# INVESTMENT: AN INDEX OF GROWTH IN INSURANCE INDUSTRY

**Festus M. Epetimehin**
**Joseph Ayo Babalola University, Ikeji- Arakeji**
**E-mail:fessy51@yahoo.co.uk**

## Abstract

*The main area of insurance company's activity is selling protection to their customers. But insurers also hold investments to cover future claims or benefits, administrative expenses and profits to shareholders. The role of insurance investment in management is to manage the funds generated by the insurance business, maximizing risk adjusted returns while meeting regulatory requirements on its assets and other financial constraints. Insurance investment managements must ensure that investment returns preserve the solvency, both regulatory and economic, of the insurance company, earn the return commensurate with the use of its capital and enable it to continue to underwrite profitable insurance business. This study is concerned with the growth of Insurance through investment in Nigeria. The specific objective is to examine the growth rate of Insurance business... Secondary data were collected from the financial department of the insurance company used as a case study. The result of the findings revealed that investment has been one of the major contributors to the growth of insurance business.*

**Keywords:** Insurance, investment, financial strategy, capital budgeting, assets

## Introduction

An investment is a sacrifice of current money or other resources for future benefits. It is a conscious act of an individual or any entity that involves deployment of money (cash) in securities or assets issued by any financial institution with a view to obtaining the target returns over a specified period of time. Increase in the value of the securities or asset and regular income available from security are the target returns on investment. Investment in an organization or industry can take different shapes and avenues. It can be done through equity shares or deposit money and can be a contribution to a provident fund account. It can also be done through the buying of stock option or acquire a plot of land. The major point here to understand is that it doesn't matter which method is chosen for investing, the goal is always to put money to work so it earns an additional profit. Even though this is a simple idea, it's the most important concept for proper understanding of investment.

Capital budgeting or investment decisions are of considerable importance to the insurance industry since they tend to determine its value by influencing its growth, profitability of capital budgeting decision

The investment decisions of a firm are generally known as the capital budgeting, or capital expenditure decisions. A capital budgeting decision may be defined as the firm's decision to use the current funds most efficiently in the long-term assets in anticipation of an expected flow of benefits over a series of years. The long-term assets are those that affect the firm's operations beyond the one-year period. The firm's investment decisions would generally include expansion, acquisition, modernization and replacement of the long-term assets. Sale of a division or business (divestment) is also as an investment decision. Decision like change in the methods of sales distribution, or an advertisement campaign or a research and development programmed have long-term implications for the firm's expenditures and benefits, and therefore, they should also be evaluated as investment decisions. It is important to note that investment in the long-term assets invariably requires large funds to be tied up in the current assets such as inventories and receivables. As such, investment in fixed and current assets is one single activity.

The following are the features of investment current decisions:

- The exchange of current funds for future benefits
- The funds are invested in long-term assets.

- The future benefits will occur to the firm over a series of years.

It is significant to emphasize that expenditure and benefits of an investment should be measured in cash. In the investment analysis, it is cash flow, which is important, not the accounting profit. It may also be pointed out that investment decisions affect the firm's value. The firm's value will increase if investments are profitable and add to the shareholders' wealth. Thus, investments should be evaluated on the basis of a criterion, which is compatible with the objective of the shareholders' wealth maximization... An investment will add to the shareholders' wealth if it yields benefits in excess of the minimum benefits as per the opportunity cost of capital. The objective of this research is to determine whether investment has anything to do with the growth of insurance companies.

**Literature review**

The critical function of insurance includes the creation of a pool of investible fund through fund mobilization and the investment of the fund in either the money or capital market or in direct investment which will improve the growth of the company or ginger the economy to achieve allocation efficiency. By creating a large amount of assets placed in the money or capital market, it contributes to the growth in the output level of goods and services in the economy. Insurance companies together with pension and Mutual funds invest into stock, bond, mortgage and real estate markets as well as issue and sell indirect securities which may be primary in nature from the borrowers of funds. These investments no doubt serve as a shield for insurance against predictable underwriting losses ( Adewale, et al.2010). Arena (2008) reported that insurance companies are well positioned to invest in assets of any maturity, ranging from short term securities to infinite maturity securities such as preferred and equity stocks.

