Effects of Claims Management on Profitability of Listed Insurance Companies in Nigeria

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The study examines the effects of claims management on the profitability of listed insurance companies in Nigeria. Using descriptive statistics and the multiple regression techniques, the data was analyzed with the aid of the Statistical Package for Social Sciences to analyze the effect of claims payments on the profitability of selected insurance companies in Nigeria, by examining their claim costs ratio to total cost and the associated expenses, as they influence the profit margin. The result reveals that ROA (profitability) has an indirect relationship with LR (loss ratio) and NC (net claims), but a direct relationship with ER (expense ratio). It further reveals that net claims have a significantly positive impact on loss ratio. The study recommends that the Nigerian insurance industry must effectively manage their claims processes, in order to reduce the number of claims for every earned premium.

INTRODUCTION

Insurance is the equitable transfer of the risk of loss, from one entity to another in exchange for payment. It is a form of risk management primarily used to hedge against the risk of a contingent, uncertain loss. It involves the pooling of funds from many insured entities (known as exposures) to pay for the losses that some may incur. Insurance as a modern concept for solving risk-related problems depends on the co-operation of a large number of people for its success. Insurance is a safeguard against risk. Any device aimed at reducing the chances of a risk occurring when it happens, reducing the extent of its damage and providing the affected persons with compensation is a form of Insurance, Enwerezoir (2000). Insurance as a modern concept for solving risk-related problems depends on the cooperation of a large basic fundamental of insurance (Udeze, 2005).

Since risk is an unavoidable event in every business venture, there will need to understand events in like manner, there will also need to understand what risk entails for. Example walking in the street imposes a danger of being knockdown by a vehicle. Since risk is ever present it cannot be eliminated but can be prevented. Even men own habits, occupation, relationship with others, the society and his political activities are sources of danger. The taste of good insurance transaction lies in the manner in which a claim is handled. This is why it is referred to as the acid test for insurance (Ogwo, Enwereuzor, Nwite, Ibeabuchi and Eche, 2000) one of the principal functions of an insurance company is the settlement of claims. It is, in fact, the fear that a claim might occur that induces individual and economic institutions to

take out insurance policies. Therefore, the payment of claims can be said to be the major function of an insurance company. The acid test of the viability of any insurance company is a prompt settlement of the claim and it is also a veritable cheapest means of advertisement.

Notwithstanding, the positive roles which the insurance industry plays in the social and economic development of our country, the industry still does not enjoy a good public image. The public sees the industry wrongly as dupes (Eche, Enwereuzor, Ibeabuchi, Nwite & Ogwo, 1999). They believe that the insurers are good at extorting money from them in form of premium but they are reluctant in settling claims when the time comes.

The most important reasons for this impression is that there is a low level of insurance awareness in our society. The public is not properly educated on the scope, function and limitations of insurance transactions especially in the issue that may cause disputes that arise in an insurance contract has to do with the settlement of claims. So an important factor that distinguished a good insurance company is its claim settlement services. It does not mean an insurer should be over liberal in order to edge itself out of the market. When the policy has been issued, the risk for the peril insured against is covered. The contingency against which protection is given or not materialized when the loss insured against actually occurs, the insured has got to make a claim on the insurer for indemnification of loss and admitted genuine claims should be settled promptly for an insurance company to maintain a good public image (Mishra, 2002). But if the loss does not occur, no payment would be made to the insured.

It is, therefore, obligatory on the part of the insurer to compensate the insured (their client) whenever there's loss on the item insured against as long as the insured abides by the condition stated in the contract or policy. Frequently, of course, claims are settled following negotiations between insured and insurer, or parties acting on their behalfs such as assessors and loss adjusters. The reported cases have been concerned with whether an insurer can reopen a settlement, but it conceivable that an insured could do so on the ground of misrepresentation undue influence by the insurer (John, 1997) this though would be difficult to show. The first and most important point to make is that the notification of a claim is the responsibility of the insurer.

