



An appraisal of socio-economic factors affecting portfolio decisions of insurance companies in Nigeria

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ABSTRACT: The main focus of this paper is the examination of some of the socio-economic factors affecting portfolio decisions of Nigerian Insurance Companies. Decision making and risk assessment are multi criteria processes that cannot be defined by rigid quantitative models thus highlighting the necessity to consider decision making by decision makers in their natural settings (social contexts, political and environment). In practice, it was found that in some cases asset or investment decisions were based on issues that bear little or no significance to economic or financial considerations as espoused in literature. Economic theory cannot be fully characterised on one dimensional scale that reflect only risk tolerance.

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INTRODUCTION

Insurance is a method of purchasing protection for a person, people or firm against financial loss. General insurance relates to losses which could result from the damage or theft of personal or business assets; life and accident insurance refers to death or injury. Insurance companies accept the risk of such losses, and issues policies to cover contingencies such as fire and flooding, death and damage, which could cause financial loss to policy holders or their dependents. The insurance company accepts the regular payment of premiums to cover such possibilities. They are based on the probability of such an event occurring, and the cost that would be involved. This is calculated by the company's actuarial department, which employs statistical techniques to analyse the level of risk. In addition, many companies offer contractual savings schemes. Here, a person will pay regular premiums with the expectation of a future return,

which could be a fixed sum, or one related to the performance of an investment fund.

Insurance may be obtained directly from the insurance company or through an intermediary such as an insurance broker, who will consider the specific requirements of each client and then recommend the company which offers the most advantageous terms and conditions. For this, they charge a commission, and pay the company the outstanding amounts at periodic intervals. In addition, some insurance companies employ agents to sell their policies.

Most non-life policies are for one year, though marine insurance cover may extend for up to three years. Liabilities are short term, so much of each premium paid is retained in liquid form as 'cash in hand and on current account'. In general insurance, the premium is calculated simply as the sum of the cost of the basic risk in the year plus a loading for expenses and profit.

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The companies use these premiums to pay claims, but also to generate income through investment in a portfolio of financial securities. On the other hand, life insurance is particularly suitable for lengthy investment periods; as such contracts extend for much longer periods, in most cases exceeding fifteen years (Ogunshola, 1976). The aim is to achieve a balance between immediate liquidity needs, so that claims can be met promptly, and longer term investments, which might generate a greater return.

A company can create funds or trusts for investors. Specialist fund managers will use the premiums collected to purchase equity in that market. The premiums buy a share, or unit, of the fund. These will be repurchased from investors, and the value of a fund varies according to the value of the securities it owns. Thus returns to investors are linked to the performance of the fund. This encourages small investors, who are able to achieve a wider spread of risk than they could achieve for themselves and the professional management of their money. In the UK, the insurance companies traditionally support domestic and overseas government fixed interest bonds, corporate stocks and shares.

Annual policies would include such items as motor insurance, cover for property and its contents, third party liability for workmen and property owners. If these were to expand, employment would be generated within the

industry, but little of the premiums would not be used for investment purposes, so would offer little to a national economic development. Life insurance premiums are fixed, but inflation reduces the purchasing power of the premium, so investments must include a growth element. Hence, since the liabilities are long term, the assets of the funds should be similarly invested. A major task within any insurance company is portfolio investment decisions, which require the use of actuarial and market information to ensure the best possible returns for each policy. This ensures that large amounts of capital are available for corporate investment but the need for competence and honesty usually leads to high levels of government regulation (Akhigbe, 1992). The wealthy are most likely to invest in life policies, pensions, and term insurance, so they are most likely to feature strongly in mature economies. Developing economies will be held back by the absence of such capital.

This does not augur well for Nigeria. Current, accurate statistics are not available, which prevents an analysis of the insurance sector in the national economy, but Zafu (1992) felt that there was strong correlation between the two, but the relationship was not sufficiently well understood by those with influence within the country. Ogunlana (1995) and Irukwu (2001) agreed that the potential market was far greater than that which had been achieved.

