INSURANCE AND FINANCIAL PERFORMANCE OF SELECTED OIL AND GAS COMPANIES IN NIGERIA

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Abstract

This study empirically investigates the impact of insurance on oil and gas industry in Nigeria using data from seven oil firms over the period from 2013 to 2018. Return on Asset (ROA) - the dependent variable is regressed on five explanatory variables which include insurance premium, insurance benefit (indemnity), oil and gas firm revenue, oil firm size and board independence. Employing panel data econometric technique, the empirical findings show that insurance premium and insurance benefit are positively and significantly related to the Return on Asset (ROA) of oil and gas firms in Nigeria. The study also finds that Board independence (a measure of corporate governance) and size have positive and significant impact on performance (return on asset).The findings also reveal that revenue is positively related to the return on asset of oil and gas companies in Nigeria. Against the backdrop of the foregoing findings, the study recommend increased participation of oil and gas firms in insurance activities by subscribing to insurance policies and payment of premium for which the firms will be indemnified (compensated) when the need arises, all things been equal. Strong corporate governance particularly board independence is also imperative to enhancing the performance of firms in the oil and gas industry in Nigeria. These should be supported with policies to increase firm size and growth in order to enhance the performance oil and gas companies in Nigeria.

Keywords: Insurance, Insurance Premium, Indemnity, Financial performance, Oil and Gas Firms

JEL Classification: C23, G22 and G30

Introduction

It has been established over the years by researchers, governments, policy makers and other stakeholders that the oil and gas industry is the mainstay of the Nigerian economy. The sector accounts for over 90% of Nigeria's export earnings and 80% of the revenue generated by the federal government (Polycarp, 2019). For example, data released by the National Bureau of Statistics (NBS) in 2019 shows that Nigeria's economic growth, which is measured by Gross Domestic Product (GDP) expanded by 2.3% (on an annualized basis) in Q3 2019, compared to 1.8% in the corresponding period of the preceding year (Q3 2018). The Q3 2019 GDP growth was a little higher than the 2.1% growth recorded in Q2 2019. According to PricewaterhouseCoopers Limited (2019), the economic performance of Nigeria in Q4 2019 was driven primarily by the oil and gas sector, which is only 9.8% of GDP and grew by 6.5% in Q3 2019, compared to the – 2.9% recorded in Q3 2018, and 7.2% in Q2 2019 respectively. The performance of the sector is due to the increased production which reached a three – year high of 2.04 million barrels per day in the three year ending 2019.

However, a cursory look at the undulating fortune of the oil and gas sector is a pointer to the possibility that oil and gas companies in Nigeria are exposed to a constellation of macro and micro disruptions in their activities. Such disruptions may be due to fluctuation in crude oil prices as we have witnessed during the covid-19 pandemic of 2020, industrial and civil unrest like the EndSars protest of October 2020, fire outbreak, vandalization of oil installation, kidnapping, and robbery among others. Specifically, in recent months, the sector has witnessed a drop in output and demand due to the adverse consequences of the covid-19 pandemic. The above factors pose risk to the activities of oil and gas firms. There is no gainsaying the fact that a

good number of these risks are insurable. According to Unugbro and Agbadudu (2009), insurance is a social financial service which provides financial compensation to victims of misfortunes. The principle of insurance is based on the law of large number and the probability that every economic unit in a given pool of insured risk will not suffer calamity or misfortune at the same time. Thus, the insurance company (insurer) usually collects premium from economic units (the insured, such as oil and gas firms) in the pool who derives benefits by way of peace of mind, risk taking and indemnity in the event of calamity (McMinn, 2020; Unugbro & Agbadudu, 2009). Indemnity implies that the insured is restored to the economic position enjoyed prior to the misfortune. We are incline to think that the availability of insurance services with specific coverage for several insurable risks for oil and gas companies in Nigeria engenders more profitable business activities by the firms, which in turn is expected to affect their financial performance significantly.