Worthy of mention, is that public should appreciate that insurance is not a charity. The shareholders of an insurance company should look forward in making profit just like any other shareholders in other commercial enterprise.

However, the interest of the policy's is to satisfy their profit motive. They are obviously in business just because they are policyholders. The insurers should appreciate that claim settlement is their shop windows. According to Aneke (2004) claims in life assurance is a demand by a person or persons to recover under a policy of insurance for the loss which may arise within the policy. Also a renowned scholar of insurance . Epectinchin (1998) in his study defined insurance claims as the right of the insured to ask for compensation from the insurer should any loss occur. An efficient and prompt claims settlement services is the most effective form of advertisement for an insurance company. But this does not mean that the insurance company must settle all claims whether they are genuine claims or not. According to Irukwub (1997) only genuine claims covered by the terms in the policy should be settled and then must be done promptly and equitable. Claims management therefore involves settling losses under that assurance contracts and adjusting any difference that arises between the company's policy holder and possibly a third-party. Claims settlement on its own means not just money or compensation extended to the policy holder who suffered a loss but refers to the whole process involved in receiving the processing and documentation of claims form to decide if payment is to be made or not. The reason is because the process takes time and involved some monetary cost, and this add to the overall cost of settlement which in the early state much attention was given to claims administration as a dominant of purchasing claims by the members of the public, this was because it was assumed that the public is aware of the claims that would afflation and those that would not.

It should be remembered that any company that must be able to carry out its function must have a good reputation and trust among the populace, but this has continued to decline over the years and given insurance practitioners and firms great concerns but for the current reforms in the sector by the government with complexities in policy from in the likes of confused wordings there could be incidence

where eligible claims could be denied by company based on the condition or warranting. These have led to more attention being on claims management since a dissatisfied insured can decide not to insured again with that company or refuse insurance entirely. He can resort to litigation action or even take other actions which will darken the image of insurance before other prospective insured who may decide not to insure the risk again. However, all life assurance policies contain a condition which lay down the procedure to be followed in the interest of the company with procedures. (Oluoma, 2000) The general procedure involved in the management of claims include the notification of claims, proof of loss and settlement of claims.

REVIEW OF RELEVANT LITERATURES

Irukwu (1989) defines insurance claim as an insurance extract in which the insurer undertakes to indemnify the insured against a loss, which may or may not arise at a future date or to pay a certain amount of money in the happening of a certain event. The loss that is insured against is known as the insured risk. Being legally valid, insurance is enforceable at law. He further stated that the primary duties of the insured under the insurance contract are to pay the agreed premium and to comply with the terms of the policy while the duty of the insurer is to comply with his own terms and promises under the policy and to pay or settle all genuine claims promptly and equitably.

The insurance industry like all other facet of the Nigerian economy is inundated with a number of problems. There is no gainsaying that some, if not all of these problems are capable of being solved by the insurance practitioners with the support of the government and the understanding of the insuring public. About the last thing that comes to the mind of an average Nigerian is the need to effect insurance policies, though business and life itself involve risks (financial or otherwise), many of which could be handled through insurance (Akintayo, 2004). Irukwu (1989) posits that "a good insurance manager must make efforts towards maintaining an efficient claims department manned by technically competent and reliable personnel". It has also been argued that various organizations since the early 80's have been embracing the management concept represented by the acronym TQM (total quality management) which has helped managers in the resolution of claims and maintenance of a good insurance culture.

However, Mayers and Smith (1988) argued that it is the insurer's responsibility to indemnify a policyholder within the term of the policy". He further opined that when claims are disputed on insubstantial grounds, the insurance industry is brought into disrepute. Hence, insurance companies must ensure payments are promptly made for claims as at when due. Generally, claim management process consists of four important aspects: settling claims, detecting fraud, lowering costs and avoiding litigation (Lalithchanadra & Kumari, 2015).

