

Factors Affecting Profitability of Insurance Companies: Evidence from Kuwait

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Abstract: Insurance plays a decisive role in the stability and prosperity of any economy where it provides a sense of security and work as a safety net for both individuals and companies. In order to ensure the continuity of services provided by insurance companies, these companies must have a solid financial position to ensure that they cover any claimed that may occur. According to literature, profitability of these companies is the corner stone for their financial soundness and thus having high profitability would result honoring the insurance claimed that they may face. This study is set to examine some factors that may affect the profitability of insurance companies in Kuwait over the period 2016 to 2023. Using OLS regression methodology, results revealed that the profitability of insurance companies in Kuwait showed a significant direct relation with capital adequacy while there was insignificant relation with management efficiency, company age, and assets size.

Keywords: Insurance Companies, Kuwait, Financial Performance, Profitability, Capital Adequacy, Management Efficiency.

I. Introduction

Insurance plays a vital role in achieving stability within an economy, leading to its prosperity. Insurance functions as a way to manage risks and ensure financial stability in markets while offering a sense of security to economic entities. The insurance sector being successful would lead to a more robust financial system, thereby enhancing other industries and overall economic growth. Ahmed et al. (2011) stated that insurance is essential for the business environment to operate efficiently as companies may struggle to manage various risks in the unpredictable and constantly changing global economy. Naveed et al. (2011) mentioned that the effectiveness of the insurance industry in risk transfer can impact economic development and institutional bankruptcies can lead to systemic crises with negative repercussions for the overall economy.

The inception of the insurance sector in Kuwait dates back to the early 1960s with the establishment of the first insurance company, Kuwait Insurance Company, in 1960. As of 2024, there are nearly 40 insurance firms in Kuwait. The insurance market in Kuwait is dominated by 4 main companies that control more than 75% of the market.

Table 1. Insurance Companies under Study

No.	Company Name	Establishing Year
1	Kuwait Insurance company	1960
2	Gulf Insurance Company	1962
3	AlAhleia Insurance Company	1962
4	Warba Insurance Company	1976

Profitability is the capacity to generate profits from all of the company's business operations. It demonstrates the effectiveness of management in generating profit by making use of all resources at their disposal. Malik (2011) and Nguyen and Nguyen (2020) argue that profitability holds significant importance in financial management as it plays a critical role in maximizing owner's wealth and determining performance.

Capital adequacy ratio is the surplus of assets value compared to liabilities value in insurance firms. In finance literature, the equity to asset ratio is utilized as a measure of capital adequacy. It serves as a key measure of an insurance company's financial stability and longevity. Insurance companies with a higher percentage of equity in relation to their assets are viewed as financially stable and able to attract a diverse range of policyholders. In simpler terms, insurance companies with a higher capital adequacy ratio are seen as safer during times of loss and bankruptcy. Conversely, insurers can enhance their creditworthiness by increasing their equity-to-asset ratio, as higher ratios correspond to lower risks. As a result, insurers will experience reduced funding costs. Moreover, insurance firms with a higher ratio of equity to assets will require less external funding. In a study by Berhe and Kaur (2017) using the data of 17 insurance companies in Ethiopia, both public and private, from 2005 to 2015. The regression analysis findings showed that the profitability of insurance companies is greatly influenced by factors such as insurance size, capital adequacy, liquidity ratio, and GDP growth rate. However, the impact on the profitability of insurance companies was minimal for factors such as the leverage ratio, the loss ratio, the company's market share, and the inflation rate.

Management efficiency is a measure of how effectively a company uses its resources to achieve the highest profit, as stated by Horton (2015). A greater return on assets (ROA) indicates that the company is better at utilizing its resources. AlAli (2020) used the data of 10 Kuwaiti banks from 2010 to 2018 and discovered a significant correlation between management efficiency and financial performance, specifically in terms of return on assets (ROA) and return on equities (ROE). In their study, Eling and Jia (2019) analyzed the correlation between firm efficiency and profitability using a worldwide dataset of more than 5000 insurance companies from 2003 to 2013, and found a significant positive connection between efficiency and profitability indicators.

One significant factor influencing financial performance is company age, which is determined by how long a company has been in business since its founding. Previous studies indicate that company's age reduces its likelihood of failing (Yasuda, 2005). A Study conducted by Ahmeti and Iseni (2022) using the data of insurance companies in Kosovo over the period from 2015 to 2020 showed that age of company have significant effects on its return on assets (ROA). On the other hand, a study by Hifza (2011) using the data of insurance companies in Pakistan over the period spanning from 2004 to 2009 showed no significant relation between company age and profitability. In a study conducted by Amal (2012) in determining the factors that affects the profitability of 25 insurance companies in Jordan over the period 2002 to 2007 concluded that there was no significant relation between company age and its financial performance. In Kenya, Mwangi and Murigu (2015) used the data of Kenyan insurance companies over the period 2009 to 2013 and they also did not find any significant relation between age and profitability.

A company's size can be determined by a variety of factors, including its total assets, number of branches, and number of employees. To express the size of the company, the majority of researchers in the field use total assets (Omondi and Muturi, 2013; Burca and Batrinca, 2014). According to Flamini and McDonald (2013), the size of the business is regarded as a significant factor since it indicates that larger businesses have a stronger market position, can take advantage of economies of scale, and thus reap greater benefits. According to Swiss (2008), the majority of research indicates a statistically significant positive correlation between a company's size and its profitability, as measured by return on assets (ROA).

