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THE ROLE OF INSURANCE INDUSTRY ON ECONOMIC GROWTH IN NIGERIA

John, John Ime
Takon, Samuel Manyo
Owui, Hycenth Okang
Obim EdimNdifon.,
Nkamare Stephen Ekpo
Ita, Richard Ita
Department of Banking and Finance, University of Calabar

Abstract

This study focuses on the role of insurance industry on economic growth in Nigeria. A study of financial services in Nigeria. It sought to assess the significance of the insurance industry, and to suggest measures that could enhance economic growth in Nigeria. To achieve the objective of the research, some indicators of development in the insurance industry, using an ex-post facto research design was applied. The data were analyzed using the Ordinary Least Square (OLS) method. From the analysis, it was revealed that there was a significant relationship between insurance income and gross domestic product in Nigeria. It was further discovered that there was a significant relationship between insurance premium and gross domestic product in Nigeria. Total insurance investment was also found to have a significant effect on gross domestic product in Nigeria. Based on the findings, the study recommended that efficient policies on the amount of premium to be paid should be enacted by National Insurance Commission, as higher premium discourages potential insurance investors from efficiently participating in the industry. Also recommended that the National Insurance Commission, in conjunction with the government should efficiently work together to ensure that the premium collected and the income generated by the industry, are diversify into economic and productive investment, in order to boost economic growth.

Keywords: Insurance, economic growth, Gross Domestic Product, Insurance income, Insurance premium, Total insurance investment

1. Introduction

The insurance industry is a highly specialized institution that gives greater security to the fortunes of the common people, and among the whole society. It is one of the financial institutions in Nigeria that aids economic growth. Nzotta (2004) defined insurance as a contract whereby one party called the insurer, in return for a consideration, called the premium, undertakes to pay the other party, called the insured, a sum of money or its equivalent in kind, upon the happening or occurrence of specified event that is linked to the interest of the insured. The modern insurance industry was introduced into Nigeria in the late 20th century, by a British Merchant called Ferdinard Volt, who established trading posts on the west coast of Africa. Before the advent of the European to Nigeria, organizations similar in purpose to insurance company were in existence, and they were known as traditional social scheme. They include social club, age grade, etc. However, the first insurance company to register its presence in Nigeria was the Royal Exchange Assurance, with its office in Lagos in 1921. The enactment of workman compensation ordinance in 1942, and the road traffic act of 1945, both contributed to the meaningful emergence of insurance industry in Nigeria.

Insurance represents a promise of future compensation relating to specific losses, in exchange for periodic payments. Insurance are similar to banks and capital markets, as they solve the need of business units and private households in financial intermediation. The only way out is to reposition organizations and businesses to meet with the demand of the period, create awareness about the industry, training and retraining of staff, minimization of the wastages and maximization of gains in the interest of the economy (Obim, John &Orok, 2018). Moreover, Udoka and Orok (2017) asserted that managing risk is an important function for business organizations dealing with money, which includes banks and insurance firms. Hence, in doing this, the insurance industry enhances national development through effective wealth creation, protection and consideration of funds lent. However, for any insurance contract to be valid there must exist an insurable interest and utmost good faith, which requires both parties to the insurance contract to make full disclosure of all material facts, before indemnity on a financial loss, or the happening of the event insured against, can be claimed. In view of this, Udoka and Orok (2017), in his studies concluded that the importance of insurance to any nation's economy cannot be undermined. He said no country can experience a meaningful development without the presence of a formidable insurance industry. This makes insurance business in any nation indispensable, irrespective of its weak contribution to the Gross Domestic Product (GDP) or its level of awareness among the populace, as it is vital to the well-being of and smooth functioning of a modern economy (Takon, John, Ononiwu & Mgbado, 2020).

From the foregoing, insurance services have come to be recognized by both individuals and corporate bodies to be an effective tool for the transfer of risks, which are vital for economic growth. These services enable people to carry out their economic activities, unmindful of the adverse effect of the risk. However, this sector is besieged with many problems, such as market distortion, high rate of inflation, various government regulations, unethical practices and fraudulent tendencies, from both the insured public and the insurance practitioners. It becomes therefore necessary, to look deep into the activities of the industry (John, Orok & Udoka, 2020). In Nigeria, the situation is different; the insurance sector's contribution to GDP is low, and returns on insurance investment lies behind the rate of inflation. Also, another major challenge faced by the industry is unfavorable macroeconomic environment. A stable macroeconomic environment provides or promotes the savings, necessary to finance investment.