Several studies demonstrate the influence of insurance business on economic growth and development (Akinlo, 2015; Etale, 2019; Nguyen & Skully, 2010). There is a growing body of literature investigating the financial performance of oil and gas firms with respect to corporate governance, corporate social responsibility and environmental accounting (Ikponmwosa & Ogbeide, 2019; Polycarp, 2019). However, a survey of extant literature reveals paucity of empirical evidence on the linkage between insurance and the financial performance of oil and gas companies especially in natural resource dependent countries in sub-Saharan Africa like Nigeria. Thus, the motivation for this study is anchored on the need to x-ray the empirical effect of insurance on the oil and gas industry in Nigeria. Specifically, the study states and probes into two hypotheses, which are; (i) insurance premium has no significant effect on the financial performance of oil and gas companies and (ii) insurance benefits has no significant effect on the

financial performance of oil and gas companies. The time frame of this study ranges from 2013 to 2018 inclusive. This period allows the study to capture the long-term benefits (if any) of the Market Development and restructuring Initiative (MDRI), been a project launched by the National Insurance Commission (NAICOM) in 2009 and implemented till 2012. The objective of MDRI includes deepening insurance penetration through increase in delivery channels, increase in local content policies for oil and gas risks *inter alia*. The rest of the study is presented as follows: in section 2, an array of related literature is reviewed; section 3 discusses the methodology and specifies the model. Section 4 deals with results and discussion of findings, while section 5 is conclusion and recommendations.

Literature Review

Concept of Firm Financial Performance

In management theory, the concept of firm performance forms the heart of strategy (Singh, Darwish & Potocnik, 2016). Empirically, most studies on strategy make use of the concept of business performance in attempts to examine various strategic outcomes. In management, the significance of performance is made clear through the many prescriptions provided for performance enhancement (Al-Matari, Al-Swidi, & Fadzil, 2014). Most studies on firm performance employs a plethora of accounting-based indicators of financial performance. This include but not limited to the level of Return on Assets (ROA), Return on Equity (ROE), Profitability Margin (PM), Return on Sales (ROS), the ratio of Expense to Assets (ETA), the ratio of Cash to Assets (CTA), ration of Sales to Assets (STS), Expenses to Sale (ETS), level of Operating Cash Flow (OCF), level of Return on Capital Employed (ROCE), Critical business Return on Asset (CROA). We note that ROA and ROE are the most widely employed measures

of financial performance in extant literature, especially in corporate finance, corporate governance and related studies (Ehikioya, 2009; Hutchinson & Gull, 2004; Ikponmwosa & Eriki, 2017; Khan, 2011; Orakwue, 2020).

Theoretical and Empirical Review

Stylized facts, seems to suggest that the nexus between insurance and growth follows a feedback mechanism. According to Sassian (2020) all things being equal, higher economic activity will drive premium growth higher while lower economic activity drags premium growth southward. Historically, an array of empirical studies shows that the economy, measured by the level of income or Gross Domestic Product (GDP) affects the performance or fortunes of the insurance industry. These includes Arena (2008); Beenstock, Dickson and Khajuria (1986); Ward and Zurbruegg (2005) and Kjosevski, (2011).

In completing the feedback loop in theory, insurance industry plays a very important role in the process of economic growth (Unugbro & Agbadudu, 2009). This is achieved by helping businesses to mitigate risks occasioned by sudden catastrophic events. According to Etale (2019), insurance provides risk management and risk adjustment services to firms in other sectors of the economy. These sectors include transportation, industrial, construction, agricultural, banking, telecommunication, mining and petroleum, among others. Intuitively, we are inclined to think that the availability of insurance coverage also provides incentives for firms (including oil and gas companies) to become more enterprising and engage in more risky activities. Such risky ventures tend to enhance business profits and boost overall economic activities. In the light of the above, most studies find that insurance industry contribute to economic growth and development (Akinlo, 2015). For example Avram, Nguyen and Skully

(2010) investigate the nexus between insurance activities and growth performance in 93 countries during the period from 1980 to 2006. The study used panel data technique and finds that insurance have a positive and significant influence on economic growth. Similarly, Cristea, Mariu and Carstina (2014) investigate the relationship between insurance investment and economic growth in Romania. The study employs time series data from 1997 to 2012. Also, the study used total insurance premium as a proxy for insurance activities and GDP as a measure of economic growth. The study finds a significant positive relationship between insurance and growth. In Nigeria, Akinlo (2013) studies the relationship between insurance industry and economic growth from the period between 1986 and 2010. The study also used insurance premiums as proxy for insurance business. The result reveals a positive and significant relationship between insurance and economic growth in Nigeria. Other studies which show a positive and significant relationship between insurance and economic growth includes Ching, Kogid and Mulok (2011); Chau, Khin and Teng (2013); Eze and Okoye (2013); Madukwe and Obi-Nweke (2014); Oyedotun and Adesina (2015); Igbodika, Ibenta and Isaac (2016); Fadun and Shoyemi (2018) and Nwosa and Mustapha (2018). On the contrary, Fashagba (2018) find an inverse relationship between insurance industry and economic growth. This inverse relationship may be absurd given that it is against logic and intuition. Also, Nwinee and Torbira (2012) investigate the nexus between insurance and economic growth. The study reveals a mixed finding between insurance and economic growth. Akuno and Kariuki (2019) investigate the effect of firm characteristics on the financial performance of energy and petroleum firms in Kenya. The study finds that firm size, board size (corporate governance) and leverage were positively related to firm's financial performance, measured by ROA. Similarly, Eke, Akpanuko and Umoffong (2019) investigate the nexus between corporate governance and profitability of

