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Research Article

Recapitalization and Return on Assets of Selected Insurance Companies in Nigeria (2010-2019)

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Abstract: The study investigated recapitalization and return on assets (ROA) of selected insurance companies in Nigeria from 2010-2019. Ex-post facto research design was adopted for this study from the secondary data obtained from the Nigerian Stock Exchange Factbook. Of the twenty-three (23) insurance companies listed on the Stock Exchange, ten (10) of them were selected for this study. Panel regression analysis was employed for this study. The study concluded that recapitalization has significant effect on return on assets of insurance companies in Nigeria. The study therefore recommended that management of insurance companies should take advantage of increase in their capital base to generate more profit in order to maximize shareholders wealth.
Keywords: Recapitalization, Shareholders' wealth, Return on assets and Capital base.

1.0 Introduction

One of the key objectives of an organization is profitability. Profitability is important to any organization for its survival. Profitability is a generic word, it can be measured in various ways, and one of such ways is the return on assets (ROA). Siddik, Kabiraj and Jughee (2017) stated that return on asset (ROA) measure of companies' performance which gives a picture of how effective the management of a company is generating profits with the available assets. It reveals the relative profitability of the company.

Capitalization is a policy aim to increase the number of long-term finances used to fund an organization. This implies a rise the company's capital structure. It can also be viewed as the issuance of extra share from the un-issued share capital for new or existing member of a company (Oluitan, Ashamu & Ogunkenu, 2015).

Recapitalization of insurance market in Nigeria started in 2005 in order to enhance the insurance program to accept globalization, improve healthy competitiveness, tap economies of scale, introduce new technology, increase productivity in the industry, and improve on profitability of the companies operating in the industry. Ultimate aim is to deepen intermediation function and ensure the developmental role of the insurance companies in order to promote economic growth, which invariably leads to better overall economic outcomes and social welfare (NAICOM, 2017).

Alani and Sani (2019) supported the recapitalization aim to encourage companies to expand their market strength, contribute to consolidation and to align and orient companies so that their network of insurance companies are sound, receptive, efficient and open and adaptive to the demands of the Nigerian economy and globalization challenges. Ambrose, Saratu and Datong (2018) argued that capitalization was undertaken to avoid structures of failure restoration of public trust, build up powerful, capable and successful players on the world stage, guarantee durability to mention but few.

Kanu and Isu (2013) stated that insurance firms in Nigeria are not declaring remarkable profit because of low capital. They therefore advised that insurance companies operating in Nigeria should be made to increase their capital in order to increase their profitability.

The scenario of insurance business in Nigeria has been characterized by low capitalization which consequently transcend into dearth of human capital and professional skills, poor return on capitals, prominence of unethical practices, non-prompt payment of claims, low contribution to GDP/capital figures, lack of innovation in product development, lack of awareness on the part of the consumers on the uses/suitability of insurance product (Alani & Sani, 2019). To this end, restructuring of risk-adjusted capitalization is important in order to improve insurance firms' ability to adequately protect policy holders. In the exercise of the powers conferred on the National Insurance Commission by the enabling laws, the minimum paid-up share capital requirement of Insurance and Reinsurance Companies in Nigeria was reviewed upward as per the table below in a circular dated 20th May, 2019.

Table 1. Capital Base for Nigerian Insurance Companies

Category of Insurance	**Capital Base (2003) ₦**	**Capital Base (2005 to 2019) ₦**	**Capital Base Effective June, 2020 ₦**
Life Insurance	150 Million	2 Billion	8 Billion
General Insurance	200 Million	3 Billion	10 Billion
Composite	350 Million	5 Billion	18 Billion
Reinsurance	350 Million	10 Billion	20 Billion
Source: National Insurance Commission Circular No: NAICOM/DPR/CIR/25/2019			

It is as a result of the discussion above, that this study investigated insurance industry recapitalization and return on assets in Nigeria from 2010 to 2019.

2.0 Literature Review

2.1 Conceptual Framework

2.1.1 Insurance

Redja and McNamara (2014) have explained that American Risk and Insurance Association defined insurance as the pooling of fortuitous losses by insurers, who agreed to indemnify the insured in the event of contingencies. From this definition, we can describe insurance as a co-operative system that spread the losses of the insured over those that have agreed to protect themselves against that risk. Apart from its traditional role of managing risk, insurance market acts as both intermediary and as provider of risk transfer and indemnification which enabled it promote growth by allowing different risks to be managed more efficiently, promoting long term savings and encouraging the accumulation of capital, serving as conduct pipe to channel funds from policy holders to investment opportunities, thereby mobilizing domestic savings into productive investment (Oyedotun & Adesina, 2015).