OVERVIEW OF THE NIGERIAN INSURANCE INDUSTRY

The British colonialists introduced their economic and commercial systems on the country. Insurance companies then were appointed as agents to offer cover for European merchants (Irukwu, 2001). The first indigenous Insurance Company was established in 1950. By 1960, twenty-five insurance Companies were doing business in Nigeria, of which four were locally owned. Insurance broking started in

Nigeria in 1955, and the Insurance Institute of Nigeria was founded in August 1959 to assist the training of Nigerians. The country gained political independence in 1960. In 1968 a Decree required that every company doing business in Nigeria be incorporated in the country. As a result, foreign insurance ceased to be Branch Offices or Agencies of British Insurance Companies.

The overseas companies which had dominated insurance business in Nigeria often transferred premiums through reinsurance to their home countries and made little investments in Nigeria. Consequently, in 1969, the government established the National Insurance Corporation of Nigeria (NICON) with authority to insure Government assets as well as carry on other functions of an Insurer. In 1973 the Government took over 49 per cent of the equity of overseas insurance companies, and sold the shares were to the Nigerian public in 1989. As a result of substantial foreign exchange earnings from the export of crude petroleum, the Nigerian economy flourished in the 1970s, and the insurance industry had its share in the ensuing prosperity (Irukwu, 2001). In terms of number of practitioners, premium income, reserves and retention capacity, Nigeria became the largest insurance market in Africa. Furthermore, the industry during this period invested in all sectors of the economy, especially Government

securities, which appeared to be sound long and medium term investments. Investors showed more caution with stocks, shares and bonds. There followed a period of national economic depression. Insurance premiums could not be met, and the industry declined, limiting the contribution made by the industry to the social and economic development of Nigeria (Ogunlana, 1995).

By 1997, the total investment of insurance companies in government securities was about N1.2 billion, while investment in stocks and shares amounted to N2.61 billion. This represented 0.7% of Gross Domestic Product (GDP). By 2001, the total investment of Nigerian insurance companies in the national economy had risen to more than N40 billion, which was 0.9% of GDP (Nigeria Insurance Digest 2002). Expansion of the industry would throw up huge investible fund to aid the national economic development hence some of the factors hindering the sector are examined.

RESULTS AND DISCUSSION

Nigeria is endowed with a vibrant spirit of private enterprise and the largest pool of potentially successful entrepreneurs in Africa. However non-oil private and productive investment had never taken off in Nigeria thereby frustrating these entrepreneurial activities domestically. This was due to poor investor incentive climate, increasing reliance on oil, oppressive governments and public sector economic policies (USAID, 2002). Despite the huge resources available, Nigeria has not been able to achieve a high level of foreign investments. Bala (2003) identified the following factors as major obstacles to economic growth in Nigeria: dependence on the oil sector, deficit budget, inadequate infrastructure, corruption, unstable regulatory/ institutional environment, crime and security concerns. Nigeria has been described as a nation where nothing works. Harriman (1982) posed thought provoking questions about the Nigerian environment

“Why won't the telephone or the bureaucrats work?. Why can't you turn on a switch or a tap, or turn up for a scheduled flight with confidence that light, or a wash or a journey will result? Why at almost every level of public or private administration do people expect bribes?”

Some of the major factors affecting portfolio decisions of Insurance Companies in Nigeria are:

1. Corruption

It is a known fact that corruption and all its ramifications have eaten deep into the fabric of Nigerian national life. Corruption has been transformed into tradition often tolerated by average citizens by supplementing low wages with gifts and bribes to expedite routine processes. Erundu et al (2004) noted that ‘Nigeria has a history of corrupt and unethical business and government practices’. Indeed, corruption has eaten deep into the fabric of Nigerian national life, and they concluded that it was ‘more likely to be an institutional concept than

an individual one'. Gichure (2006) argued that the African culture is different from the western, and that the African situation coupled with immense poverty, combined to create divergent views on ethical behaviour. For example, the Africans would be more concerned with how to feed the extended family, which would be regarded as an obligation, than any consideration of breaking international copyright regulations.

