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# IMPACT OF INSURANCE INVESTMENTS ON NIGERIAN CAPITAL MARKET

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**Abstract:** *The study was on impact of insurance investments on Nigerian capital market. Its specific objectives were to examine the impact of Insurance Investment in Government Securities in Nigeria Capital Market and analyse the impact of Insurance Investment in Stock and Bond in Nigeria Capital Market. Research design was Ex-post facto. Ordinary least square regression was used as analytical technique. It was found that Insurance investment in Government Securities has positive and significant impact on Total Market Capitalisation; and Insurance investment in Stocks and Bonds has positive and significant impact on Total Market Capitalisation. From the findings of the study it is concluded that collectively the insurance industry investments in the Capital market have the capacity to make very significant impact on Market capitalization. The recommendations made were that the insurance industry should make further investments through diversification of their portfolio in Government Securities by buying into that of other countries as well. Also, the insurance industry should invest in Stocks and Bonds that are backed with guarantees. This can be by buying more of forwards.*

***Keywords:*** *Insurance investments, Nigerian, Capital market*

## INTRODUCTION

The Nigeria Insurance Industry is one of the key sectors of the Nigerian economy and plays a very vital role in the nation as a whole (Agbamuche, 2012). The industry mobilizes funds that are channelled into productive investments and also acts as a catalyst of economic growth, helping to accelerate the process of qualitative structural transformation. It basically provides services in the form of security against general uncertainties which are likely to occur in everyday life, thereby resulting in liabilities which translate to a financial loss. These services are usually provided by the insurer to the insured in return for a given small consideration known as a premium which basically serves as the main source of insurance funds and also used in the settlement of claims (Agbamuche, 2012). The accumulated insurance premium and source of insurance fund are not kept dormant rather they are

invested in capital market and other investment outlet as specified in section 25 of Insurance Act of 2003.

The world today looks very different than it did five or 10 years ago. How we invest, conduct business transactions, think about risk — has changed. Over the past decade, the stock market has been trending upwards, with occasional market corrections. But 2008's recession has had lingering effects; the appetite for risk has been diminished. Investors started looking at the insurance industry as a source of opportunity and a way to diversify to minimize exposure (Marsh, 2017). The Nigerian insurance industry channels a substantial part of its surplus funds to the capital market. The capital market is a network of specialized financial institutions, series of mechanisms, processes and infrastructure that, in various ways, facilitate the bringing together of suppliers and users of medium to long term capital for investment in socio-economic developmental projects (Al-Faki, 2006). In other words it is a platform for the mobilisation of funds from the savings (surplus) sector of the economy to the savings deficit sector. Capital Markets may look at the insurance industry to: access a risk that that is not correlated to other markets like mortality/longevity; access assets to manage; or simply invest in an area where returns are thought to be attractive (SOA, 2016). Therefore, it will not amount to an overstatement to assert that Nigeria insurance industry through its investment aids the smooth operation of the capital market.

## STATEMENT OF THE PROBLEM

Insurance companies have a pivotal role in delivering values which surpasses the needs and expectation of the people and at the same time are affordable.The Nigerian position is different to what is obtainable in Europe, America and Asia. The industry invests less than 1% of funds in stock and bonds, government securities, as well as real estate properties and mortgages. Irrespective of the sector's investment in the Nigerian Capital market, the impact has not truly reflected to the growth of the Nigeria economy. Empirical interest from the academia on the effect of insurance investments in the Nigerian economy has been minimal. This is particularly with regards to the investments of the insurance industry in the Capital market. It is in order to assess the insurance industry in this context that this study was undertaken.

## OBJECTIVE OF THE STUDY

The general objective of this study is to evaluate the effect of Insurance investment fund in Nigeria Capital Market. However, the specific objectives are:

1 To examine the impact of Insurance Investment in Government Securities in Nigeria Capital Market.

2 To analyse the impact of Insurance Investment in Stock and Bond in Nigeria Capital Market.

**Importance of the activities of insurance companies carries out the activities in the financial markets**

1) Insurance provides financial stability and reduce uncertainty through indemnity all those who have suffered loss. In this way it reduces the effect of mass bankruptcies that could have catastrophic consequences on production, employment, state tax revenues, and the state of an economy in general.

2) Voluntary investments of these funds on financial markets provides security for future for annuity holders that based on their payments be paid out monthly is stable until the end of their lives.

3) Growing of small amounts of money collected in the form of premiums, insurance companies are able to finance large investment projects and thus positively affect the economic growth of the country.

4) Insurance provides effective risk management and transforming evaluating risk. When investing, insurance companies thoroughly investigate the creditworthiness of the borrower, which allows other investors in the market to obtain information about the characteristics of other firms in the environment when making investment decisions.