2.1.2 Recapitalization

Recapitalization is an important component of the economic policy reform package. It is the process where firms increase their capital stock by issuing shares to existing shareholders or new shareholders or a combination of both. In whatever way one sees it, recapitalization is one of the government's policies reforms that enables organizations to increase its capital stock substantially to sustain adequate economic growth and development (Ahmed, 2016). The low capitalization of Nigerian insurance companies may be a fundamental bottleneck that may inhibit the functioning of the institutions for growth and achievement of core objective in the drive towards enhancing and sustaining the economic and social imperatives of human endeavor carried out through either government institutions or private enterprises (Alani and Sani, 2019), it is for this reason that government through NAICOM increased the minimum paid up share capital of Insurance and Reinsurance companies in a circular issued in May, 2019.

2.1.3 Return on Asset (ROA)

Profitability is a crucial objective of any business as it keeps insurance companies in business and equally essential for survival. Profitability is a generic word. It can be measured in various ways, one of such ways is the return on assets (ROA). Return on assets (ROA) ratio is commonly used to measure insurance companies' performance and it gives picture of how effective the management of insurance companies is in generating profits with the available assets.

The return on assets ratio formula is calculated by dividing net income by total assets.

ROA (Olowe, 2017) = Profit after Tax/Total Assets

Collins (2017) stated that ROA is used to measure management's ability to make more profit from the company's assets and can also be used to compare ROA for other companies in the same industry. ROA is also used to evaluate the benefit of investing in a new system versus expanding a current system through choosing the one that ideally increases productivity and income as well as reduces asset costs resulting in an improved profit.

2.2 Theoretical review

2.2.1 Financial Intermediation Theory

Financial intermediation theory was developed in 1960 by Gurley and Shew. The theory explains the importance of intermediation process of financial intermediaries in the economy as a whole. The financial intermediation theory is based on the theory of informational asymmetry and the agency theory. Financial intermediaries are regarded as companies that have as sole purpose the maximization of profit.

2.2.2 Shareholders' Theory

Milton Friedman propounded the shareholder theory in 1970. He opined that the objective of most businesses is to increase shareholder's profit. The implication of this is that a business belonging to shareholders should be managed in their interest. The emphasis of the shareholder theory is on the maximization of its shareholders' value. The shareholder's theory is also promised on the fact that managers are hired as agents by shareholders to operate a business in their interest, thus empowering them legally and morally to act on their behalf.

2.2.3 Value at Risk Theory

The value at risk theory was brought to literature in 1996 by a researcher named Leong Latiny. The scholar postulated that there are values attached to every risk in business ventures all that is required by the investor is to analyze the risks inherent in the business and decide ahead of time whether the risk is worth taking. Value at risk (VAR) is a common technique used by banks, security firms and companies that are involved in trading energy and other commodities. The importance of the concept of value at risk is demonstrated by the fact that the Basel Committee on Banking Supervision has included a regulatory capital charge for operational risk and value at risk (Owolabi, Oloyede, Iriyemi & Akinola, 2017).

2.3 Empirical Review

Ambrose, Saratu and Datong (2018) empirically assessed the effects of bank recapitalization on the profitability of deposit money banks in Nigeria from 2005-2016 using fifteen (15) banks quoted on the Nigerian Stock Exchange. Data used for the study were obtained from secondary source. The data were analyzed using pooled regression analysis through STATA window 14 package. The findings from study revealed that bank recapitalization has significant effect on return on assets (profitability).

Adeyele and Maiturare (2012) reported that the recapitalization of insurance sector is a strong policy drive that will increase not only the profitability level of the industry but also its stability and will improve the capacity of insurers to underwrite "significant risk".

Adegbaju and Olokoyo (2008) examined the effect of consolidation on the profitability of commercial banks in Nigeria between the year 2000 and 2010. The study used a t-test to find out whether a significant difference exists between the profitability ratios before and after consolidation. The study revealed that bank consolidation has improved the efficiency of the banks and it showed that bank consolidation program is of great success in the Nigerian context.

Ibrahim and Abubakar (2011) examined the pre and post effect of the recapitalization on the profitability of quoted insurance companies in Nigeria. The study though descriptive in nature, revealed that recapitalization has not impacted significantly on the profitability of quoted insurance businesses in Nigeria. Attaining capitalization requirements is achieved through consolidation, convergence as well as an efficient capital market. It is therefore important to stress that recapitalization is primarily driven by the need to achieve the objectives of consolidation, competition and convergence (Deccan, 2004).

3.0 Methodology

Ex-post facto research design was adopted for this study. Secondary data obtained from the Nigerian Stock Exchange as at 31st December 2019 was used for the study. There are twenty-three (23) insurance companies listed on the Nigerian Stock Exchange. The sample selected are ten (10) non-bank financial institutions. The period of this study covered ten (10) years from 2010 to 2019. Data were extracted from the annual reports of the sampled non-bank financial institutions in Nigeria for the period of the study.