The problem of bribery and corruption is not peculiar to Nigeria but exist in all societies to a greater or lesser extent. Beekun and Badawi, (2005) reported that as contained in the report of the Transparency International, the two most corrupt countries in the world have Muslim majorities – Nigeria and Bangladesh – which suggests 'that there is a wide gap between normative Islam and the practices in some Muslim countries'

There had been documented cases of Executives at France's Elf Aquitaine taking bribes in exchange for awarding business deals and Russia's Gazprom purchased materials for new pipelines through intermediaries owned by company officers. Although, big cases like these make headlines in the press but many cases of looting by insiders go undetected. There are remote and immediate causes of corruption in Nigeria. The structure of the society produced a small proportion of the people controlling the national wealth. This class tends to lord it over the rest, exploiting and manipulating them. As argued by Salami (1984) the foundation of this structure was laid by the colonial masters whose sole objective was to turn themselves into a superior and privileged class. In the beginning of colonialism, indigenes were restricted from interacting with them and instances abound where exclusive clubs were created for their recreation. Furthermore, government rest houses were carved out for their residences as distinct from the local populace. Consequently, at

independence their erstwhile protégés (indigenous elites) inherited the position of the colonialist and perpetuated the status quo. Therefore, the possession of house and car became a status symbol. Unfortunately, no one seems to care how these assets were acquired and this tendency has encouraged fraudulent practices. These fraudulent practices manifest themselves in many ways. They could take the form of cash or material offers or promises for award of contract, promises of promotion or lucrative posting, investment in particular projects and placement of funds for investment purposes. The situation was aptly captured up by Tokunboh (1972) thus:

"It is not an exaggeration of the tragic events of the years since independence to say that all efforts to establish a just and efficient administration have been frustrated by corruption. The evil exist in every facet of our society. You bribe to get your child into school; you pay to secure a job and you also pay in some cases to retain it; you pay ten percent of any contract obtained; you dash the tax officer to avoid paying taxes; you pay the policeman to evade arrest. This sordid state of affairs has virtually developed into a conspiracy against the people".

As could be seen from the above, corruption represents the inner dynamic of the society in which the people knowingly engage with embezzlers and abusers of power. Within the insurance industry, there are clearly many opportunities for corruption to exist, from adjusted premiums to suit specific insurers to investment decisions which favour particular companies. There is also the 'favour' which could result from tribal loyalty or friendship as well as bribery. For example, the premiums of general business policies can be allowed to remain with the agents or brokers for lengthy periods, so that they have what could be regarded as interest free loans. This is not the most satisfactory way

to do business because for every single day that the money was retained by the agent, there was a corresponding loss of investment to the insurer.

2. Political environment

The political system is a broad term covering the forms and institutions by which a nation is governed. Developments in this area affect business operations because organisations interact with government and its agencies as consumers or by virtue of the set of laws that influence and constrain the conduct of organisation (Akhigbe, 1992). Prudent financial management of an insurance company is perhaps one of the most important roles of an effective management. Freeman, (1979) states that the solvency of the company must be maintained to protect those persons who are looking to the company for the protection against economic losses as well as assuring the adequacy of reserves. Williamson (2003) maintained that individuals make rational investment decisions within markets and to greater or lesser extent within the constraints of law and regulation. Furthermore, DiMaggio and Powell (1991) found that individuals as social beings are influenced by the coercive, mimetic and normative forces of society's institutions. All business operates within the frameworks established by government (Akhigbe, 1992), and Nigeria is no exception. Regulation and control of the Nigerian Insurance Industry is enforced under the Insurance Act 2003 together with directives and guidelines issued by the regulatory body (NIACOM). The governmental control and regulations of investments are influenced by government public service functions, fiscal policies and regulatory functions. While the permanence of rules, regulations and attitudes allows effective planning and gives confidence to investors, the growth and even the survival of a business can

be influenced by political interference. Frynas (1998) has noted that 'business managers name Africa's political instability as a key obstacle to economic development'.