Objectives of the study:

The specific objectives of this study are:

i) To assess the effect of insurance income on gross domestic product in Nigeria;
ii) To investigate the contribution of insurance premium on gross domestic product in Nigeria;
iii) To examine the effect of total insurance investment on gross domestic product in Nigeria.

2. Literature Review

Insurance is a means of protection from financial loss. It is a form of risk management, primarily used to hedge against the risk of a contingent or uncertain loss. An entity which provides insurance is known as an insurer, insurance company, insurance carrier or underwriter. A person or entity who buys insurance is known as an insured or policyholder. The insurance transaction involves the insured assuming a generated and known relatively small loss in the form of payment to the insurer, in exchange for the insurer's promise to compensate the insured in the event of a covered loss (Nzotta, 2004). The loss may or may not be financial, but it must be reducible to financial terms, and usually involves something in which the insured has an insurable interest, established by ownership, possession or pre-existing relationship. In practice, the insured receives a contract, called the insurance policy, which details the conditions and circumstances under which the insurer will compensate the insured. The amount charged by the insurance policy is called the premium. If the insured experiences a loss, which is potentially covered by the insurance policy, the insured submits a claim to the insurer for processing by a claim adjuster. However, the insurer may hedge its own risk by taking out reinsurance, whereby another insurance company agrees to carry some of the risk, especially, if the risk is too large for the primary insurer to carry.

Insurance involves pooling funds from many insured entities (known as exposures) to pay for the losses that some may incur. The insured entities are therefore protected from risk for a fee, with the fee being dependent upon the frequency and severity of the event occurring. In order to be an insurable risk, the risk insured against must certain characteristics. In Nigeria, the National Insurance Commission (NAICOM) is saddled with the role of supervising and sanitizing the industry, as well as the enforcement of code of ethics among insurance firms (Nzotta, 2004). However, when a company insure an individual entity, there are basis legal requirements and regulations. Commonly cited legal principles of insurance include;

i) Indemnity: This is when insurance company compensates the insured in the case of certain losses only up to the insured's interest.
ii) Benefit Insurance: The insurance does not have the right of recovery from the party who caused the injury, and is to compensate the insured, regardless of the fact that insured had already sued the negligent party for the damages. For example; personal accident insurance.
iii) Insurable Interest: The concept requires that the insured have a stake in the loss or damage to the life or property insured. What that stake is, will be determined by the kind of insurance involved and the nature of the property ownership or relationship between the persons. The requirement of an insurable interest is what distinguishes insurance from gambling, as the insured typically must directly suffer from the loss.
iv) Utmost good faith: The insured and the insurer are bound by a good faith bond of honesty and fairness. Thus, material facts must be disclosed.
v) Contribution: Insurers which have similar obligations to the insured must contribute in the indemnification of the insured, based on the principle involved.
vi) Subrogation: The insurance company acquires legal rights to pursue recoveries on behalf of the insured. The principle also holds that an insurer having paid a claim has the right to take over any other methods the policy holder has for obtaining compensation for the same event.
vii) Proximate Cause: The cause of loss (the peril) must be covered under the insuring agreement of the policy, and the dominant cause must not be excluded.
viii) Mitigation: In case of any loss or causality, the asset owner must attempt to keep loss to a minimum, as if the asset was not insured.

