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EFFECTS OF CLAIMS MANAGEMENT ON PROFITABILITY OF INSURANCE COMPANIES IN NIGERIA

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ABSTRACT: *The study reviewed the effects of claims management on profitability of insurance firms in Nigeria with a view to examine the effect of net claim, expense ratio and loss ratio on the return on asset of listed insurance firms in Nigeria from 2010 to 2018. Time series annual data were collated from financial statement of account of insurance companies. The data were analysed via regression analysis which involved ordinary least square estimation technique. The study found that net loss has direct and significant effect on return on asset, expense ratio has positive with an insignificant effect on return on asset and loss ratio has an indirect with an insignificant effect on return on asset of quoted insurance firms in Nigeria. It was concluded that, claims management promote positive influence to insurance companies' profitability in Nigeria. Thus, insurance companies in a bid to make profit should not forget the main reason for their existence which is bringing the insured back to his/her pre-loss position by paying genuine claims. Therefore, all efforts should be made to pay genuine claims promptly as this increase the confidence of the general public in insurance and the industry as a whole.*

KEYWORD: Claims Management, Profitability, Insurance Companies, Expense and Loss Ratio, Nigeria

JEL Classification: G22, C22, C79

INTRODUCTION

The role of financial and non-financial (insurance) sector in promoting the economic drive of a country has been well recognised and documented by empirical scholars, theoretical thinkers, and stakeholders across finance sector whereby many of them support the assertion that financial and non financial (insurance) sector cannot be detached from an economy. However, insurance companies like other businesses in both financial and non-financial industries is at the frontline of making profit irrespective of the risk involved or attached to their services. Based on this, it is quintessential for any insurance firm to identify, ascertain, manage her exposure to risk and deport adequate analysis to eschew losses arising from

compensation claims put forward by the insured (Owolabi, Oloyede, Iriyemi & Akinola, 2017).

Insurance can therefore be considered as a system of transferring risk of loss from an entity to another entity in trading for financial resources, it is a form of risk management fundamentally employed to protect against the contingent risk and unknown loss. It involves the pooling of funds from many insured entities to pay for the losses actually incurred by some of the insured (Oyedokun & Gabriel, 2018). Insurance business chiefly encapsulates three segments among others which are underwriting, investment and claims processing/management (Ogunnubi, 2017). Claims management serves as a screen to the customer which enables the insurers to improve her customers' purchase, confidence, retention and business foresight for product and services offered by the firm and company's profitability (Capgemini, 2011). Thus, in meeting expectation needed for proper portfolio underwriting, there must be efficiency and effectiveness of claims management procedures (International Business Machines Corporation, 2011).

Gallagher (2012) clearly affirms that managing claims involved effective claims administration arising from loss occurrences. Insurance claim management consist of the departmental stipulation, corporate policies and industry practices that insurance firms use to validate policyholder's payment or reimbursement requests (Marquis, 2011). To a large extent, the insured opinion on and loyalty to the insurer depends on how insurer handles a claim put forward by the insured (Yusuf & Ajemunigbohun, 2015). Thus, for insurance companies to successfully manage claims there must be an immediate, effective and efficient way of handling genuine claims (Lloyd's Minimum Standard-Claims Management, 2014). Capgemini (2011) corroborates this further by stating that, when an insurance company provides a quick and open procedure as well as the best way of handling a claim, such firm can be sure of adding more new customers to itself which in the long run will enhance firm's profitability. Organisation for Economic Co-operation and Development as cited in Yusuf, Ajemunigbohun and Ali (2017) contends that a good insurance claim management which include reporting, receipts, assessment and processing of claims; files and procedures; prevention and detection of fraud; complaints and dispute settlement; and supervision of claims-related services can be ascertained by stimulating and maximising the wealth of its shareholder thereby leading to firm profitability.

