FIRMS' LIQUIDITY AND FINANCIAL PERFORMANCE OF LISTED INSURANCE COMPANIES IN NIGERIA

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Abstract

This study determined the influence of firms' liquidity on financial performance of quoted insurance companies in Nigeria. The study employed a descriptive research design. The population of the study consisted of twenty (20) insurance firms listed on the floor of Nigerian Stock Exchange as at 30th September, 2021 covering the periods of 2014 to 2019. The sample size of the study is made up of seven (7) insurance and assurance companies in Nigeria. Simple random sampling technique was employed in selecting the sample size of the study. The study used GLS random effects regression method to analyze the data of the study. The outcome of the study revealed that capital adequacy ratio is the major factor that influences financial performance of quoted insurance firms in Nigeria. The study finally recommended that, management of quoted insurance firms in Nigeria should offer their shares to the general public for subscription, this will in turn increases their capital/ revenue, and the resultant effect would be investment in viable assets and this will enhance the financial performance in the long run.

Keywords: Firms' Liquidity, Financial Performance, Current Ratio, Premium To Asset Ratio, Capital Adequacy Ratio.

1. Introduction

Liquidity is a vital financial indicator that shows whether a company has the ability to meet its short term obligations or not without suffering undesirable losses. Liquidity plays an important role in the effective operation of a business. An organization should ensure that it does not suffer from insufficient liquidity to meet its short term needs. Furthermore, keeping excess liquidity is not beneficial to the business since idle deposit does not generate any return to corporations. It can be inferred that a well-managed firm will neither suffer inadequate liquidity nor experience excess liquidity. Liquidity means having adequate money in the form of cash or near-cash assets in order to meet financial obligations. In commerce, cash is king, particularly during tough economic times or when the markets are unbalanced. Without cash, businesses cannot finance their bills nor carry out development policie/s, and they may find it difficult to obtain credits or have the benefit of business opportunities. An enterprise that cannot settle its creditors when due and continues not to honor its commitments to the providers of credit, goods and services can be declared a bankrupt company. Active liquidity management is necessary for the growth and profitability of organizations. Good liquidity management is therefore an essential focus for all organizations so as to avoid insolvency and eventual bankruptcy due to poor profitability.

Thus, liquidity risk is a risk of inadequate liquid assets to meet payouts from projects, forcing the sale of assets at lower prices and leading to losses. Loss from meeting liquidity comes either from quick sales or by paying interest on borrowings to meet payouts (Nabee1 & Hussain, 2017). Meanwhile, liquidity management refers to the preparations and controls required to ensure that the company retains adequate liquid assets either as an obligation to satisfy the related creditors' demand or as a measure to apply the requirements of the regulatory authorities. The central goal of liquidity management is to ensure that cash inflows of an enterprise are matched with its cash outflows. The aims of liquidity management can be summarized as follows: Meeting all cash outflow requirements frequently on a regular basis, avoiding the obtaining of finances at market premiums or via the unnecessary sales of assets, compliance with postulated liquidity conditions and statutory reserve requirements (Olagunju, David & Samuel, 2012).

Financial performance refers to the degree to which business goals are being achieved. It is the method of assessing the outcomes of firms' strategies and operations in monetary terms. It is used to measure firms' overall economic health over a given time period and can also be used for comparisons of similar firms across the same industry or to compare industries or sectors in aggregation. Profitability relates to the measurement of operating efficiency of corporations. The profitability ratio evaluates efficiency of organizations using their assets to determine the net earnings as well as return on equity which focuses on return to the shareholders wealth of an enterprise. Organizations have various measures of financial performance. However, the common measures of financial performance are the Return on Assets (ROA) and Return on Equity (ROE). Profitability's information is vital for decision making and it is used by stakeholders of the companies such as managers, investors and financial analysts as yardstick for dividends payment, management efficiency instrument and mechanism for decision making evaluation (Azam, 2017).