Any risk that can be quantified, can potentially be insured. Specific kinds of risk that may give rise to claims are known as Perils. An Insurance policy will set out in details which perils are covered by the policy, and which are not. Below are non-exhaustive lists of the different types of insurance that exist.

i) Vehicle Insurance: Vehicle Insurance protects the policy holder against financial loss in the event of an incident involving a vehicle they own, such as traffic collision, damage to or theft of the car, legal responsibility to others for bodily injury or property damage, etc.

ii) Health Insurance: Health Insurance covers the cost of medical treatments. Medical Insurance protects policyholders for medical costs. In most developed countries, all citizens receive some health coverage from their government, paid for by taxation, and are often part of an employer's benefit.

iii) Disability insurance: This policy provides financial support in the event of the policy holder becoming unable to work because of disabling illness or injury. It provides monthly support to help pay such obligations as mortgage loans and credit cards.

iv) Causality Insurance: This insures against accidents, not necessarily tied to any specific. It is a broad spectrum of insurance that a number of other types of insurance could be classified, such as auto, workers' compensation, and some liability insurances, like crime, terrorism, kidnap and ransom, political risk, etc.

v) Life Insurance: It provides a monetary benefit to a decedent's family or other designated beneficiary, and may specifically provide for income to an insured person's family, burial, funeral, and other final expenses. Life insurance policies often allow the option of having the proceeds paid to the beneficiary, either in lump sum cash or an annuity.

vi) Aviation Insurance: This is a type of property insurance that protects aircraft hulls and spares, and associated liability risks, such as passenger and third-party liability.

vii) Builder's risk insurance: Insures against the risk of physical loss or damage to property during construction. Builder's risk insurance is a coverage that protects a person's or organization's insurable interest in materials, fixtures or equipment being used in construction or renovation of a building or structure, should those items sustain physical loss or damage from an insured peril.

viii) Crop insurance: This may be purchased by farmers to reduce or manage various risk associated with growing crops. Such risks include; crop loss or damage caused by weather, hail, drought, frost damage, insects or disease.

ix) Marine Insurance: Covers the loss or damage of vessels at sea or inland waterways, and of cargo in transit, regardless of the method of transit. When the owner of the cargo and the carrier are separate corporations, marine cargo insurance compensates the owner of the cargo for losses sustained from fire, shipwreck, etc.

The world we live in is full of uncertainties and risks (Takon, John, Mbaze-Ebock, Akpan, Asukwo, Awah & Nkamare, 2020). Individuals, families, businesses, properties, and assets are exposed to different types and levels of risks. These includes; risk of losses of life, health, assets, property, etc. while it is not always possible to prevent unwanted events from occurring, financial world has developed products that protect individuals and businesses against such losses, by compensating them with financial resources. Insurance is a financial product that reduces or eliminates the cost of loss or effects of loss caused by different types of risks. Apart from protecting individuals and businesses from any kind of potential risks, the insurance sector contributes significantly to the general economic growth of the nation, by providing stability to the functioning of businesses and generating long-term financial resources for the industrial projects. Among other things, insurance sector also encourages the virtue of savings among individuals and generates employments among the populace (Nzotta, 2004). Moreover, Insurance provides financial support and reduces uncertainties in business and human life. It provides safety and security against particular event. There is always a fear of sudden loss, of which insurance provides a cover against. Also, Insurance facilitates the spreading of risk, from the insured to the insured, which is the basic principle of insurance

Theoretical Framework

Few financial propositions supporting insurance activities in an economy include the growth theory and the theory of financial intermediation. The growth theory was propounded by R. U. Herrod and E. Domar in 1955. The theory states that demand does not automatically equal supply, nor does saving automatically equal investment. The growth theory states that well developed financial intermediation can promote economic growth through marginal productivity of capital efficiency in channeling savings to environment, saving rate and technological innovations. The channel to growth model tries to link the financial intermediation function of insurance companies to economic growth. According to Webb, Grace & Skipper (2005), this theory is relevant to the study when life insurance reserves can be used as approximation of the investment function. They used technical reserves of both life and non-life insurance companies as proxy for their investment function, and the expected effect on economic growth was positive. Life and non-life insurance as a financial intermediation activity, contributes to economic growth, through accumulation of productive capital within an economy, and the improvement of the efficiency of investment. From the growth theory, it was discovered that the insurance sector foster economic growth in the following ways;

i) Providing broader insurance coverage directly to firm, as well as improving their financial soundness;
ii) Fostering entrepreneurial attitudes, encouraging investment, innovation, market dynamism and competition;
iii) Promoting sensible risk management by household and firms, and contributing to sustainable and responsible development.