Investment is one term that has been greatly misunderstood and its definition may appear deceptively simple. The term forms part of everyday usage, which may give the impression that there is a common or shared understanding of the term. However, investment is a broad term invoking different meanings in everyday, economic and legal usage. The term 'investing" could be associated with the different activities, but the common target in these activities is to "employ" the money (funds) during the time period seeking to enhance the investor's wealth. Funds to be invested come from assets already owned, borrowed money and savings. By foregoing consumption today and investing their savings, investors expect to enhance their future consumption possibilities by increasing their wealth. It can be defined as the commitment of capital to purchase financial instruments or other assets in order to gain profitable returns in form of interest, income or appreciation of the value.

Investment is a parallel concept to Savings, where savings is done with an intent to cope with increasing inflation, Investment on the other hand is done with and intention to earn revenue streams or have capital gains from money invested, and it also generates employment and increases the production level of a country. Individuals either save or invest their surplus money based on how much risk they are willing to take. From the point of risk, Lintner, (1965) concluded that investment can be defined as the act which involves the choice by an individual or organization after some analysis to place money in instrument or asset that has certain level of risk and provides possibility of generating returns over a period of time. It can further be explained that investment as an instrument of generating funds involves deployment of money in securities or assets issued by any financial institution with a view to obtaining the targets return over a specified period of time. The target returns on an investment is the increase in the value of securities or asset and regular income available from the securities or asset. (Adewale, et al.2010).

Jensen, et al (1976) defined investment as the purchase of an asset, old or new by an individual or a corporation. He explained further that occasionally, the term might be restricted to the purchase of an asset on the stock exchange.

Therefore, deducing from the definitions given above, we can see that investment is a very important tool for any business entity as we are considering insurance business. We can say it is the backbone or shock absorber of any insurance company because investment helps in capital preservation, liquidity management (having available funds when needed) and return expectations

**Types of investment decisions**

There are many ways to classify investments. One classification is as follows

**Expansion and diversification**

A company may add capacity to its existing product lines to expand existing operations. A firm may expand its activities in a new business. Expansion of a new business requires investment in new products and a new kind of production activity within the firm. If a packaging manufacturing company invests in a new plant and machinery to produce ball bearings, which the firm has not manufactured before, this represents expansion of new business or unrelated diversification. Sometimes a company acquires existing firms to expand its business. In either case, the firm makes investment in the expectation of additional revenue. Investments in existing or new products may also be called as revenue-expansion investments.

**Replacement and modernization**

The main objective of modernization and replacement is to improve operating efficiency and reduce costs. (Ranade and Ahuja, 2001) Cost savings will reflect in the increased profits, but the firm's revenue may remain unchanged. Assets become outdated and obsolete with technological changes. The firm must decide to replace those assets with new assets that operate more economically. If a cement company changes from semi-automatic drying equipment, it is an example of modernization and replacement. Replacement decisions help to introduce more efficient and economical assets and therefore, are also called cost-reduction investments. However, replacement decisions that involve substantial modernization and technological improvements expand revenues as well as reduce costs.

**Investment of insurance funds**

For insurance companies, the business of underwriting is usually only half the equation. The rest is managing the assets that support and pay for the liabilities they carry for others. But more insurers are choosing to look to outside firms to help them navigate the increasingly complex world of asset management. Insurance is one of the most successful service industries that many strong economies of the world are using to achieve their spectacular development and greatness. By affording protection to life and property it brings security of person and property with accompanying peace of mind which promotes and encourages adventure and entrepreneurship (Ajayi, et al.1981). One of its major economic functions is to promote the mobilization of funds thus, offering a basis for financial intermediation to commerce, trade and industry. As an industry, it is a source of employment to many. Its loss prevention function also contributes to risk improvement. Above all, it contributes substantial taxes to government coffers, creating more goods, more jobs, improving earning, providing educational and health facilities.