According to Butler and Francis (2010), claims payment represents the largest single cost to insurers and 80.0 per cent of all premiums are spent on claims payment and associated handling charges. Hence, Redja (2008) opined that claim management includes all managerial decisions and processes concerning the settlement and payment of claims in accordance with the terms of insurance contract. Greene and Segal (2004), quoted in Kasturi (2006) submitted that the performance of insurance company in financial terms is normally expressed in net premium earned, profitability from underwriting activities, annual turnover, return on investment and return on equity. These can be categorized into profit performance measure and investment performance measure. Profit, according to Yusuf and Dansu (2014) is important to investors and management as sources of dividends and growth, while to the policyholder, it provides security against insolvency.

Financial ratios have been agreed and used as measures of profitability (Al-Shami, 2008; Malik, 2011). These ratios include Return on Assets (ROA), Return on Equity (ROE) and Return on Invested Capital (ROIC). ROA is a key indicator since it measures profitability relative to the total assets, which shows how well a company uses its asset to make earnings (Malik, 2011).

Profitability in the insurance sector of Nigeria has been seriously affected by rising claim expenses (Vanguard, 2017). The focus of this research is therefore to show the effect of claims payments on the profitability of the Nigerian insurance industry.

METHODOLOGY

This study adopted ex-post factor research design which is based on the secondary data extracted from the published annual financial reports of two selected insurance companies in Nigeria, covering the periods 2012 to 2017 (6 years). The insurance companies are American International Insurance Company plc (AIICO) and International Energy Insurance company plc (IEI). The choice of these two, out of the twenty-five insurance companies on the floor of the Nigerian Stock Exchange represents 0.08 proportion of the population, and it was carried out by simple random and purposive sampling. According to Amadi (2005), a sample of 0.05 proportion of a population is adequate for making inferences. The data generated from the financial statements of these companies are Return on Assets (ROA), Loss Ratio (LR), Net Claims (NC), Expense Ratio (ER), and the Net Premium (NP),

where:

        Return on Asset (ROA) = Net Income before taxes/Total Assets,
        Loss Ratio (LR) = Total Net Claims/Earned Premium,
        Net Claims (NC) = Total claims paid in the year,
        Expense Ratio (ER) = Total Underwriting expenses/Earned Premium,
        Net Premium (NP) = Total Premium − Premium paid to Re-insurer.

The formulated null hypotheses for this study are;

Hypothesis 1: *ROA is not significantly influenced by LR, ER and NC*

Hypothesis 2: *LR is not significantly influenced by NP and NC.*

The linear multiple regression models (adopted from Yusuf and Dansu, 2014) to test these hypotheses are:

$$ROA = \alpha 0 + \alpha 1(LR) + \alpha 2(ER) + \alpha 3(NC) + \varepsilon \tag{1}$$

$$LR = \alpha 0 + \alpha 1(NP) + \alpha 2(NC) + \varepsilon \tag{2}$$

The dependent variables are ROA in model (i.) and LR in model (ii.), while the independent variables are LR, ER and NC in model (i.) and NP and NC in model (ii.).

DATA ANALYSIS AND DISCUSSION

The data generated were analyzed using descriptive statistics, multiple linear regression and ordinary least square regression techniques, with the aid of the Statistical Package for Social Sciences (SPSS).

TABLE 1
MEAN AND STANDARD VARIATION OF THE EXPLANATORY VARIABLES
FOR THE SELECTED COMPANIES

	AIICO	IEI	AIICO	IEI
	Mean	Mean	Standard deviation	Standard deviation
Variables				
ROA	0.52584	0.515612	0.118653	0.131864
LR	0.63627	0.371049	0.472019	0.119183
NC	8,475,229,833	1,367,612,000	3,059,197,286	364,489,334
ER	1.050955	0.640837	0.547703	0.121901
NP	16,100,000,000	1,983,506,333	6,601,439,853	1,471,445,766