5) Conducting international trade between partners who are not sufficiently familiar with is often conditioned by the existence of certain types of insurance. Thus ensuring encourages the development of international trade.

6) Granting discounts in premiums, and preventive measures to protect against fire, injury at work, etc., insurance companies affect the prevention and reduction of losses of the insured or of society as a whole.

## THEORETICAL FRAME WORK

The theoretical consideration for the study is the theory of Financial Liberalization Theory. This theory has its origins in the work of McKinnon (1973) and Shaw (1973). It was Patrick (1966), however, who published the seminal work on the relationship between financial

development and economic growth. He hypothesized two possible relationships, a "demand-following" approach, in which financial development arises as the economy develops, and a "supply-leading" phenomenon, in which the widespread expansion of financial institutions leads to economic growth (Arestis, Nissanke and Stein, 2005). Led by seminal papers of McKinnon [1973] and Shaw [1973], a significant number of studies have pointed out that financial liberalization can exert a positive effect on growth rate as interest rate levels rise towards their competitive market equilibrium, while resources are efficiently allocated.

## EMPIRICAL REVIEW

Sambo (2016) assess the effect of insurance investment on GDP in Nigeria. Its specific objective was the consequence of insurance investment by asset type to the total contribution to Nigerians GDP using monthly data from 1996 to 2012 has not been empirically established. *Ex-post facto* research design method was applied to the study. The study employed monthly time series data for the portfolio of investment within this period and the GDPt as its variables. Multiple regression model was utilized to estimate the relationship for the combine variables while linear regression for the total investment against GDP using Gretl- 1.9. 12 for the analysis. Consequently, the study concludes that the statistically positive $R^2$ of 74% indicates a joint relationship between insurance investments and GDP in Nigeria. It was recommended that the increase in insurance investment that form its industry portfolio would maximize the investments and result to increase in economic development.

Igbodika, Ibenta and John (2016) examined the contributions of insurance investment to economic growth of the Nigerian economy for the period 1980 to 2014. Economic growth is proxied by gross domestic product while insurance sector development is proxied by insurance investment. The study used time series data generated from Central Bank of Nigeria (CBN), Statistical bulletin and Nigerian Insurance Digest for various years. Thus *Ex-post facto* research method was used. Augmented Dickey- Fuller and Philip-Peron methods were employed to establish stationarity of the data. Johansen co-integration tests were done to establish long run effect among the variables. It revealed the existence of at least one co-integrating effect at1% and 5% levels of significance. The study adopted generalized method of moments (GMM) technique for analyses. The result of the study reveals that;

insurance sector investment has positive and significant effect on Gross Domestic Product. The study recommends mandatory insurance protection for all investors, not only to encourage them but also as a boost for the economy. Moreover, insurers should diversify their investment portfolio to enable them to guarantee the stability of their return and ability to pay claims.

Egbeonu (2016) investigated the pattern of flow between insurance investment portfolio and economic development in Nigeria. As an *Ex-post facto* study, data was extracted from CBN statistical bulletin and World Bank record 2013, various econometric tools were used to performed the analysis; multiple regression analysis, unit root test, Engle – Granger co-integration and Granger Causality. The individual coefficient result of OLS revealed positive and significant relationship between bills of exchange, investment in stocks and bonds, while inverse and insignificance relationship was found between investment in Government securities; Granger causality result revealed that the pattern of relationship between insurance investment portfolio and economic development was demand following (Economic development → Insurance investment portfolio). It is therefore recommended that insurance sector awareness be increase and encourage in the country.

Ubom (2014) examined the link between investment portfolio of insurance firms and the variables of economic development such as the growth rate of gross domestic product (GDP), unemployment, capacity utilization and inflation rates in Nigeria from 1990 to 2011. The study used *Ex-post facto* method. Blends of desk, exploratory and descriptive research design were used. Data were analyzed using descriptive and inferential tools. The discoveries were that insurance companies in Nigeria got over 95% of income on yearly basis from premium and accumulated large sum of funds after expenditures on claims but invest less than 1% of such funds. Stock and bonds, government securities as well as real estate properties and mortgages dominated the investment portfolio of these financial institutions with heavy concentration in the assets of quoted companies. Hence, small and medium scale enterprises were not funded. As such, insurance firms were not making any significant influence on economic development in the country as evidenced in the marginal growth rates of gross domestic products (GDP) and capacity utilization, among others. Therefore, the recommendations were that insurance companies should increase their wealth allocations to investments with proper spread and mix to cover small and medium

scale enterprises and short term loans and to introduce finance and insure products to broaden their income base. This is expected to enhance their investment positions and contributions to economic development and growth in the country.