Empirically, there have been sparse of literature on claims management and insurance profitability in Nigeria. Among the prominent scholars that have investigated effects of claims management on firm performance is Yusuf and Dansu (2014); Ogunnubi (2017); Yusuf, Ajemunigbohun and Alli (2017); Oyedokun and Gabriel (2018); Ajemunigbohun, Isimoya and Ipigansi (2019) to mention but a few. However, most of these researchers have employed primary data (questionnaire) as a research instrument for their studies as if there are no secondary data which is most suitable for the study of this nature. Nonetheless, To the few of them whose studies such as (Yusuf & Dansu, 2014; Ogunnubi, 2017) employed secondary data as a means of data collection, they could not analysed beyond 2011 and 2015 respectively as if there is no available data up to recent time. To this end, this study will add to literature by building on recent annual data which is 2018 to investigate the effects of claims management on insurance profitability in Nigeria.

LITERATURE REVIEW

Asokere and Nwankwo (2010) describe insurance claims as a request made by the insured person to the insurer to pay the benefits agreed upon under a defined policy. It is a demand placed by an individual or organisation against a loss covered by insurance policy (Brooks, Popow & Hoopes, 2015). Claims management is essential and vital to an insurer's success. A well manageable claim strengthens customer relationships amidst all odds, assists in regulatory compliance and fraud prevention and detection (Computer Sciences Corporation, 2011). Claim management therefore involves the appraisal of the claims performance, monitoring of claims expenses, legal costs, settlement costs, compromises and making arrangement for future payments and avoiding error, delay and disputes in the payment of claims (Amoroso, 2011).

Profitability on the other hand, is an undeniable factor for the continued existence of business globally, this is because, no business owner goes into business with a setback and loss-control mindset, therefore, the sole aim of entering into the business arena is to make profit. Okoli (2011) adds that without profit, a business will not be able to grow and meet some of its short term obligations and goals. Profit serves as a source of dividends and growth to an investor and management, whereas, it serves as additional security against insolvency to the insured and regulators (Ayele, 2012). McClenahan (2015) argues that profitability has a golden ring to investors and insurers, whereas, to policyholder of a stock insurer, it appears like a mark-up, and to the policyholders of a mutual company, it is neutral. Regulatory bodies of insurance companies either encourage profitability when faced with solvency, or try to reduce it when regulating rates. In recent times, profitability of insurance companies has been debated against her sister (banking) industry, however, for insurance companies to stand out profitably like the banking sector, it must be adequately functional in underwriting practices (Borokini as cited in Anaesoronye, 2010). This indicates that underwriting is a key determinant amongst other aspects of insurance business. It also embraces the assertion of Nguyen (2006), that profitability is regarded as a very essential goal of financial management because the principal aim of financial management is to maximise the owner's wealth, because of this, profitability is an essential determinant of performance.

Relevant theories like stakeholder theory (Freeman, 1984), risk management theory (Wenk, 2005), and corporate demand theory (Iqbal, Rehman & Shahzad, (2014) articulate the importance of risk sharing and transferring in insurance business. Risk diversification is necessary in underwriting portfolio of insurance companies; this is used to curtail the annihilation of such companies by taking advantage of the expertise of reinsurance companies in stabilising the shareholders' return (Doherty & Tinic, 1981). Iqbal, Rehman & Shahzad (2014) elucidates the willingness of a ceding company to purchase reinsurance coverage against the risks it has assumed. The primary insurers are faced with higher business plight because of excessive risk exposures and high degree of enhanced volatility in their level of cash flows hence, there is need to ponder on appropriate risk management for its cover and therefore, have a reinsurance arrangement in order to remove the risks of insolvency and further lower the cost of expected bankruptcy (Mayers & Smith, 1990).

In an empirical investigation carried out by Yusuf and Dansu (2014) on association linking claims cost and profitability in the Non–life sector of the Nigerian insurance industry over the period of 2002 to 2011, the study evidently found from the regression result that profitability directly associates with net claims and expense ratio but associates indirectly with loss ratio.

Kim (2015) uses panel regression analysis on 25 insurance companies to investigate the relationship between claims management and firm profitability in United State of America from 2000 to 2014. The study expressed it clearly that loss reserves and reinsurance recoveries were significant. Yusuf and Ajemunigbohun (2016) assess the effectiveness, efficiency and promptness of claims handling process within the Nigerian insurance industry. The study concludes that claims handling procedures should be managed promptly to evade shortfall in operational objectives of organization. Owolabi, Oloyede, Iriyemi and Akinola (2017) investigate the nexus between risk management and profitability of insurance Company. Findings from regression analysis disclosed that financial risk management practices, operational risk management practices and strategic risk management practices have a positive and significant effect on the profitability of insurance firm.