Source: Authors computation, 2018

Table 1 shows the result of the descriptive analysis of the Return on Assets (ROA), Loss Ratio (LR), Net Claims, Expense Ratio (ER), and the Net Premium (NP) of the two insurance companies used for this study for 6 years. A comparative analysis from the table reveals that AIICO did slightly better than IEI in terms of ROA (52.6% to 51.6% respectively), but more poorly in term of Loss Ratio (LR) on claim payments from its total premium (63.6% to 37.1% respectively). The mean Net Claim (NC) for AIICO for this period is considerably higher than that of IEI, although the mean premium income (NP) is almost double the NC. IEI could only generate 69% of its NC as premium income. The standard deviation of the Expense Ratio (ER) for IEI appears to be better than AIICO, suggesting more stable underwriting expenses as compared with the earned premium.

Model 1

TABLE 2
REGRESSION CO-EFFICIENT, T-VALUES AND COLLINEARITY
STATISTICS FOR THE VARIABLES

Model	Unstandardized Coefficients		Standardized Coefficients			Collinearity Statistics	
	B	Std. Error	Beta	T	Sig	Tolerance	VIF
1 (Constant)	.534	.088		6.091	.000		
Loss Ratio	-.369	.264	-1.099	-1.398	.200	.149	6.729
Net Claim	-1.391E-13	.000	-.005	-0.14	.989	.712	1.404
Expense Ratio	.205	.208	.745	.987	.353	.161	6.206

Source: Authors computation, 2018

The model obtained from the result of the regression analysis on the variables in the first hypothesis is: **ROA = 0.534 − 0.369(LR) + 0.205(ER) − 1.391E-13(NC)**

The negative co-efficient of the loss ratio (LR) implies that for every unit increase in LR, there is a corresponding decrease of 0.369 in profitability, as measured by ROA, while keeping other variables constant. This shows an indirect relationship between LR and ROA. Thus to maximize profit, an insurer must considerably minimize its claim expenses. This finding is consistent with those of SAS (2012) and Yusuf and Dansu (2014).

Similarly, the positive co-efficient of ER indicates that a unit increase in ER, results into a corresponding increase of 0.205 in ROA. This is a direct correlation between the two variables, thus confirming that ER directly influences the profit margin. It can be inferred that other administrative expenses, also impact on the profitability of insurance companies in Nigeria.

From the model above, it can further be seen that NC and ROA have an indirect relationship. Keeping all other variable constant, for every one trillion Naira increase in NC, there is a corresponding 1.391 decrease in ROA. This could be due to poor claim and risk management, inadequate premium charge and poor loss reserving. These are among the various challenges Nigerian insurers must overcome in order to remain solvent.

The constant value (α_0 = 0.534) implies that, if the independent variables (loss ratio, expense ratio and net claim) are missing, the Return on Asset equals 0.534. This can be translated to mean that an insurance company in Nigeria will still realize profit, even when it does not incur major claim and administrative expenses.

The tolerance values and VIF values in table 2 above respectively identify the problem of multicollinearity in each independent variable. Since the tolerance values of all the independent variable are greater than 0.1 and VIF are less than 10, it shows that the problem of multicollinearity does not exist among all the predictor variables. Hence, all the independent variables were used in the model.

HYPOTHESIS TESTING

Hypothesis 1: ROA is not significantly influenced by LR, ER and NC

TABLE 3
CO-EFFICIENT OF DETERMINATION (R2)

Mode	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.515a	.265	-.010	.1203169

Source: Author's computation, 2018

From table 3 above, the co-efficient of determination (R2) is 0.265, suggesting that about 26.5% of the dependent variable (ROA) is explained by the independent variables (LR, ER and NC). This is the size of the overall effect of all the independent variables.

TABLE 4
ANOVA

Mode		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	.042	3	.014	.963	.456[b]
	Residual	.116	8	.014		
	Total	.158	11			

Source: Author's computation, 2018

From table 4, the ANOVA value (F) is 0.963 (df = 3; p>0.05), which is not significant at 0.05 level. This shows that there is no significant relationship between ROA, loss ratio, expense ratio and net claims. The null hypothesis 1 is thus accepted, meaning that even though there exists direct or indirect relationship between the dependent and independent variable, the relationship is not significant. The corresponding t-values in table 3, further support this assertion.