Theory Of Financial Intermediation

This theory was propounded by Merton and Bodie in 1995. The theory states that financial intermediation adds specific friction to models of resource allocation, based on the perfect market. Namely, if there is a perfect market, all the traders are price takers, there is no private information and the allocation of resources is optimal. Thus, in a pure neo-classical framework, there is no role of financial intermediation to add value, but according to the traditional theory of financial intermediation, the real-world market is characterized by frictions that include transaction cost and asymmetric information, and the reduction in transaction cost as the main function of financial intermediaries. In order to encompass the traditional financial intermediation theory, the changes in the financial environment, and to understand the role of the insurance companies to economic growth, the study adopts the functional approach to the financial system, proposed by Merton and Bodie (1995).

The relevance of the theory is based on some core functions; the provision of mechanism for the pooling of resources, resource allocation, provision of means of risk management, providing price information to help coordinate centralized decision making in various sectors of the economy, providing means to deal with the inventive problems created, when one party to a financial transaction has information that the other party does not or when one party acts as an agent of the other. However, insurance companies are important and key players in any financial system. As financial intermediaries, they mobilize saving from the insuring public usually in the form of premiums, and channel these funds to various investment outlets. Thus, this study is anchored on the theory of financial intermediation, since insurance firms are visible in the intermediation process.

Empirical Evidences

It has been realized that very few studies have been done on insurance and economic growth. Significant of such studies are those of Oke (2012) examined the relationship between economic growth and insurance sector growth. The study employed fixed effect model and co-integration analysis to determine the short-run and run relationship between economic growth and insurance sector growth and development in Nigeria. The result reveals that insurance sector growth and development positively and significantly affect economic growth. The study recommended that National Insurance Commission (NAICOM), in collaboration with the Federal Government should enforce laws on insurance practice in Nigeria. Mojekwu, Agwuegbo and Olowokudejo (2011) conducted a study on the impact of insurance contributions on economic growth in Nigeria. The study used dynamic factor model to analyze the functional relationship between the volume of insurance contributions and economic growth in Nigeria. The results showed that insurance contributes greatly to economic growth in Nigeria. The study recommended that National Insurance Commission should efficiently work together to ensure that the premium collected and the income generated by the industry, are diversify into economic and productive investment. Pen, Chin and Chin (2011) investigated the effect of life insurance on economic growth and what conditions affects the insurance growth nexus. The study adopted secondary data using multiple regression statistical tool. The findings confirmed the positive impact of the development of the life insurance market on economic growth. Peter and Kjell (2006) studied the relationship between insurance and economic growth, a theoretical and empirical analysis. They applied a cross country panel analysis using annual insurance premium data from 29 European countries over 1992 to 2004. It was revealed that there is weak evidence for a growth-supporting role of life insurance to bank and stock sector.

3. Methodology

The design used for this study is the ex-post facto research design. The choice of design is based on the fact it does not provide the study an opportunity to control the variables; mainly they have already occurred and cannot be manipulated. The study is longitudinal and data for this analysis are mostly from secondary sources. This is evidently true as data were obtained from the Central Bank of Nigeria (CBN) Statistical Bulletin between 1990 to 2020.The primary objective of this study is to estimate the role of the insurance industry on the economic growth of Nigeria. To achieve this, the Ordinary Least Square (OLS) multiple regression statistical method is used to estimate the model. The model is given as;

GDP = f (IINC, IP, TII)

Where;

GDP = Gross Domestic Product

IINC = Insurance income

IP = Insurance premium

TII = Total insurance investment

$$GDP = b_0 + b_1IINC + b_2IP + b_3TII + U$$

Where;
b_0 = Constant term
$b_1 – b_3$ = Parameters to be estimated
U = Stochastic error term
The economic a priori test shall be conducted to enable this study examines the magnitude and size of the parameters estimate. This evaluation is guided by economic theory to ascertain if the parameter estimate conforms to expectation.

4. Analysis and Discussion of Findings

Table 1: The regression results of the role of insurance industry on economic growth in Nigeria.

