Determinants of Profitability of Islamic and conventional Insurance Companies in Pakistan: an Internal Evaluation

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Abstract

This paper analyzes the profitability of insurance industry in Pakistan over the period from 2010 to 2013 by using multivariate regression analysis which was two in number. The constituent of the micro-meter analysis explore the idea about insurance industry for profitability. The Gearing ratio, NPLs ratio and asset management are originate to have significant impact on the profitability of insurance industry in both models. The size of the insurance companies is a significant meter for profitability. Return on assets is utilized to measuring insurance industry profitability. ROA was insignificant relationship and using a proxy to gauge the profitability of insurance industry.

Key terms: Insurance Industry, Profitability, Determinants, Pakistan.

Financial Performance is a prominent parameter for determining the growth of industry. Consistent and efficient operation enhances prosperity in society and further strengthened economy of the country (Rahman et al.). The importance of insurance was recognized in the 1st conference of United Nations Conference on Trade and Development (UNCTAD) in 1964. The economic prosperity and growth of a country is based on insurance and reinsurance market. This industry transfer risk and provide safeguard for natural miss haps (Ward & Zurbruegg, 2000). The insurance industry create financial sound environment, mobilize savings, and also be used for protecting government securities. (Skipper, 2001). The insurance companies not only save the surplus fund from the surplus economic unit, but also providing savings for economic units. The fund circulates in the form of economic instruments, which stimulate production and employment.

The financial performance of Pakistan insurance industry depicts stability and boom with ROA is o.36 per annum (Akhter and Rehman 2011).The two parameters of profitability are external and internal factor, the internal factor composed of liquidity, capital adequacy and expenses management. The profitability and total asset of the companies are direct related. (Goddard, Molyneux and Wilson, 2004).The variable of other than total assets explore positive effect on profitability (Rahman, Jan, Iqbal, & Ali (2012). The collection of liquidity, asset management and debt management can be determined by profitability.

Statement of Problem

The Islamic and conventional insurance initiated their operation on the vision of Mutual assistance and profitability under the ceiling of Security exchange commission of Pakistan, which increase efficiency and enhance investment opportunities for share holder. In this study all the stake holder required the profitability, which is a decision making tools for big chunks. The research problem is to identify which parameters have significant effect on profitability.

Objective of the Study

The objective of this paper is to identify particular determinants of Islamic and conventional insurance profitability in Pakistan. This paper investigate the significant variables that having weight on profitability. These structural factors are vital in reviewing the connection between profitability of insurance companies and changes in business environment.

Literature Review

Myers and Smith (1990), a small business organization offer more Services risk management than larger firms. Naceur (2003) concluded that the large the size of the bank) and fixed cost are associated with interest margin and profitability the lone have direct relationship while the size have inversely related with profitability Bashir and Hassan (2003) and Staikouras and Wood (2003) empirically depict that profit are negatively affected due to higher loan ratio. Amor et al. (2006) conducted a study on the industry of commercial institutions ,insight the widespread of the selected enterprise that OECD (Organization for Economic Co-operation and Development) countries depicts high profitability on the basis of higher leverage ratio and lower overheads ratio. Malik (2011). Financial management key determinants are profitability and also wealth of shareholder, which are important indicators of performance. The findings of this study depict that there is no relationship between profitability and age of the company, and there is considerably positive connection between size of the company and profitability. The volume of capital is significantly and directly association to profitability. Loss ratio and leverage ratio depict opposite but considerable relationship with profitability. Akhtar et al. (2011) empirically analyzed the profitability of banks during the period of 2006-2009 and used Regression model. The NPL ratio and asset management ratio depict significant effect on profitability and it also cleared from the study that total assets are good indicator of Profitability and ROE has inversely related with profitability. Akhter and Rehman (2011) conducted research study about the insurance industries of Pakistan and compared with advance and under-developed countries. It concluded that the insurance industry is satisfactory and some internal key parameters are yardstick for profitability and economic development. Rahman et al. (2012) concluded that financial institutions have significant impact on the economy and some internal factors of financial statements contribute on the profitability i.e. total equity to total asset, total loan to total asset and deposit to total asset have positive relationship with the institution profitability.

Research Methodology

This research paper fundamentally is based on quantitative research, composed of econometric model to investigate and determine the parameters of profitability.

Data and Source of data

The financial institution issued annual reports on annual biases for the information of their stake holder. Six insurance companies have been selected for the study which includes both Islamic and conventional insurance companies. Four year data has taken for evaluation and this data has obtained from the annual reports, journals, books and website of the selected insurance companies

Research Model

ROA= α+ LT β1+ Lnβ1 G.R+ + β3NPL + 0Eβ4 +LA+5 β +ε------ (3)
ROE = a + LNTβ1 + GRβ 2 + NPLsβ3 + OE β4 + LA5 β + €------- (4)

Descriptive Statistics

Descriptive statistics for all under study are reported in table 1. First two variables are dependent variables while the rest of them are Independent variables.