On investment Chui and Kwot (2008) submitted that the investment function is an extremely important function in the overall operations of insurance companies. According to him, since premiums are paid in advance, they can be invested until needed to pay claims and expenses. Naturally, the aims of venturing into insurance business is to provide insurance coverage to the insuring public at a cost commensurate with the risk and at the same time invest the insurance funds to enable the insurance company pay for the risk insured and also have return on investment for the owners of the business. Among the various uses of premium, investment is the only utilization which provides positive income in future for the company. Investment in insurance business is concerned with the application of insurance funds which are not immediately required for expenditure, or for payment of insurance claims and benefits. When the funds are not meant for immediate "consumption", they are employed to be productive and increase in value or even multiply, depending on how long they are engaged in the productive activities. It is obvious that the premium paid by the insured is not enough to take care of the risk insured that is why the premium after being collected has to pass through investment.. Some money is always set aside so that the company can respond quickly to catastrophes, when a large number of claims will have to be paid in a short period of time. The nature of insurance is such that insurance company holds insured's premium until it is needed to pay claims. By investing the money in the interim and making a return, insurance company is able to offset the cost of claims and charge insured less than they would otherwise pay. Even when investment returns are much more modest, this is an excellent way to keep premiums as low as possible for consumers. And also as a result of the nature of Insurance operation in which premiums are collected from many people (Insured) which accumulated into a fund for the compensation of few which may or may not involve in an accident in the future; there is a need for the Investment of this excess fund to provide profit for the company for the benefit of the owner of the company like shareholders, employers, employees and the government which may consequently result in the growth of the country's economy.

Investment has become a very important tool in the industry where a considerable amount is invested. As a matter of fact, most companies would not exist now without income from their investment, and a large proportion of the profit of insurers is not a result of technical insurance underwriting, therefore in insurance industry, many insurance companies rely on investment as the underwriting profit may not be available due to the rate at which claims are being settled. Investment has therefore being the indices of growth that are being heavily relied upon but observation has shown that with all the benefits attached to investment, most of the insurance companies are not embracing it adequately thereby denying themselves the benefits of growth of assets and profitability. This project shall therefore look at various investments tools applicable to insurance companies and various strategies applicable to a successful investment.

**Growth in insurance business through investment**

Insurance industry consists of such financial institutions which help us to be protected from a variety of perils. It helps in pooling together risks and reduces the impact of large losses on firms and households—with a beneficial impact on output, investment, innovation, and competition. The insurance sector also plays a vital role in the improvement of the efficiency of other segments of the financial sector, such as banking and bond markets, by enhancing the value of collateral through property insurance and reducing losses at default through credit guarantees and enhancements.

It is important that insurance companies invest these funds judiciously with the combined objectives of liquidity, maximization of yield and safety.

Insurance companies invest their equity capital, technical reserves and other temporally available financial resources. Investment earnings made by insurance firms make a valuable contribution to their operating results and enable them to reduce premiums and increase dividends and bonuses, thereby improving their competitiveness (Gordon, 1983; Alile and Anao 1986). Insurance investments also have an important economic and social impact on the nation – insurance capitals and reserves are important source of capital funds to the economy. Life insurance contract are long-term in nature and the liabilities of life insurers extend over long period. Most life insurance investments are therefore long-term in nature. Investment income is extremely important in reducing the cost of insurance to policy owners since the premium can be invested and earn interest. The income is reflected in the payment to policy owners, which reduces the cost of insurance. In contrast to life insurance, non-life insurance contracts are short term in nature. For these reason, the investment objective of liquidity is extremely important. Non-Life insurers' investment income is extremely important in offsetting unfavourable underwriting experience. Different insurance companies have investment in different sectors to get income from their investment. Copeland (1988) focuses on economic significance of insurance as "insurance business contributes to formation of national income by creating value added role in providing indemnification and role as institutional investor".