Torbira & Ogbulu (2014) investigation into the relationship between fund mobilization by insurance companies and gross fixed capital formation (GFCF) in Nigeria and specifically how the latter responds to stimuli emanating from the insurance companies. A five variable-predictor multivariate regression model was estimated and analyzed. The short run results reveal that four explanatory variables namely: premium from fire, accidents, motor vehicles and employee liabilities insurance policies positively and insignificantly correlate with Gross Fixed Capital Formation while the relationship between premium from marine insurance policies and GFCF is both negative and insignificant. In the long run, the fund mobilization variables by insurance companies positively and significantly impact on the growth of gross fixed capital formation. In addition, the Granger causality test provides no evidence of causality among the variables. The paper therefore recommends the formulation and implementation of policy measures that will increase insurance penetration, improve insurance fund mobilization and enlarge the insurance market in Nigeria.

Agbamuche (2012) employed Chi-square model in his study on Investment of insurance funds in the Nigerian Capital market, and find out that; (i) the insurance industry invest substantial parts of its funds in the capital market. This implies that the surplus funds of the insurance companies after claims to policyholders have been paid out is then invested in the capital market in the form of government securities, corporate funds, real estate, mortgages etc. (ii) that the investments of insurance funds contributes to the socio economic growth of the country. This implies that as insurance contributions increase, economic growth would also increase hand in hand, (iii) that the insurance industry contributes positively to the growth of the capital market. This implies that the insurance industry is also a centre of capital formation, mobilization and allocation of resources within the economy because it deals with long term securities and it enables the funding of other deficit sectors of the economy. This finding shows that the major source of funds available to the insurance industry is through premium incomes; however other incomes come in the form of issuance of shares and other investment returns, (iv) that the insurance industry is a relevant sector

of the economy. This would suggest that a direct or positive relationship exists between the insurance industry, insurance contribution and economic growth in the country. Ultimately a relevant and formidable insurance sector would help greatly in boosting overall economic growth in Nigeria.

## METHODOLOGY

The model for the study was derived from Sambo (2016) who stated that

GDP = f(TI)

where GDP = Gross Domestic Product and TI = Total Insurance Investment. Adjusting the model to suit the present study GDP is replaced with TMKCAP = Total Market Capitalisation while TI is broken down into respective areas of investments of the insurance industry namely Insurance investment in Government Securities, Stocks and Bonds and Bills of Exchange. As such the general model for the study is stated as:

TMKCAP = f(TINVGS + TINVSB + TINVBE)

Therefore, the respective model applicable to each objective of the study is stated below:

**Hypothesis One Model**

The functional relation of the model is given as:

TMKCAP = f (TINVGS) ……(i)

The model is specified as follows:

$TMKCAP = \beta_0 + \beta_1 TINVGS + \mu$……(ii)

Where: TINVGS = Total Insurance Investment in Government Securities; TMKCAP = Total Market Capitalisation; $\beta_0$, = Constant parameters; $\beta_1$ = Coefficient parameter of TINVGS; and $\mu$ = error term.

**Hypothesis Two Model**

The functional relation of the model is given as:

TMKCAP = f (TINVSB)……(iii)

The model is specified as follows:

$TMKCAP = \beta_0 + \beta_1 TINVSB + \mu$ …….(iv)

Where: TINVSB = Total Insurance Investment in Stocks and Bonds; TMKCAP = Total Market Capitalisation; $\beta_0$, = Constant parameters; $\beta_1$ = Coefficient parameter of TINVSB; $\mu$ = error term.

**Description of model variables**

**Independent variables**

**Total Insurance Investment in Government Securities**: This is the total of all Government Securities investments made by the entire insurance industry in a year.

**Total Insurance Investment in Stocks and Bonds**: This is the total of all Stocks and Bonds investments made by the entire insurance industry in a year.

**Dependent variable**

**Total Market Capitalisation**: This is the total Naira value it would cost to buy the aggregate of financial instruments on sale in the Nigerian Capital market at their current prices in a given period (day, week, month or year).

**Analysis**

**Test of Models Adequacy**

| Variables | Durbin Watson | Adjusted Coefficient of Determination |
|---|---|---|
| Government Securities | 0.728 | 0.850 |
| Stocks and Bonds | 0.917 | 0.877 |

**Hypothesis One**

At an Adjusted Coefficient of Determination of 0.850 (which is nearer to one than zero) the model has a good fit to the analysis. That is to say, Insurance investment in Government Securities bears responsibility for 85 percent of the total variation in Market Capitalisation in the model. Also with a Durbin Watson value of 0.728 it shows there is a positive autocorrelation between the variables. That is to say, they can be directly predicted from each other. In other words, the strength of the relationship between them was very high.

**Hypothesis Two**

The Adjusted Coefficient of Determination of is 0.877. This value is also nearer to one than to zero. Therefore, the model for the test has a good fit for the analysis. It proves that in the model 87.7 percent of total variation in Market Capitalisation is due to insurance investment in Stocks and Bonds. Its Durbin Watson value of 0.917 establishes that there is a positive autocorrelation between the variables. Therefore, they can be directly predicted from each other showing they have a high relationship.