Insurance market contributed enormously to the financial services industry of almost all developed and developing countries especially in the areas of economic growth, allocation of efficient resources, reduction of transaction costs, generating liquidity and stimulation of investments and elimination of financial losses. The functions of insurance companies and other financial institutions are to establish effective and efficient monetary structure by risk transfer, intermediation and premium mobilization in the economy. Accordingly, financial institutions channel resources and transfer risks from one monetary unit to another. One of the most severe liquidity pressure faced by an insurer is a greater submission of policies due to a loss of confidence in its financial assets. Risk is a normal component of commerce and common life. It is a circumstance that raises the probability of losses/gains and the unclear potential events which could influence the success of financial institutions (Jegede, 2005).

The issue of liquidity is very vital to the existence of any organization, especially insurance firms. Therefore, the illiquidity of firms especially insurance companies can lead to loss of businesses thereby reducing the possibilities of earnings and profitability. This is because high liquidity position of a business makes it meet up with obligations of which some lead to funding

of loans and advances that could help the insurance businesses to earn revenue in the form of interests and loans. The problems of inadequate capital base, illiquidity and insolvency, poor asset quality and low earnings are some of the constraints faced by the insurance sector in Nigeria. In respect of the growing advantage of liquidity to insurance businesses, a number of empirical literature have been carried out to examine the effect of firms' liquidity on financial performance. However, most of the empirical literature like (Laminfoday, 2018; Nabeel & Hussain, 2017; Muriithi & Waweru, 2017; Kama & Njeru, 2016) were carried out on industries located in foreign countries. Only quite a few studies concentrated on Nigerian industries, like (Otekunrin, et al, 2019; Olarewaju & Adeyemi, 2015). More so, the few empirical studies that are documented in Nigeria in relation to firms' liquidity and financial performance are mostly carried out in the banking industry, with no empirical evidence in the insurance sector. Therefore, this study sought to fill such gap.

Thus, the main aim of this study is to investigate the effect of firms' liquidity on financial performance of listed insurance companies in Nigeria. Other specific objectives are to evaluate the influence of:

i   Current ratio on financial performance of listed industrial goods companies in Nigeria.
ii   Premium to asset ratio on financial performance of listed industrial goods companies in Nigeria.
iii Capital adequacy ratio on financial performance of listed industrial goods companies in Nigeria.

Based on the above objectives, the following hypotheses are formulated to guide the outcome of the study.

$H0_1$: There is no significant effect between current ratio and financial performance of listed insurance companies in Nigeria.

$H0_2$: There is no significant effect between premium to asset ratio and financial performance of listed insurance companies in Nigeria.

$H0_3$: There is no significant effect between capital adequacy ratio and financial performance of listed insurance companies in Nigeria.

2. Literature Review
2.1   Conceptual Review
2.1.1   Liquidity
Liquidity is the ability to meet expected and unexpected demands for cash through continuing cash flow or the sale of an asset at fair market price. Liquidity risk is the danger which arises when an entity will not have enough cash or liquid assets to meet its cash commitments. In order to remain into being and maintain its operations as a going concern, a business must keep liquid and meet its cash commitments as and when they become due. Even though, firms traditionally are concerned with long term capital planning and capital construction, the current development is that many businesses across different industries concentrate on working capital management. When there is poor management of working capital, resources may be unreasonably tied up in

unviable assets. This will reduce liquidity of the business and also the corporation will not be in a position to invest in productive assets. This will also affect profitability of an enterprise. The existence of adequate liquidity and its careful management can make significant difference between the success and failure of an enterprise. Liquidity can be determined in terms of liquidity ratios namely current ratio, quick (acid test) ratio or cash ratio. Current ratio is the ratio of the current assets to the current liabilities and it measures the margin of liquidity. Quick (acid test) is an indicator of company's short-term liquidity and is expressed as current assets (net of inventories) divided by current liabilities. It indicates a company's ability to meet its short-term commitments with its most liquid assets. The cash ratio is most used as a measure of firms' liquidity. A company's most liquid assets are its cash and marketable securities and that is why analysts also look at the cash ratio. It can therefore determine if, and how quickly, an enterprise can pay back its short-term debt. A strong cash ratio is useful to creditors when deciding how much debt, if any, they would be willing to offer to the receiving party (Pandey, 2005).