Table 1. Descriptive statistic

Parameters	Means	Standard deviation
Return on Assets (ROA)	0.0006376	0.00231
Return on Equity (ROE)	0.0012254	0.043345
Gearing Ratio	2.047000	0.115430
Company Size	1.342200	0.011432
NPLs Ratio	0.056700	0.002360
Asset management	0.0147120	0.00540
Operating Efficiency	0.013400	0.00130
Capital Adequacy	0.100100	0.12360

Correlation Analysis

Table 2 discussed the correlation matrix for all explanatory variables. The results of Pearson correlation coefficients depicts that the problem of Multicollinearity is not present. The Pearson correlation coefficients matrix displayed a positive connection with of gearing ratio, asset management, operating efficiency with the size of the company. NPLs ratio exhibits negative interaction with bank size. Operating efficiency, NPL ratio and capital adequacy exhibit negative relation with gearing ratio, and asset. Management exhibits positive relationship. Asset management reports negative, while operating efficiency and capital adequacy exhibits positive relation with NPLs ratio. Operating efficiency and capital adequacy shows negative relation with asset management. Finally, Pearson correlation coefficients reveals, positive relation of capital adequacy with operating efficiency.

Table 2. Pearson Correlation Coefficients

	CS	GR	NR	AM	OE	CA
CS	1	.121**	-.0007	.2311**	.001	-.121
GR		1	-.0159	.0001	-.098	-.312
NR			1	-.243**	.024	.143
AM				1	-.043	-.271
OE					1	.152
CA						1

*Correlation is significant at 0.001 level (Significance value<0.001)
**Correlation is significant at 0.10 level (Significance value<0.10)
CS: Company Size, GR: Gearing Ratio, NR: NPL's Ratio, AM: Asset Management, OE: Operating Efficiency, and CA: Capital Adequacy

Regression Analysis

In model (A), the on the whole parameters depicts significant change on the profitability of the company. The size of the company denote the market value of the company because of company are capable to make certain their market share and get high revenue and ROA at ten percent is significant. Size displayed Positive relation according to the (Al-Tamimi, 2005; Sufian, 2009) the capturing of huge market segment is due to large production of the company. In gearing ratio, ratio of debt is larger than the equity ratio that means the company is highly potential to coped risk. The relationship of the gearing ratio, NPLs ratio and capital adequacy are reveal negative and the coefficients displayed significant effect on profitability at the level of 0% .the gearing ratio is significant at 5% level of significance. The NPLs has negative relationship as concluded by the preceding research (Sacket & Shaffer, 2006). The asset management and operating efficiency showed positive and negative relationship. In all statistical coefficients are significantly affect by the profitability at the 0% level Chirwa (2003); Miller & Noulas (1997) reported the matching relationship of operating efficiency with the profitability.

Table 3. Regression Statistics for Model (A)

	Un-standardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
Constant	.015	.012		.56	.231
CS	.006	.032	.12	.13	.063
GR	.000	.054	-.23	-.34	.023
NR	-.123	.187	-.342	-312	.000
AM	.212	.0564	-.12	1.23	.000
OE	-.30	.123	.32	-2.32	.000
CA	-.013	.023	-.177	-2.11	.000
R-squared	0.451		Mean dependent var.	.000032	
Adjusted R-squared	0.342 0.546		S.D. dependent var.	.002334	
Sum squared resid.			F-statistic	60	
Durbin-Watson stat.	1.92		Prob. (F-statistic)	.000	

In model (B), the correlation of the size of the insurance companies is affirmative (positive) (Al-Tamimi, 2005; Sufian, 2009) so it is concluded that size is insignificant with return on equity (ROE). The insignificant outcome of the size of the insurance companies flash the light that the diseconomies of scale or may be because of diverse market progenitors. The financial instruments utilize to determine the weight of non-performing loans in insurance companies is NPLs ratio. Which are prominent instruments for reflecting performance. The connection of asset management and NPLs ratio is institute to be a positive and negative (Sacket & Shaffer, 2006).the coefficients are significant at 0% level in all stipulation. The working efficiency and capital adequacy ratio recognized negatively association and ROE is insignificant. The relation of operating efficiency and capital adequacy could be leveraged with prior research (Alexiou & Sofoklis, 2009; Sufian & Habibullah, 2009; Ramlall, 2009) and (Naceur & Goaied, 2002; Hunter & Srinivasan, 1990; Al-Tamimi, 2005) correspondingly. The gearing ratio set up to be a negative relationship. The coefficient is significant at the level of 5% in all specifications (Barnhill, Papapanagiotou, & Schumacher, 2002).

Table 4. Regression Statistics for Model (B)

	Un-standardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
Constant	-.0213	.0134	.11	-.23	.121
CS	.034	.089	-.21	.134	.043
GR	.-0371	.043	-.352	-.876	.021

NR	-.165	.187	-.135	-.767	.000
AM	.263	.0564	.12	1.11	.000
OE	-.213	1.23	-.17	-1.32	.234
CA	-.0435	1.45		-1.11	.432
R-squared	0.1564		Mean dependent var.	.00564	
Adjusted R-squared	0.1223		S.D. dependent var.	.02334	
Sum squared resid.	0.523		F-statistic	22	
Durbin-Watson stat.	1.92		Prob. (F-statistic)	.00000	

Conclusion

The study focus on to establish the effect of insurance companies precise variables of profitability for Islamic and conventional insurance by manipulating the data sheltered for the period of 2010-2013). The dependent parameters for performance are return on assets and return on equity. Gearing ratio, NPLs ratio and asset management are establish to have significant affect on the profitability of Islamic and conversational companies in both models and size of the companies is a significant meter for profitability. Return on assets and ROE is used as proxy for metering insurance companies' profitability.ROA depicts insignificant result. The study explore new imitative for policy makers, and top management to perceive on some factors that can be an instruments for achieving the organizational goal.

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