Aduloju and Ajemunigbohun (2017) analyse the significant association among ceding office gross premium income, underwriting profit and financial stability. Evidence from Pearson correlation test established that reinsurance purchase significantly increases the insurers' premium income. Also, profitability has a direct association with reinsurance utilisation. The study concludes that purchasing reinsurance reduces the insolvency risk of insurers by stabilizing loss experience and improving capacity. In a further empirical study researched in Lagos State, Yusuf, Ajemunigbohun and Alli (2017) explore the influence of insurance claims management among selected insurance companies in Nigeria. Empirical investigation from t-test result revealed that the various claims handling processing have significant effects in the claims management processes of insurance companies. The findings from the study confirm the level of significance of the different claims handling processing of the insurance companies' claims management in Nigeria. Anigma and Mwangi (2017) did a cross-country on effects of underwriting and claims management practices on the performance of insurance firms in Kenya, Uganda and Tanzania. Result indicates that underwriting and claims management practices by non financial performance are directly and significantly associated, whereas, the reverse is the case when compared with financial performance.

Putra (2017) in Indonesia determine the role of growth of income, assets, ratio of claim and risk based capital affecting Profitability of life insurance companies from 2009 to 2015. Result from the analysis of static panel regression signifies that revenue growth, asset do not have significant effect on profitability, claim ratio and risk based capital have negative significant effect on profitability. While simultaneously the income growth, asset, claim ratio, risk based capital significantly affect the profitability of life insurance companies. Oyedokun and Gabriel (2018) analyse the influence of claims management on the profitability of listed insurance companies in Nigeria. Using multiple regression technique, it was discovered that profitability has a negative nexus with loss ratio and net claims, but depict a direct nexus with expense ratio. Furthermore, net claims and loss ratio have significant effect. Ajemunigbohun, Isimoya and Ipigansi (2019) apply frequency percentage and t-test statistics to determine claims fraud associated with homeowner's insurance coverage in Nigerian insurance industry. The study infers that in order to promote stable, confidence-based, result oriented and trustworthy market environment, there is need for adequate fraud deterrent. Also, the government should promote anti-fraud strategy design that will enhance efficient operation and effective service delivery of insurance industry.

RESEARCH METHODOLOGY

Research Design, Population and Sampling size

This study applied ex-post facto research design in its discourse. The study population was made up of all registered and quoted insurance companies on Nigeria Stock Exchange out of which only 5 namely, AIICO General Insurance Co. Ltd; NICON Insurance Plc, Investment and Allied Insurance, Mutual Benefit Assurance Ltd, and Great Nigeria Insurance are selected for the study purpose.

Model Specification, Description of Variables, Analytical Technique, Source of Data

In reference and modifications to Yusuf and Dansu's (2014) model, the proposed mathematic model for this study is stated as:

ROA = f (NC, ER, LR) --- 1

In econometric terms, the model is restated as:

$ROA = \alpha_0 + \alpha_1 NC + \alpha_2 ER + \alpha_3 LR + \mu_t$ --- 2

Where: ROA = Return on asset

NC = Net claims

ER = Expenses ratio

LR = Loss ratio

f = Functional notation

Description/Measurement of the Variables

Variables	Measurement
Return on Asset (ROA)	Net income before taxes as a percentage of total asset
Net claims (NC)	Total claims paid in a period
Expenses ratio (ER)	Total underwriting expenses as a percentage of earned premium
Loss ratio (LR)	Total net claims as a percentage of earned premium

Source: Author's compilation (2020) based on previous studies

Cross-sectional data on return on asset, net claims, expense ratio and loss ratio from 2010 to 2018 were sourced from Annual statement or selected insurance companies. For easy analysis, this study adopts the least square regression estimates. Other estimation tests that are considered in the analysis are t-test, f-test, R^2 test, Adj R^2 test and Durbin Watson test.

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A priori Expectation

$$\frac{\partial NC}{ROA} > 0;\ \frac{\partial ER}{ROA} > 0; \frac{\partial LR}{ROA} < 0$$

This implies that there is possibility of net claims and expense ratio to be positively correlated to profitability index of Insurance firms while loss ratio may be negatively related to profitability index of Insurance companies in Nigeria under the study period.