2.1.2 Liquidity Management

Liquidity management is used as a general term, which comprises of both cash management and cash flow projection, including all the activities aiming to ensure the availability of adequate liquidity. Cash management is a regular task aiming to ensure that sufficient liquidity is available for solving daily cash needs. Cash-flow forecast or cash flow management is a key aspect of the financial management where businesses plan their cash requirements to avoid unnecessary emergencies of liquidity. Panigrahi (2013) posited that liquidity management is a set of strategies and processes that ensure businesses are able to access cash as needed to pay for goods and services, make payrolls and invest in new projects that worthwhile. Liquidity management formulates a very vital aspect of all organizations these days. It has become so imperative that even profitable corporations can fail if they do not have the cash available to meet up with their recurrent cash demand and their short term cash commitments as and when due. A liquidity management strategy means a business has a plan for meeting its short-term finances and immediate cash obligations without experiencing any significant loss. It implies that a firm is managing its assets, including cash to meet all liabilities, cover all expenditure and maintain financial stability.

2.1.3 Financial Performance

Verboncu and Zalman (2005) defined performance as a particular result obtained in management, economics, marketing etc. that express elements of competitiveness, efficiency and effectiveness of the organization and its procedural and structural components. In broader sense, financial performance means the degree to which financial goals are been attained. It is the practice of measuring the results of a firm's policies and operations in monetary terms. It is used to measure firm's overall financial health over a given period of time and can also be used to make comparisons of similar firms across the same industry or to compare industries or units in general. The importance of financial stability ranges from enabling an organization to have sufficient fund for quality service delivery, maximizing the potential of service delivery, ability

to meet short term obligation as and when due and maintenance of good credit risk. This makes financial performance an important area of concern that has attracted the attention of researchers, organizational managers, government and the public at large (Verboncu & Zalman, 2005). Profitability is commonly determined using the following ratio: Gross Margin, Operating Margin, and Return on Assets, Return on Equity and Return on Capital Employed. For the purpose of this study, Return on Assets is adopted as a proxy of profitability. This is because it is more encompassing than other profitability variables and the proxy had widely been used by scholars in calculating financial performance.

2.2   Empirical Review

Otekunrin, et al, (2019) studied the performance of selected quoted money banks in Nigeria and liquidity management of 17 banks listed on the Nigerian Stock Exchange (NSE) between 2012 and 2017, the study extracted secondary data from the financial statements of 15 quoted banks for six years and analyzed it using Ordinary Least Square (OLS) method. Capital ratio, current ratio and cash ratio were the proxies for liquidity management while performance proxies was return on assets. The study found that liquidity management and banks' performance are positively related. It was concluded that liquidity management is an essential factor in business operations and consequently leads to business profitability. It was therefore recommended that, proper liquidity management would help in solving the problem of agency costs that arise when control of companies is separated from the ownership.

Laminfoday (2018) worked on the association between liquidity risk management and financial performance of commercial banks in Sierra Leone. The study concentrated on eight commercial banks and a descriptive study design was adopted. Secondary data were obtained from the banks financial statements covering five years from 2013 to 2017. The results of the research showed a significant and negative relationship between liquidity risk management and financial performance of commercial banks in Sierra Leone. The study also revealed that liquid assets to total assets had the greatest impact on financial performance and had an inverse relationship.

Nabeel and Hussain (2017) examined liquidity management and its impacts on banks' profitability in Pakistan from 2006 to 2015. The study embraced correlation and descriptive statistics research design and employed regression techniques in analyzing the secondary data from 10 banks. The quick ratio, current ratio, cash ratio, interest coverage ratio and capital adequacy ratios are proxies for liquidity management. Return on asset, returns on equity, and earnings per share are proxies for profitability. The study found a positive relationship between liquidity management (proxy by interest coverage ratio, capital adequacy ratio and quick ratio) and the banks' profitability while there was a negative relationship between liquidity management (proxy by cash ratio and current ratio) and the banks' profitability.

Muriithi and Waweru (2017) carried out a study on liquidity risk and financial performance of 43 commercial banks in Kenya over a period of 2005-2014. Liquidity risk was measured by liquidity coverage ratio and net stable funding ratio. While financial performance was poxied by

return on equity. Panel data techniques of random effects estimation was used for the study. Findings of the study indicated that net stable funding ratio is negatively associated with banks' profitability both in long run and short run while long run current ratio does not significantly influence the financial performance both in long run and short run. It is recommended that banks' management should pay the required attention to liquidity management.