**Test of Hypotheses**

Restatement of Hypotheses

$H_0$: Insurance investment in Government Securities has no positive and significant effect on Total Market Capitalisation.

$H_0$: Insurance investment in Stocks and Bonds has no positive and significant effect on Total Market Capitalisation.

The decision rule holds that where t-calculated is higher than t-tabulated the Null hypothesis is rejected and its alternative accepted.

T-tabulated is derived as t∞/2(n-k)

Where ∞ = 5 percent level of significance;

n = length of the period per variable which is 19 periods (from 1996 to 2014);

k = number of variables which is 2 per hypothesis

(NB: t-tabulated value is taken from percentage points of t-distribution statistical table)

**Table Result of Hypothesis One Test**

| Model | | Unstandardized Coefficients | | Standardized Coefficients | | |
|---|---|---|---|---|---|---|
| | | B | Std. Error | Beta | t | Sig. |
| 1 | (Constant) | -822.581 | 846.537 | | -.972 | .345 |
| | GOVERNMENTSECURITIES | .582 | .057 | .926 | 10.137 | .000 |

Hypothesis One test had t-calculated as 10.137 (See Appendix One). T-tabulated = t (0.05/2)(19-2) = (0.025)(17) = 2.110. As a predictor of effect, at 5% level of significance, given the outcome of the result the Null hypothesis is rejected. That is to say, Insurance investment in Government Securities has positive and significant effect on Total Market Capitalisation.

**Table Result of Hypothesis Two Test**

| Model | | Unstandardized Coefficients | | Standardized Coefficients | | |
|---|---|---|---|---|---|---|
| | | B | Std. Error | Beta | t | Sig. |
| 1 | (Constant) | 190.441 | 692.100 | | .275 | .787 |
| | STOCKSANDBONDS | .050 | .004 | .940 | 11.379 | .000 |

Hypothesis Two test had t-calculated as 11.379 (See Appendix Two). T-tabulated = t (0.05/2)(19-2) = (0.025)(17) = 2.110. As a predictor of effect, at 5% level of significance,

given the outcome of the result the Null hypothesis is rejected. That is to say, Insurance investment in Stocks and Bonds has positive and significant effect on Total Market Capitalisation.

**Implication of Result**

The findings emanating from this study are as follows:

1. Insurance investment in Government Securities has positive and significant effect on Total Market Capitalisation.
2. Insurance investment in Stocks and Bonds has positive and significant effect on Total Market Capitalisation.

In view of objective one, from the result of Hypothesis One test, Insurance investment in Government Securities will pull an increasing impact on total market capitalisation. This is given that a unit change in Insurance investment in Government Securities pushes upwards the deepening of the capital market as well as the likely returns the insurance industry stands to receive from investment of its fund. That is to say, Insurance investment in Government Securities being positive and significant widens the size of Government Securities in the Nigerian Capital market which further extends the depth of total market capitalisation. This finding is in line with Catalan, Impavido and Musalem (2000), Waldamannati (2008) and Eze and Okoye (2013).

On objective two, the result from Hypothesis Two test show that Insurance investment in stocks and Bonds will also pull an increasing impact on total market capitalisation. This is given that a unit change in Insurance investment in Stocks and Bonds pushes upwards the deepening of the capital market as well as the likely returns the insurance industry stands to receive from investment of its fund. That is to say, Insurance investment in Stocks and Bonds being positive and significant expands the total value of Stocks and Bonds in the Nigerian Capital market which further extends the depth of total market capitalisation. Also, this finding is in line with Catalan, Impavido and Musalem (2000), Waldamannati (2008) and Eze and Okoye (2013).

## CONCLUSION

As institutional investors insurance companies are very important participants in the financial market, especially in the capital market. They have a very important role as they contribute to the strengthening of competition in the financial market, stimulate financial

innovation, strengthen corporate governance, contribute to increase market integrity, pressure for modernizing market infrastructure, encourage the development of regulations, which primarily stems from their longterm business horizon. From the findings of the study it is concluded that collectively the insurance industry investments in the Capital market have the capacity to make very significant impact on Market capitalization.

## RECOMMENDATIONS

Based on the findings of the study the following recommendations are made:

1. The insurance industry should make further investments through diversification of their portfolio in Government Securities by buying into that of other countries as well.
2. The insurance industry should invest in Stocks and Bonds that are backed with guarantees. This can be by buying more of forwards. A forward contract is a customized contract between two parties to buy or sell an asset at a specified price on a future date (Investopedia, 2017). This will help the industry to have control over what it puts its fund into giving it room to recall when liabilities arise and have to be settled.

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