Share Capital	Cash Reserve
Profit After Tax	1	0.530*	0.396**
Share Capital		1	0.735**
Cash Reserve			1

Source: SPSS Computed Results from Table: 4.1

Regression Analysis

In order to further establish the relationships and effects of financial sector's reforms on financial performance, regression analysis was conducted as share capital was used to represent proxy for financial sector's reforms while profit after tax was used as proxy for financial performance.

Table 4.3 below summarizes the regression results. As indicated in the regression statistics shows that, the R-Square is 0.259, which suggests a positive relationship between variables. The F-statistics shows that the equation or model employed is statistically significant at a value of 12.885 with p value (significant F = 0.000) which means that the relationship between profit after tax and share capital is highly statistically significant (sig f < 0.1 is statistically significant). Of course, the judgment and estimation indicate that the share capital is found to be highly positive and significance at a t-statistics of 3.590, with a positive impact on profit after tax, having the value of its coefficient as 0.530. The sign indicates that coefficient of share capital is positively related to profit after tax.

Table 4.3: Result of the Regression Analysis

Variables	Outputs
R	0.530
R square	0.281
Adjusted R square	0.259
t-Statistics	3.590
Significant	0.001
F-Statistics	12.885
Coefficient	0.530

Source: SPSS Computed Results from Table: 4.1

The study found that the results for both periods after reforms indicated strong positive correlations between insurance reforms and performance of the selected quoted insurance companies at < 0.1 significant. The regression analysis shows that the performance of quoted insurance companies is positively related to share capital as well as reserves during the period before reforms. The results for the period after reforms indicated that as the unit of share capital increase in the post reforms period, it tends to increase the profit of quoted insurance companies by 3.590; while a unit increment in reserve value tends to reduce the profit by 1.561. Looking at the aggregate effect of the variables, the profit after tax of the quoted insurance companies is more positively affected in the post-reforms. This means that when the share capital and reserves are altered concurrently by the same proportion, the aggregate effect is outstanding.

Comparing the t-statistics with the significant values; share capital showed significant impact at 10% level of significance during the post-reform. This could be explained in terms of the quantum of reserves (mostly share premium) that accumulated from the new issue of shares by the insurance companies to meet the reforms requirements. The hypothesis formulated in this study is tested using the t-statistics, showed significant t-statistics results in terms of share capital and reserves at 10% and 5% significant level. This means that the 2005/2006 reforms does have

significant impact on the performance of quoted insurance companies in Nigeria, the study, therefore, reject the null hypothesis.

CONCLUSION AND RECOMMENDATIONS

The Federal Government of Nigeria utilizes the process of reforms to strengthen the operating performance of the insurance industry. The 2005/2006 reforms exercise aimed at strengthening insurance companies' financial picture in anticipation of an expansion that will make the companies stronger overtime. The findings from this study revealed that reforms have impacted significantly on the performance of quoted insurance companies in Nigeria.

There are some indications for improvements in absolute average profit figures during the post-reforms, the increase of the share capital base of insurance companies in Nigeria does commensurate with the level of performance achieved by the companies. Thus, the findings from this study confirmed with the predictions that reforms will significantly impact on the operating profits of insurance companies.

Despite the fact that, the significant effects of the global financial crisis on the operating results of companies during the 2008 and 2009, the study concluded that reforms has impacted significantly on the performance of quoted insurance companies in Nigeria. This conclusion aligned with that of Fatula who concluded that reforms will enable the insurance companies to secure more lucrative contracts and make significant profits.

In order to ensure that quoted Nigerian insurance companies continue to grow significantly and to achieve the aim of reforms in the industry, the following recommendations are proffered based on the findings of the study.

b. One of the findings which this study revealed was the dearth of capacity for operators as well as regulators and supervisor in the reforms era. Much as the operators need to develop adequate and appropriate capacity to cope with the reforms challenges, regulators and supervisors themselves need also to shore up their capacity to meet the challenges of supervising insurance companies which they were not exposed to, before.

c. The study strongly recommends the strict implementation of the risk-focused and rule-based regulatory framework by the regulators. This it is believed will reduce the high incidence of huge bad debts profile of insurance company and consequently improve the assets quality of insurance company for better performance.

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APPENDIX A RESULT OF THE REGRESSION ANALYSIS

M o d e l S u m m a r y

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.591	.281	.259	3.89982E5

a. Predictors: (Constant), Share Capital

A N O V A

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	1.960E12	1	1.960E12	12.885	.001 ^a
Residual	5.019E12	33	1.521E11		

Total	6.978E12	34		
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a. Predictors: (Constant), Share Capital

b. Dependent Variable: Profit After Tax

C o e f f i c i e n t s ^a

M o d e l	Unstandardized Coefficients		Standardized Coefficients	t	S i g .
	B	Std. Error	B e t a		
(Constant)	191462.081	122632.773		.161	.128
Share Capital	.121	.034	.530	.399	.001

a. Dependent Variable: Profit After Tax