Kamau and Njeru (2016) examined the effect of liquidity risk on financial performance of six insurance companies listed at Nairobi Securities Exchange for the periods 2012-2015. The risks studied include operational risk, market risk and credit risk. The study was descriptive in nature. It was established that operational, market and credit risks have negative effects on financial performance. The study recommended that measures should be put into place to hedge these risks and hence maintain a healthy performance.

Otieno and Nyagol (2016) assessed the relationship between liquidity risk management and financial performance of microfinance banks in Kenya. Longitudinal research design utilizing panel data covering the period from 2011 to 2015 was used. The findings indicated that liquidity risk management with FGR and CAR parameters had a strong positive correlation.

Olarewaju and Adeyemi (2015) examined the casual relationship between liquidity and profitability of quoted banks in Nigeria. A sample size of 15 banks were selected from the existing 19 quoted banks. The study employed Pairwise Granger Causality to test the presence and direction of causality between the banks' liquidity and profitability. The study found that there was no causal relationship between liquidity and profitability of the sampled banks. The study recommended that the Central Bank of Nigeria should ensure close supervision and monitoring and ensuring that banks maintain adequate liquidity to supporting and strengthen financial sector stability.

Abbas and Mourouj (2015) conducted a study on the impact of the important banking indicators, such as liquidity risk indicators on financial performance of quoted banks in Iraq. The study selected a sample of 47 for a period of ten years (2005 to 2014). The study indicated a higher percentage of cash and cash assets compared to other assets of the sampled banks. This indicates the accumulation of non-profitable liquid funds which greatly affected the various financial performance ratios of the banks.

Nimer, Warrad and Omari (2013) carried out a study on the impact of liquidity on Jordanian banks profitability. The study sought to find out whether liquidity through quick ratio has significant impact on Jordanian banks profitability through return on assets. The study used the financial reports of 15 Jordanian banks listed at Amman Stock Exchange (ASE) from 2005-2011. The return on assets compares income with total assets. The independent variable in this study was the quick ratio. A simple regression was employed to test the study hypotheses. The outcome of the study revealed that there is a significant impact of independent variable (quick ratio) on dependent variable (return on assets).

Emami, Ahmadi and Tabari (2013) studied the effect of liquidity risk on the performance of commercial banks in Iran. In the estimated research model, two groups of bank-specific variables and macroeconomic variables are used. In this study, the performance of fifteen Iranian banks was examined during an eight-year period from 2003 to 2010 using panel data. The data were drawn from the financial reports of the sampled banks and the data related to macroeconomic variables including the growth of gross domestic product, consumer price index are drawn from central bank's website in order to determine the inflation ratio. To select between common effects and the fixed effects, Limner's F-test was used. And also, to select one of the models for the fixed effects against the random effects, Hausman specification test was used. The study found that liquidity risk has a significantly and negative effect on both criteria of the performance i.e. return on assets and return on equity.

2.3 Theoretical Framework

There are two theories that accord this study, namely liquidity preference theory and risk return theory.

2.3.1 Liquidity Preference Theory

Keynes described liquidity preference theory stating that individuals value cash for both the transaction of existing businesses and it's used as a store of value. Thus, they will sacrifice the ability to earn interest on money that they want to expend in the present, and that they want to have it on hands as a precaution. On the other hand, when interest rates rise, they became more willing to hold less cash for these purposes in order to secure a profit. Individuals need money as they have expenditure plans to finance or speculating on the future fluctuations of the interest rates, or finally, because they are uncertain about the outcome of the future. So, it is advisable to hold some resources in the form of future purchasing power. These motives are known as transaction, speculative and precautionary motives of holding cash. The liquidity preference method suggests that businesses pursue active cash policies instead of passively obliging the demand for credits (Bibow, 2005).

2.3.2 Risk Return Theory

Markowitz is the pioneer researcher that promulgated the risk return theory. The theory that underpins the findings of this study is risk return theory; this is because insurance firms are both risk-taking and profit making business oriented, and their operations deals with earning of profits in commensurate with the risks attached to them. The greater the risk, the higher will be the profitability of insurance businesses and vice versa. This notion is true when the insurance firms' risk appetite is lower than the risk tolerance.