Government establishes ground rules under which an organisation may operate and through this intervention inject a new degree of uncertainty in the operations of the organisation. These elements of legal and regulatory structures are of greatest concern to investors. Furthermore, an economy that is politically unstable would not be conducive for business operations. It will be recalled that many businesses collapsed in Nigeria during the civil war and during the major political riots through arson. The growth and survival of an organisation can be hampered by incessant and unnecessary interference by the political class thereby leading to large scale distortions in the economy. Nigeria has failed to offer such stability. Since independence, regimes had often ended by force. The civilian Balewa government of 1960 to 1966 ended with an attempted coup and assassination. There followed five successive military regimes. Ironsi did not survive the year, being terminated by coup and assassination. Gowson's rule, from 1966 to 1975, was terminated by a coup; Mohammad lasted until 1976, when there was another attempted coup and assassination. Obasanjo handed over power after elections, but the victor, Shagari, experienced a military coup in 1983. His successor, Buhari fell in another military coup in 1985. Babangida stepped down in 1993, and Shonekan became head of the Interim Government but another military coup enabled Abacha to rule until 1998. Seven different military governments had followed seven military coups and three unstable civilian governments. 'Ethnic and religious diversity was at the root of local conflicts as well as governmental change' (Frynas, 1998).

In the 1960s 'corrupt despotic regimes' led to 'the negation of possibilities for growth and development' in Africa (Ihonvbere, 2000) The Nigerian state is still largely undemocratic, and under the control of a weak, factionalised, corrupt and largely unproductive elite' (Ihonvbere, 2000) which 'has remained incapable of constructing the necessary political platform to articulate a holistic programme for growth and development'.

Sometimes, Government policy has shown a lack of appreciation of the nature and function of insurance funds. For instance, Section 5(2) of the National Housing Fund Decree 1992 stipulated that Insurance Companies should invest at least 40 per cent of their life funds and 20 per cent of non-life funds on real estate development. However, over-investment in property is dangerous to insurance. It is also inappropriate to invest a large amount of non-life funds, which are short term in nature, on long term investments such as real estate development. Furthermore, the Decree made no stipulation for the retrieval of insurance funds, yet they belong to policyholders to be used on a day to day basis for the purpose of indemnifying those of them who suffer losses. The same decree specified an interest rate of 4 per cent, whereas the commercial rate is nearer 20. If implemented fully, the Decree would have eroded the capacity of Insurance Companies to meet their claims liabilities and might have damaged the industry.

3. Social Environment

Related to the political environment are social issues conditioning business operations in Nigeria. The Nigerian business climate like its counterpart anywhere else is a product of the society within which it operates. Thus, the shortcomings inherent in the social environment are traceable to the structure and nature of the Nigerian society itself. The Nigerian social values seem somewhat misplaced. Social values are

linked to wealth. This situation leads to apathy, deliberate non performance, greed, abuse of office and inflation of costs to accommodate kickbacks. Furthermore, Nigeria is a society where everyone insists on rights without the corresponding duties or obligations. Nigerians have multiple loyalties to the immediate family, their society or state even before the entity called Nigeria. All these exert a pull on them and it is virtually impossible to detach themselves from these multiple loyalties. Also, it must be noted that the Nigerian society is basically tribal and this situation has been recognised officially. There are very few employment application forms without a column to indicate your tribe. The creation of new states has worsened the situation. As argued by Salami (1984) that the tendency for primordial loyalty and ethnic chauvinism to override the desire for other considerations became pronounced. Most Nigerians belongs to one tribal association or another and they overplay the ethnic and tribal card when it comes to the questions of hiring, promotion and taking of investment and business decisions. Apart from tribal considerations, religion influences how people take action and decisions in their business organisation. Religion is important in many societies and can play a role in the investment decision process (Ejizu, 2002). The traditional religion is still practised in Nigeria but it no longer enjoys control or dominance in the life of the people. The above is in consonance with the work of Ejizu (2002) who discovered that missionary activity, Islamic religious campaigns and colonisation have given rise to a different background with the current social and political order resembling the state of affairs in European countries thereby relegating religion to the background. Thus, Christianity, Islam and traditional religion are practiced by the people. The values, tradition, religion and customs of a society will influence how individuals formulate

their investment policies. (Akinwale, 2006 and Akinwale and Abiola 2007).