Ayadi (2003) describes the role of insurance investment management as to manage the funds generated by the insurance business, maximizing risk adjusted returns while meeting regulatory requirements on its assets and other financial constraints. The author further states that insurance investment management must ensure that investment returns preserve the solvency, both regulatory and economic of the insurance company earn the return commensurate with the use of its capital and enable it to continue to underwrite profitable insurance business. Hirshleifer (1983) states that: as it is crucial for insurance industry to survive and develop, the insurance investment enables insurance companies to offset their possible underwriting losses and make a considerable profit. Lintner (2005) states that the risk faced by an insurance fund manager differs from what the typical fund manager faces because of the fact that the risk in insurance investment management must factor in the liability side of its balance sheet that includes benefit amounts for shareholder capital as well as the reserves that are necessary for the insurer future claims. The challenge of investment management is to improve the financial position of a company relative to its competitors, so that, year by year, it is gaining on them in its ability to add to premium volume, to stand large insurance exposure, to innovate, to raise capital, to acquire companies, and to increase dividends. Because of the deterioration of underwriting profit margins, investment results seem to be drawn more and more directly into the competitive problems of the industry.

**Research methodology**

A research was carried out using Zenith Insurance Company Plc as a case study through the use of secondary data mainly from the annual report of the insurance company to determine the relationship between investment and the growth of the company. Zenith Insurance Company Plc is a subsidiary of one of the largest bank in Nigeria that is Zenith Bank Plc.

**Model specification for the research hypothesis**

Y= $a + bx + ei$

Where Y= dependent variable (that is assets)

a=intercept or constant. That is, the value of growth when there is no investment.

b= slope (gradient). That is, the rate of growth when there is investment.

X= Independent variable. That is, investment.

e=error term.

**Presentation of data**

| Years | Total assets (billion naira) | Investment (billion naira) |
|---|---|---|
| 2007 | 8,360,730 | 4,510,445 |
| 2008 | 9,505,397 | 3,244,071 |
| 2009 | 10,388,355 | 2,738,582 |
| 2010 | 11,902,111 | 2,987,908 |
| 2011 | 12,627,487 | 3,228,184 |

Source: Annual Report

**Testing of overall significant**

H0: there is no substantial growth contributed by investment

H1: there is substantial growth contributed by investment to insurance business

Since F-calculated of 9.415 was greater than F-tabulated of 9.280, then the null hypothesis was rejected and the researcher concluded that there was a substantial growth contributed by investment to insurance business.

This further implied that substantial growth and investment were positively related. This means that once the insurance business stopped investing growth definitely would stop. Therefore there was a significant relationship between growth and investment in insurance business.

**Testing of individual regression coefficients**

H0: investment is not significant on growth

H1: investment is significant on growth

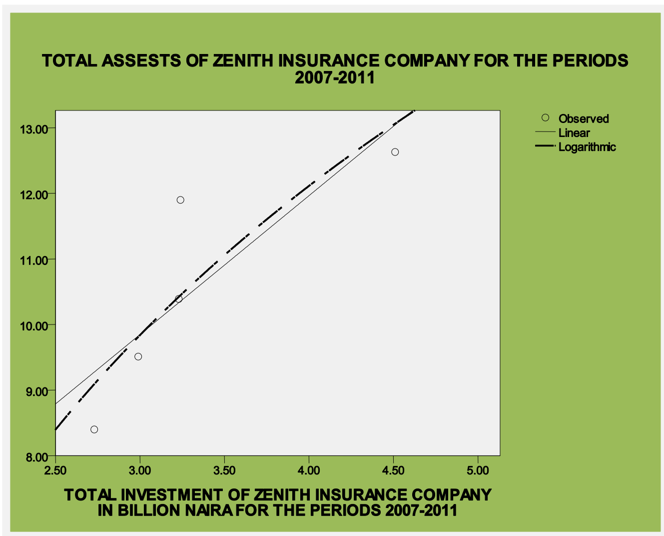
Reject the null hypothesis if the par-value is less than 0.05 or otherwise accept the null hypothesis. Since the p-value for investment (that is, 0.049) less than 0.05, then the null hypothesis was rejected and the researcher concluded that investment was significant for insurance growth.

**Model**
Y=1.149+ 7.909X

**Coefficient of determination ($R^2$)**
R2=Sum of square regression/sum of square total
i.e. R2=SSR/SST=9.007/11.187=0.758

**Interpretation**
If the coefficient of determination obtained in the table was multiplied by 100%, then, we had 75.80%. This showed that 75.80% of growth was as a result of investment. This further mean that investment brought about 75.80% of growth for the industry.