Dependent Variable: LGDP

Variable	Coefficient	Std Error	T-statistic	Probability
C	0.728530	0.260145	2.800467	0.0160
LIINC	23.76108	9.760379	2.344689	0.0000
LIP	1.914498	0.703016	2.723203	0.0000
LII	3.303380	1.047103	2.894065	0.0336

R-squared 0.742196
Adj. R-squared 0.684392
SER 0.530350
F-stat 3.778914
DW stat 2.497458

From the above result, it could be deduced that if all the independent variables are held constant, the Nigeria Economy will stand at 0.728530. Again, the result showed that all insurance sector indicators have positive relationship with the Nigeria economy as the parameters entered the model with positive sign. Implying that a one per cent increase in insurance income, insurance premium and insurance investment resulted in 23.96108, 1.914498 and 3.303380 respectively in the growth of the economy. The goodness of fit of the model is indicated by the adjusted R^2 value of 0.684392 or 68.4 per cent, indicating that the model fits the data well. The total variation in the observed behavior of the Nigeria economy is jointly predicted by the variation in insurance income, insurance premium and insurance investment up to 68.4 per cent, the remaining 31.6 per cent is accounted for by the stochastic error term. The overall significance of the model was also tested using the ANOVA or F-Statistic. Here, the high significance of the F-Statistic value of 3.778914 confirms that the high predictability of the model did not occur by chance; it actually confirmed that the model fitted the data well. We also tested for the presence of auto correlation in the residual of the model, since the calculated DW value of 2.497458 does not lies within 4-dw, at 5% level of significance, we conclude that the model is free from the correlation of its residual. In order to test the hypotheses, the following decision rule is specified. Based on these results and the decision rule, the null hypothesis was rejected and the alternate was upheld. It was concluded that there is a significant relationship between total insurance investment and gross domestic product in Nigeria. The study empirically examined the role of insurance industry on the economic growth of Nigeria. Based on the analysis of the results, the study revealed that a significant relationship exists between insurance income and economic growth. This by implication means that an improvement in the level of income generated by the industry will certainly lead to a corresponding increase in economic growth. This finding is supported by the findings of Wadlamannati (2008), who examined the effect of insurance growth and reforms on economic growth of India, using the growth of insurance penetration (life, non-life and total) as proxies for insurance sector growth. The study revealed a positive contribution of the insurance sector to economic growth and development. The study also revealed that insurance premium has a significant effect on economic growth. This by implication indicates that an increase in insurance premium payment will lead to growth in the Nigeria economy. This finding is in line with the view of Monogbe (2015) that total insurance premium contributes positively and significantly to the development and growth of the Nigeria economy. Another major finding of the study revealed that there is a significant relationship between insurance investment and economic growth in Nigeria. This finding is in line with the findings obtained by Ozuomba (2013) which established that there is a direct and positive relationship between investment in insurance and economic growth in Nigeria, as this encourages more people to buy insurance, thereby increase premium income and provide investible funds, which can be directed into lucrative investments, for increased capital formation and productivity.

5. Summary of Findings, Conclusion and Recommendations

This study was carried out to evaluate the role of the insurance industry on economic growth in Nigeria. In order to validate the work, theoretical and empirical literature, relevant to the subject matter were reviewed. The ordinary least squared (OLS) was adopted to examine the performance of variables of the insurance sector in Nigeria. Consequently, the following findings were made.

i) There is a significant and positive relationship between insurance income and gross domestic products in Nigeria.

ii) Insurance Premium has a significant impact on gross domestic products in Nigeria.

iii) There is a significant relationship between total insurance investment and gross domestic products in Nigeria.

Recommendations

In view of the above summary of findings, the following are recommended.

i) Efficient policies on the amount of premium to be paid should be enacted by National Insurance Commission, as higher premium discourages potential insurance investors from efficiently participating in the industry.

ii) The National Insurance Commission, in conjunction with the government should efficiently work together to ensure that the premium collected and the income generated by the industry, are diversify into economic and productive investment, in order to boost economic growth.

iii) The National Insurance Commission (NAICOM), in collaboration with the Federal Government should enforce laws on insurance practice in Nigeria. This is necessary because huge amount of capital can be generated for further investment if insurance is effectively and efficiently enforced among the populace.

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