3. Methodology

This study employed a descriptive research design. The population of the study consisted of twenty (20) insurance companies listed on the floor of Nigerian Stock Exchange as at 30th September, 2021 covering the periods of 2014 to 2019. The sample size of the study are made up of seven (7) insurance and assurance companies in Nigeria comprising of Wapic Insurance Plc,

Lasco Assurance Plc, Niger Insurance Company Plc, Cornerstone Insurance Company, Universal Insurance Company, African Alliance Insurance Company and Leadway Assurance Company. Simple random sampling technique was employed in selecting the sample size of the study and GLS random effects regression was used to analyze the data of the study.

3.1   Model Specification

In order to evaluate the influence of firms' liquidity on profitably among the quoted insurance companies in Nigeria, the study adapted with little modifications the model used by Otekunrin, et al, (2019). The model was modified as below:

$$Y = a + B_1 X_{1it} + B_2 X_{2it} + B_3 X_{3it} + B_4 X_{4it} + E$$

Where; Y= Return on Assets ; a= Gradient or slope of the regression; B_{1-4}= Regression coefficients; X_1= Current Ratio; X_2= Premium to Asset Ratio; X_3= Capital Adequacy Ratio; X_4= Firm Size; E= Error Term

Table 1: Summary of the Variables of the Study and their Measurements

Variable Indication	Description	Variable Measurement	Source
Dependent Variable: ROA	Return on Assets	Profit After Tax/ Total Assets	Otekunrin, Fagboro & Femi (2019)
Independent Variables: CRR	Current Ratio	Total Current Assets/ Total Current Liabilities	Nabeel & Hussain (2017)
PAR	Premium to Asset Ratio	Net Premium/ Total Assets	Kamau & Njeru (2016)
CAR	Capital Adequacy Ratio	Total Capital (Equity + Preference)/ Total Assets	Nabeel & Hussain (2017)
Control Variable: FSZ	Firm Size	Natural Logarithm of Total Assets	Abbas & Mourouj (2015)

Source: Generated by the Researcher from the Contents of the Study.

4. Results and Discussion

This section provides a summary statistic of the data gathered on the dependent and explanatory variables of the study.

Table 2 Descriptive Statistics

Variables	Obs	Mean	Std.Dev	Min	Max
ROA	42	1.778	1.331	-0.980	3.890
CRR	42	0.884	0.282	0.480	2.170
PAR	42	53.792	14.843	21.940	68.200
CAR	42	23.945	9.282	8.040	39.120
FSZ	42	20.773	1.006	19.110	22.311

Source: Generated by the Researcher (2021) from Stata 16.0 output

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From the table 2, a total of 42 observations were recorded. The result showed that financial performance (ROA) of the sampled insurance firms has an average value of 1.78, with minimum and the maximum values of -0.98 and 3.89 respectively. This signifies that there is no much variation in the profitability of sampled companies as portrayed by the standard deviation of 1.33. This means that the sampled insurance firms are within the same range in terms of financial performance.

Current ratio has an average value of 0.88 with a standard deviation of 0.28, which implies that the current ratio deviates from the mean value by 0.60. The minimum value is 0.480 and the maximum value is 2.170. Premium to assets ratio has a mean value of 53.792 with a standard deviation of 14.843, which indicates that premium to asset ratio deviates from the mean value by 38.95. The minimum and the maximum values are 21.940 and 68.200 respectively. The mean value of capital adequacy ratio is 23.945 with standard deviation of 9.282, which implies that capital adequacy ratio deviates from the mean value by 14.67. The minimum and maximum values are 8.040 and 39.120 respectively. The mean value of firm size is 20.773 with standard deviation of 1.006, which implies that firm size deviates from the mean value by 19.767. The minimum and maximum values are 10.110 and 22.311 respectively.