**Curve fit**




**Findings**

Four research questions were formulated for the study. These were:

- What are the trends of insurance funds generated by insurance industry taking into consideration the periods 2007-2011? What factors determine the areas of investment of funds?
- What forms of investments are insurance funds put into the most?
- What appropriate strategies can be put in place to ensure effective management of the insurance funds?

For the research question one, the researcher discovered that the trends of insurance funds generated were fluctuating overtime.
More so, for the research question two, the researcher discovered that there were many factors determining the areas of investment of the company. The chief among them was profitability of the investment. Moreover, for the research question three, the researcher found out that the form of investments the insurance funds of zenith General Insurance Limited were put into ranges from shares, government bonds, investment in subsidiaries, and investment in properties to investment in oil and gas.

Also, for the research question four, the researcher discovered that there were many strategies an insurance company could adopt to effectively manage its funds. These include:

- The establishment of committees to manage the funds.
- Continuous reinvestment of the funds and
- Etc.

Also, the F-statistics calculated for the research hypothesis formulated for the study was greater than the F-tabulated. For this, the researcher concluded that there was substantial growth contributed by investment to insurance business.

In addition testing the significant of regression coefficient investment on growth revealed a significant relationship between the two since the p-value for investment was less than 0.05. Moreover, the coefficient of determination obtained of 75.80% showed an existence of good relationship between investment and growth in insurance business in Nigeria. By this value the researcher concluded that investment was a good predictor for growth for insurance business in Nigeria.

To sum up, it should be stated that the investment activity is one of the basic elements of the financial strategy of insurers. The investment activity has a significant influence on the solvency of an insurance company. It should be considered from a perspective of an additional income generated through running the investment activity. On the other hand, it should be emphasized that gaining an income from the investment activity can be applied in the basic activity of a company, for example, to reduce the financial premium through financing the expenses of the insurance activity and compensations and benefits resulting from the investment activity. Investing financial resources through insures' companies increase also their security since it secures the company against a depreciation of the financial resources, which is particularly significant for the technical reserves.

**Conclusions**

After much analysis of the data collected, the following conclusions were made;

- That investment was important to growth of insurance business in Nigeria.
- That there were various ways the insurance business in Nigeria invest their funds and
- That investment contributed seriously to the growth of insurance business in Nigeria.
- The federal government should as well use regulations to put under check the excesses of managers of insurance companies in the country to ensure that the pooled funds are not pocketed or personally used but objectively directed into investments that would better the lot of the entire stakeholders of the insurance companies

**References**

Adewole A.P. and Maduegbuna A.N. (2010). Predicting Insurance Investment: A Factor Analytic Approach. *J. Math. Stat. Sci. Publication*, 6(3): 321-324.

Ajayi, S.I. and O. O. Ojo.(1981); *Money and Banking*, London George Allen and Urwin,

Alile, H. I. and A. R. Anao. (1986); *The Nigerian Stock Market in Operation*.Lagos The Nigerian Stock Exchange.

Arena, M. (2008). Does Insurance Market Promote Economic Growth? A Cross-Country Study for Industrialized and Developing Countries, *Journal of Risk and Insurance*, 75(4): 921-946.

Ayadi, O.F (1983); "The Nigerian Capital Market and the Random Walk Hypothesis" Unpublished MSc Finance Dissertation, University of Lagos,

Chui A.C. and Kwot C.C. (2008). National culture and life insurance consumption; *J. Int. Bus. Stud.*, 39:88-101.

Copeland, T. E. and J. F. Weston;(1988) *Financial Theory and Corporate Policy*, (3rd Ed), Addison- Wesley, Gordon, M. J. (1959); "Dividends, Earnings and Stock Prices" *Review of Economics and Statistics*, Vol. 41, 99-105.

Hirshleifer, J. (1983); "On the Theory of Optimal Investment Decisions," *Journal of Political Economy*, Reprinted in Archer and D' Ambrosio,

Lintner, J. (1965); "Security Prices, Risk and Maximal Gains from Diversification." *Journal of Finance*, Vol. 20, 587-616.

Randle A. and Ahuja R. (2001). Impact on Saving via Insurance Reform, Indian Council for Research on International Economic Relations; Working p. 67.