4. Macro- Economic Framework

Basically macro economics is concerned with the general state of the nation's economy. It deals with some of the most challenging issues of our time –inflation, taxes, unemployment and budgeting. The world economy has been depressed for some time now and Nigeria had its own share of the recession. Inflationary pressure is caused by hikes in exchange rate, constant fall in price of crude oil (currently oil prices has more than doubled), rising interest rates and high expenditure on public services and non productive capital investment. In the context of inflation, investors may take the view that by devaluing the currency, government is effectively devaluing its own loan repayments and consequently long term interest rate rises. On the other hand, equity dividends and property rents are much more likely, though by no means certain, to retain their real values based on real units of production. Also, tax policies and investment incentives impact positively on the environment.

It must be noted that for the past few years, Nigeria's political fabric has been showing positive signs. In 1999, Nigeria ended 15 years of military rule. The civilian administration has introduced a reformist agenda under a home grown development programme (NEEDS) with the twin objectives of combating corruption and the introduction of wide ranging initiatives fostering a more favourable economic climate. This is a key impetus to a stable and credible macroeconomic environment which will enable many businesses to thrive. The inflation rate had been relatively high in the past few years, but it increased sharply from 6.9 percent in 2000 to 18.9 percent in 2001. Despite the tight monetary measures adopted by the Central Bank of Nigeria in checking inflation, the situation

has not helped the country at all. The current rate of 11 percent is projected to increase further to about 20 percent, within the first few months of 2004. Inflation posed the greatest challenge in portfolio management. It increased the cost of meeting claims since high rates of inflation implied fall in currency values and reduced the attractiveness of life insurance (under which the benefits are expressed from the outset in monetary terms) and for with-profit policies, increases in bonus rates were added to compensate for this fall. Furthermore, operating expenses levels increased more rapidly than the rate of total premium received as the rate of inflation exceeded the average rate of investment returns on the insurance funds maintained by the company to meet the liabilities (Ogunshola, 1976). In effect, the real value of the insurance to the policyholder was diminished because what was paid out to him at the end of the contract was not up to cost levels at that time even though the money would have appeared adequate at the time the policy was taken out. For the non-life sector, the situation was less damaging as premiums could be reviewed for the new business and existing policies were reassessed annually. The investment climate also suffered some setbacks due to a high interest rate regime, high foreign exchange rate and plethora of taxes, which combined to make the business environment unfriendly and unattractive to investors (NIA 2003).

Tax relief would help the insurance industry become more attractive to investors. In Nigeria an insurance company pays tax at the standard rate of company tax on the income it receives from investing the funds which it builds up to enable it meet its liabilities. This reduces the benefits for policyholders with the savings types of life insurance policies. A substantial proportion of life business involves pension schemes, which were taxed in the same way.

CONCLUSION

It must be noted that that the environmental factors identified above focus on those with the potential to influence investment decisions whilst noting that these factors may interact at multiple levels including macro economic and social levels.

Social factors include norms, collaboration patterns and the practical and social roles that are affected in investment decision making. Put in an another way, one would therefore expect that having high levels of negative social vices (corruption, tribalism and nepotism) in the Nigerian environment would impact negatively as presented. Therefore the above findings have highlighted the fact that investment factors are often more indeterminate and complex than as suggested by the orthodox portfolio literature. In this sense therefore, it has been demonstrated that investment decision making is dependent on the state of the economy which is directly influenced by environmental factors. Another important finding was the influence of sociological factors, a stable enabling environment and actions of political players in giving out directives impacting asset portfolio decisions. However, the options of investments are strictly regulated by the insurance act which constricts the investment avenues and the

maximum level that any insurance business can attain in a particular investment area. Thus, decision making on investment in asset portfolio of insurance business is guided by regulatory requirements outside the control of the decision makers. Also, it was shown that investment and business opportunities which emanate from political stability and consistency of economic policies give rise to favourable returns on investment. Orthodox financial theory cannot explain governmental actions geared towards the control of insurance investments. The governmental control and regulations of investments are influenced by government public service functions, fiscal policies and regulatory functions hence not explained by the orthodox financial theory. Most industrial sectors feel that they should be allowed to benefit from positive government action, but there would appear to be a case here. The UK has shown that insurance companies can be powerful institutional investors, especially with the benefit of government policies designed to encourage the sector. The injection of huge capital investments into Nigeria would encourage economic growth and this is an achievable objective for any government seeking growth.

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