Tables 3 Correlation Matrix

Variables	ROA	CRR	PAR	CAR	FSZ
ROA	1.0000				
CRR	-0.3621	1.0000			
PAR	0.1195	-0.8264	1.0000		
CAR	0.4075	0.3237	-0.3603	1.0000	
FSZ	0.3081	0.2989	-0.2812	0.4976	1.0000

Source: Generated by the Researcher (2021) from Stata 16.0 output

From table 3 it is seen that association between current ratio and financial performance of the sampled insurance companies is weak and negative, while that of premium to assets ratio is weak and positive and that of capital adequacy ratio is moderate and positive and also, that of firm size is weak and positive with correlation coefficient values of -0.3621, 0.1195, 0.4075 and 0.3081 respectively.

Table 4 Random Effects (RE) Regression Results

Variables	Coefficients	Probability-Value
Overall R^2	0.5362	
F-Statistic	42.78	0.0000
Hausman Chi2	0.77	0.0712
Hettest Chi2	0.66	0.4151
Mean VIF	2.31	
CRR	-0.1386	0.000
PAR	-0.0353	0.040
CAR	0.0586	0.001
FSZ	0.3171	0.054
CONSTANT	-3.3047	0.333

Source: Generated by the Researcher (2021) from Stata 16.0 output

Table 4 presents GLS random effect regression results. The results showed that the overall R^2 coefficient of determination is 0.5362, this means that 54% of the variations in the financial performance is caused by explanatory variables, while 46% of the variations is explained by other factors not covered by the study. Also, the probability of F-value of 0.0000 implied that the model is fit and significant at 1% level of significance and the variables are appropriately selected. The Hausman Specification test of the model suggested random effects regression model was preferable over fixed effects (Hausman Chi2 value of 0.77 and p-value of 0.0712). The Breusch and Pagan test for heteroscedasticity (Hettest Chi2 value of 0.66 and p-value of 0.4151) suggested that there is no problem of heteroscedasticity. The table also showed the absence of multicollinearity as evident by the mean Variance Inflation Factor (VIF) value of 2.31 which is less than 10.

The results of GLS random effects indicated that current ratio has a significant and negative effect on the return on assets of listed insurance firms in Nigeria as indicated by the coefficient value of -0.1386, which is statistically significant at 1% level of significance (P-value of 0.000). This implied that financial performances reduces as the current ratio increases. This result is consistent with that of Laminfoday (2018) but denied that of Otekunrin, et al, (2019). The result also revealed that premium to assets ratio has a significant and negative effect on the return on assets of listed insurance firms in Nigeria as indicated by the coefficient value of -0.0353 which is statistically significant at 5% level of significance (P-value of 0.040). This implied that financial performances reduces as the premium to assets ratio increases. This outcome is in support of the results of but different with findings of Kamau & Njeru (2016). Furthermore, the result indicated that capital adequacy ratio has a significant and positive effect on the return on assets of listed insurance firms in Nigeria as indicated by the coefficient value of 0.0586 which is statistically significant at 1% level of significance (P-value of 0.001). This implied that financial performances increase as the capital adequacy ratio increases. This is agreement with the findings of Nabeel & Hussain (2017), but contradicted that of Laminfoday (2018). Lastly, the result also revealed that firm size has an insignificant and positive effect on the return on assets of listed insurance firms in Nigeria as indicated by the coefficient value of 0.3171 which is statistically insignificant at 5% level of significance (P-value of 0.054). This implied that financial performances increases as the firm size increases. This result is inconsistent with the findings of Abbas & Mourouj (2015).

5. Summary and Conclusion

The study concluded that capital adequacy ratio is the major factor that influences financial performance of quoted insurance firms in Nigeria. This means that the increase in share capital (both equity and preference share capital) leads to increase in the profitability of quoted insurance firms in Nigeria. The negative but significant effect of current ratio and premium to asset ratio on financial performance is a pointer that indicates decrease in profitability due to increase in current ratio and premium to asset ratio of quoted insurance firms in Nigeria. The study recommended that, management of quoted insurance firms in Nigeria should offer their

shares to the general public for subscription, this will in turn increases their capital/ revenue, and the resultant effect would be investment in viable assets, and this will enhance the financial performance in the long run. The study also recommends that the management of the insurance businesses in Nigeria should re-strategize their liquidity management policies so as to improve the profitability of their firms.

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