RESULT AND DISCUSSION

Presentation of Result

Table 1: Fitted Regression

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	47.02820	33.08668	1.421364	0.1714
NC	64.61494	7.924434	8.153886	0.0000
ER	0.621847	0.163192	1.210531	0.3006
LR	-0.043698	0.182838	-0.239000	0.8129

R-squared	0.974283	F-statistic	167.2157
Adjusted R-squared	0.952982	Prob(F-statistic)	0.000000
Observation	45	Durbin-Watson stat	2.062248

Source: Author's Computation (2020), E-view 9.0 version

The relationship between the claims management and insurance profitability variables were mathematically expressed as:

$ROA = 47.02820 + 64.61494_{NC} + 0.621847_{ER} - 0.043698_{LR}\ \mu$

Interpretation and Discussion of Finding

The coefficient of value net claims (NC) which is estimated to be 64.61494 is positive and significantly related to profitability of insurance firms in Nigeria. By implication, net claims will significantly increase Nigeria insurance companies' profitability by 64.61%. Theoretically, the study conformed to the earlier economic *apriori* expectation of a positive effect with profitability of insurance companies. The result of expense ratio also depicted a positive and insignificant effect on profitability of insurance firms in Nigeria. Therefore, the coefficient of expense ratio is expressed as 0.621847, which means that a percent increase in expense ratio will bring about 6.21% increase in profitability of insurance firms in Nigeria with an insignificant effect. Expectedly, the result is in consistence with the theoretical expectation of positive relationship with profitability of insurance firms in Nigeria. Conversely, loss ratio has negative with an insignificant effect on profitability of insurance firms in Nigeria. The result vividly indicated that loss ratio have a coefficient value of -0.043698. By interpretation, a per cent increase in loss ratio will negatively and

insignificantly result to about 04.36% decrease in profitability of insurance firm in Nigeria. The result equally conformed to the *apriori* expectation of negative relationship with the firm profitability in Nigeria.

By calculations, the result implies that NC and ER contributed about 64.61% and 0.62% to ROA while LR decreases ROA with about 04.36% on ROA in Nigeria. However, some policy implications were drawn from the study. Firstly, the negative effect of loss ratio signifies that in order for an insurance company to remain profitable, there must be a way of minimising her claims expenses, thus, non-financial industry (insurance) should be vigilant to fraudulent claims, recoveries form salvage, subrogation, or third parties (SAS, 2012). In furtherance to this, insurance firms should keep her eyes more on accurate loss reserving, claims forecasting, and litigation management. The positive effect of expense ratio revealed that, should there be a naira increase in expense ratio, there will be an equivalent increase in profitability of insurance firms. This indicates the direct proportional association that exist between expense ratio and return on asset. As such, firms with great investment on human capital development, training and staff motivation will derive maximum returns leading to greater profitability in the long run. In tandem to the aforesaid, net claims portrays a positive effect on ROA, thus, a naira value increase in net claims will correspond to the same value increase in profitability. This may not be far fetch from the enhanced underwriting activities and adequate loss reserving by insurance companies, hence, the more risks are carefully selected and premium charges is adequate, the more possible it will be for an insurer to realise the expected profit in an accounting year.

CONCLUSION

The study is set to investigate the influence of claim management on the profitability of insurance firms in Nigeria. Profitability is one of the essential and vital tools of organisational performance. It is more essential for insurance firms because it is used to measures the company's propensity to pay compensation to its clients, motivate its employees, and maximise the wealth of its shareholder. This study explored that claim costs greatly influence the profitability of insurance firms in Nigeria. Claim managers should work in cooperation with other sections of the insurer from the policy formation stage to its cessation. This will not only avert the payment of fraudulent claims but will definitely promote timely payment of genuine claims and increase the profitability of firm through effective cost control. The study is in consistence with previous studies of Yusuf and Dansu (2014), Ogunubi (2017) that claims management contributes positively to profitability of insurance firms in Nigeria. This work recommends that insurance firms in a bid to make profit should not forget the main reason for their existence which is bringing the insured back to her pre-loss position by paying genuine claims. Therefore, all efforts should be made to pay genuine claims promptly as this increase the confidence of the general public in insurance and the industry as a whole.

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