Model 2

TABLE 5
REGRESSION CO-EFFICIENT, T-VALUES AND COLLINEARITY
STATISTICS FOR THE VARIABLES

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	.455	.051		8.946	.000		
	Net Claim	1.351E-10	.000	1.613	10.911	.000	.356	2.806
	Net Premium	-6.152E-11	.000	-1.344	-9.088	.000	.356	2.806

Source: Author's computation, 2018

The model obtained from the result of the regression analysis on the variables in the second hypothesis is: **LR = 0.455 + 1.351E-10(NC) – 6.152E-11(NP)**

The positive co-efficient of NC indicates that for every ten billion Naira increase in net claim, the loss ratio increases by 1.35units. This shows a direct correlation between loss ratio and net claim. Table 5 reveals that this relationship is significant with t-value of 10.911 (p<0.05; beta = 1.613). The interpretation of this is that 135% loss is generated from every ten billion Naira premium income earned. Since this loss is significant, Nigerian insurance companies must improve on their claim management processes, in order to reduce the amount of claims for every premium collected. Similarly from the model, the negative co-efficient of NP implies that for every hundred billion Naira increase in net premium, there is a corresponding decrease of 6.152 units in the loss ratio. The t-value of -9.088 (p<0.05 and Beta = -1.344) shows that this relationship is significant. This result is consistent with findings in literatures that when premium growth results in reduction in loss ratio, an insurance company is said to be profitable.

The tolerance values and VIF values in table 5 respectively identify the problem of multicollinearity in each independent variable. Since the tolerance values of all the independent variable are greater than

0.1 and VIF are less than 10, it shows that the problem of multicollinearity does not exist among all the predictor variables. Hence, all the independent variables were used in the model.

HYPOTHESIS TESTING

Hypothesis 2: LR is not significantly influenced by NP and NC.

TABLE 6
CO-EFFICIENT OF DETERMINATION (R2)

Mode	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.964a	.930	.914	.1042899

Source: Author's computation, 2018

Table 6 shows that the co-efficient of determination (R2) is 0.930. This suggests that about 93.0% of the dependent variable (LR) is explained by the independent variables (NC and NP). This is also confirms the size of the overall effect of all the independent variables.

TABLE 7
ANOVA

Mode	Sum of Squares	Df	Mean Square	F	Sig.
1 Regression	1.298	2	.649	59.678	.000[b]
Residual	.098	9	.011		
Total	1.396	11			

Source: Author's computation, 2018

From table 7, the ANOVA value (F) is 59.678 (df = 2; p<0.05), which is significant at 0.05 level, implies linearity between loss ratio and the predictors. This shows that there exists a significant relationship between dependent variable (loss ratio) and the independent variables (net claims and net premiums). The null hypothesis 2 is thus rejected in favour of the alternative. The model obtained can thus be used for predicting future activities in the Nigerian insurance industry.

CONCLUSION AND RECOMMENDATION

Profitability in the insurance industry is affected by many factors, including rising claims payments. Profitability determines an insurance company's ability to make claims payments as at when due. The purpose of this study is to examine the effect of claims payments on the profitability of insurance companies in Nigeria. The findings in this study have revealed that ROA, which is a measure of profitability, has an indirect relationship with LR (loss ratio) and NC (net claims), but a direct relationship with ER (expense ratio). It has further been revealed that net claims positively correlate with loss ratio.

The study recommends that claims managers in the Nigerian insurance industry must effectively manage their claims processes, in order to reduce the number of claims for every earned premium. In addition, a careful attention must also be given to another administrative cost, such as the underwriting cost, which is capable of reducing the company's profit margin. Future studies can consider the effect of the explanatory variables on other measures of profitability.

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