3.1 Data Analysis Method

Panel data regression analysis was employed for this study on the ground that a combination of cross-sectional and time series data would provide a better result for this research.

3.2 Model Specification

To examine the effect of re-capitalization on return on asset of selected insurance companies in Nigeria, the study has two variables i.e dependent and independent variables. Using functional relationship of:

$Y = f(x)$

Where:

Y – Dependent variable (Profitability i.e return on asset)

X – Independent variable (capitalization)

X – is broken down as follows:

x_1 – Debt equity ratio (DER)

x_2 – Issued share capital (ISC)

x_3 – Total shareholders capital (TSC)

Model derived from the study:

$ROA = \beta_0 + \beta_1 DER + \beta_2 TSC + \mu$

4.0 Data Analysis and Result

4.1 Research Objective:

a) To determine effect of recapitalization on return on assets of selected insurance companies in Nigeria.

To answer the question above, regression model was carried out and the result is presented in table two below.

Table 2. Regression Model

Variable	Random-effect Coefficient	Std. Error	t-test	Probability
C	0.187703	0.341630	0.549433	0.5840
DER	0.000258	0.000903	0.285116	0.7762
ISC	-0.027913	0.033959	-0.821960	0.4131
TSC	0.011698	0.004477	2.612852	0.0104
R^2	0.146660			
Adj. R^2	0.119993			
F-stat	5.499696			
Prob (F-stat)	0.001575			
Durbin-Watson	1.661704			
Hausman Test	$Chi^2_{(2)} = 0.058822$			
Source: Authors' Computation 2021				

Diagnostic Test

The results of the Hausman tests for the method (p-values of 0.9963) as presented in table two revealed that Random Effect is the most appropriate estimator, therefore, random effect is the most appropriate and used for the analyses of the model. Based on the results of the diagnostic test carried out; model is estimated using random-effect regression model.

ROA = f(DER, ISC, TSC) F

$ROA = \beta_0 + \beta_1 DER + \beta_2 ISC + \beta_3 TSC + \mu$ Model

$ROA = 0.187703 + 0.000258\ (DER) - 0.027913\ (ISC) + 0.011698\ (TSC) + \mu_t$

The model above tested effect of recapitalization on return on assets.

Interpretation of Result

Coefficient

The result of the regression model presented in table two evidenced that debt equity ratio (DER) has a positive significant effect on return on assets (ROA) ($\alpha = 0.000258$, $p = 0.7762$); a unit increase in debt equity ratio (DER) would result to 0.000258 increase in return on assets (ROA). Issued share capital (ISC) has a negative significant effect on return on assets (ROA) ($\alpha = -0.027913$, $p = 0.4131$); a unit increase in issued share capital (ISC) would result to -0.027913 decrease in return on assets (ROA).

Total shareholders capital (TSC) has a positive insignificant effect on return on assets (ROA) ($\alpha = -0.011698$, $p = 0.0104$); a unit increase in total shareholders capital (TSC) would result to 0.011698 increase in return on assets (ROA).

Adjusted R-Squared

The explanatory power of the independent variable reflects that the variations in the independent variable yields 12% variation in return on assets (ROA), while the remaining 88% change in return on assets (ROA) is caused by other factors not captured in this model.

F-Statistics

At the level of significance of 0.05, the p-value of F-statistic 5.499696 is 0.001575, which is less than 0.05 and this indicates that capitalization has a significant effect on return on assets of listed insurance companies in Nigeria.

Durbin-Watson Statistics

According to result from the analysis, the test for autocorrelation in the residuals from the statistical regression analysis is 1.661704. This means that there is a positive autocorrelation between capitalization and return on assets of listed insurance companies in Nigeria.

Decision

Test of Hypothesis: At the level of significance of 0.05, the p-value of F-statistic 5.499696 is 0.001575, which is less than 0.05 level of significance. Therefore, the study rejects the null hypothesis which stated that recapitalization has no significant effect on return on asset of insurance companies in Nigeria.

5.0 Conclusion and Recommendations

5.1 Conclusion

From the study, we concluded that recapitalization has significant impact on the profitability (which in this study is return on assets) of selected insurance companies in Nigeria. This finding is in agreement with a similar study carried out by Alani and Sani (2019).

5.2 Recommendations

Based on the result of this study, we recommend as follows:

a) The management of insurance companies should take advantage of the increase in capital to increase their operations so as to generate more income thereby increasingly the profitability of insurance companies in Nigeria.
b) Increasing capital base of insurance and reinsurance companies is not enough to create sound insurance industry in Nigeria, insurance industry can expand the market and increase gross premium earned which in turn will lead to higher profitability.
c) Better image should be created for insurance industry in Nigeria. The challenge is that insurance companies are eager to collect premium but reluctant to pay compensation when it the event against which they insured occurred.

Conflicts of interest

There is no conflict of interest of any kind.

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