Based on data from 120 companies listed on Bursa Malaysia between 2012 and 2014, Alarussi and Alhaderi (2018) discovered a significant positive correlation between firm size and profitability. Abate (2012) studied the factors affecting the profitability of insurance companies in Ethiopia and found a statistically significant positive relation between the size of the insurance company and its profitability in terms of return on assets (ROA). Using the data of 25 insurance companies in the United Arab Emirates (UAE), Al-Shami (2013) found a significant positive relation between company size and profitability. Amal (2012) used the data of 25 insurance companies in Jordan over the period 2002 to 2007 to determine the relation between insurance company size and its profitability and concluded that there was a significant relation between them which is consistent with Ahmeti and Iseni (2022) in their study of insurance companies in Kosovo and Hifza (2011) in Pakistan. On the other hand, while researches presented in this research showed positive relation between assets size and profitability, Mwangi and Murigu (2015) showed an inverse relation in their study of insurance companies in Kenya. Furthermore, in a study on Albanian insurance companies over the period 2008 to 2013, Kripa (2016) did not find any significant relation between company size and profitability.

II. Methodology

This research is set to examine number of factors that affects the financial performance of insurance companies operating in Kuwait. The study uses return on assets (ROA) as a profitability proxy for the company against a number of internal factors that includes capital adequacy (CA), management efficiency (Eff), natural logarithm of company age (lnAge), and the natural logarithm of company assets size (lnSize) as an independent variables.

$$ROA_{i,t} = \alpha + \beta_1 CA_{i,t} + \beta_1 Eff_{i,t} + \beta_1 lnAge_{i,t} + \beta_1 lnSize_{i,t} + \varepsilon \quad (1)$$

Data and Empirical Results

This research is based on the data of the largest four insurance companies that are listed at Kuwait Stock exchange (KSE) over the period 2016 to 2023. The data used in this research were downloaded from Kuwait Stock Exchange (KSE) website.

Descriptive Analysis is presented in table 2, where it can be seen that the average return on assets (ROA) of the companies under study is 3.64%. Skewness and kurtosis of the data are used to identify whether or not the data are normally distributed, and by looking at the table it can be seen that the data are normally distributed since both skewness and kurtosis are within the acceptable range of ± 3 and ± 10 respectively.

Table 2. Descriptive Analysis

	ROA	Capital adequacy	Efficiency	ln age	ln size
Mean	0.0364	0.3666	0.2385	3.9636	5.4513
Standard Deviation	0.0328	0.1182	0.1516	0.1341	0.7499
Kurtosis	7.2601	0.3234	1.4517	-1.0921	-0.0169
Skewness	2.8764	0.1056	0.5575	-0.5451	0.7996
Count	40	40	40	40	40

The correlation matrix is established to investigate the connection between the variables being researched. The matrix ranges from -1 to +1, with -1 indicating a complete opposite relation and vice versa. The matrix is utilized for identifying multicollinearity within the data as well. Multicollinearity can lead to excessive standard error estimates of regression coefficients and misleading conclusions regarding the significance of independent variables in the model under consideration. In this study, multicollinearity is identified using a threshold of 0.70, as recommended by Kramaric et al. (2017) and Morara and Athenia (2021). Examining the Pearson correlation matrix presented in table 3 reveals the absence of multicollinearity within the data.

Table 3. Pearson Correlation Matrix

	ROA	Capital adequacy	Efficiency	ln age	ln size
ROA	1				
Capital Adequacy	0.499	1			
Efficiency	-0.046	0.155	1		
ln age	0.453	0.094	0.054	1	
ln size	0.060	-0.541	-0.114	0.613	1

By looking at the OLS regression output in table 4, it can be seen that capital adequacy showed a statistically positive effect on the profitability of insurance companies in Kuwait confirming Berhe and Kaur (2017) findings that capital adequacy have a direct relation with insurance companies financial performance. On the other hand, the results indicates that management efficiency did not show any significant relation with insurance companies operating in Kuwait which contradicts Alarussi and Alhaderi (2018) findings. In the literature the effect of company age on its financial performance showed a conflicted results while researchers such as Ahmeti and Iseni (2022) found a significant relation between company age and its financial performance, others such as Amal (2012) and Mwangi and Murigu (2015) showed that that relation does not exist. Results in this study confirms Amal (2012) and Mwangi and Murigu (2015) findings and opposes Ahmeti and Iseni (2022) by showing that there is not significant relation between company age and its financial performance. Many researchers such as Hifza (2011), Omondi and Muturi (2013) and Burca and Batrinca (2014) indicated a significant direct relation between the assets size and return on assets (ROA) in insurance companies. In this study, that relation despite having a positive effect, it was statistically insignificant.

Table 4. OLS Regression Output

<i>Regression Statistics</i>					
R Square		0.436			
Adjusted R Square		0.371			
F		6.759			
Significance F		0.000			
Observations		40			
	<i>Coefficients</i>	<i>Standard Error</i>	<i>t Stat</i>	<i>P-value</i>	
Intercept	-0.377	0.211	-1.783	0.083	
CA	0.146*	0.073	1.983	0.055	
Eff	-0.030	0.028	-1.058	0.297	
Ln Age	0.088	0.079	1.119	0.271	
Ln Size	0.003	0.017	0.184	0.855	

*, **, *** represents the confidence level at 90%, 95%, and 99% respectively.

III. Conclusion

This study was set to examine the effect of a number of factors on the profitability of four insurance companies that are listed at Kuwait Stock Exchange (KSE) over the period 2016 to 2023. Using OLS regression model to examine the relation, results revealed that out of the four variables under study, only capital adequacy showed a significant direct relation with profitability. Other factors that included, management efficiency, age, and assets size did not show any significant relation with profitability.

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