quoted oil and gas firms in Nigeria from 2010 to 2018. The findings reveal a significant and positive relationship between corporate governance and profitability of oil and gas firms in Nigeria.

From the foregoing, the majority of extant literature tends to support the hypothesis that insurance positively and significantly affect economic growth. However, there is paucity of empirical literature on the linkage between insurance and the performance of firms in the oil and gas industry in resource dependent countries in sub-Saharan Africa like Nigeria. There is consensus by researchers and policy makers that the Nigerian economy is driven primarily by the revenue generated from the petroleum industry (NBS, 2019; PricewaterhouseCoopers Limited, 2019; Polycarp, 2019). Thus, this study focuses on the relationship between insurance industry and the financial performance oil and gas firms.

Methodology

Population, Sample and Data

The population of this study is made up of about 140 oil and gas firms duly registered and operating in Nigeria (Jarushub, 2020; Nairametrics, 2020). However, the study takes a convenient sample of seven (7) local and international oil companies (IOCs) operating in Nigeria. The choice convenient sampling is based on data availability. The list includes Nigeria Agip Exploration, Addax Petroleum Development, Statoil, Total, Shell Petroleum Development Company, Chevron and Mobil. The data ranges from 2013 to 2018 and sourced from the annual financial reports of the oil firms, and the website of National Bureau of Statistics (NBS).

Theoretical Framework

In this study, a theoretical framework showing the nexus between insurance and financial performance of oil and gas firms is developed. This framework is adapted from the stylized facts between insurance and economic growth argument and is based on the premise that insurance provides benefits to oil and gas firms. This further enhances profit seeking and risk taking activities of oil and gas firms. In other words, as insurance companies increase their coverage of risk in oil and gas sector, they generate more premiums and so provide more benefits to oil and gas firms in the event of calamity as enshrined in the principle of insurance. We are incline to think that such insurance coverage or hedge against risk further spurs oil and gas firms to embark on more enterprising and profit seeking activities. *De facto*, the higher the risk, the higher the expected returns (financial performance) from any given venture or project.

Additionally, based on extant literature, other factors also influence the financial performance of firms. These include firm size and corporate governance (Akuno & Kariuki, 2019; Eke *et al*., 2019) as well as firm revenue, which could be a function of the overall performance of the economy. Thus, from the foregoing, the web of relationship between insurance and the financial performance of oil and gas firms is depicted by the schematic diagram in figure 1.

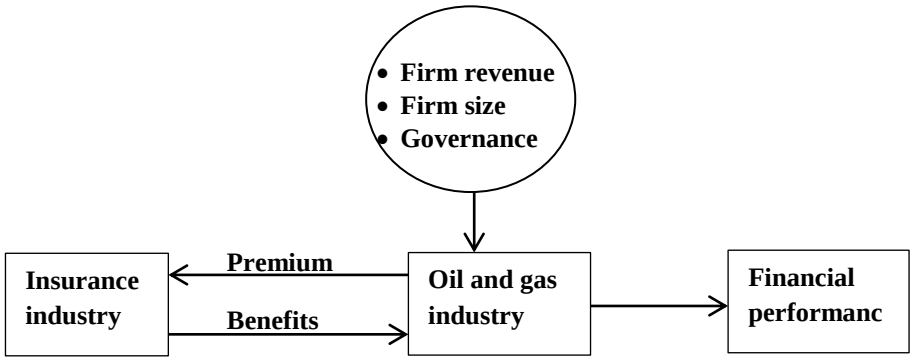

Figure 1: Nexus between Insurance and Financial Performance of Oil and Gas Industry
Source: *Author's construction, 2020*

Model Specification

Based on the literature review and theoretical framework above, a financial performance model is developed for this study. The mathematical form of the model is given as;

$OFFP = f(IP, IB)$………………………………………………………………………….. (1)

Where OFFP is oil and gas firm financial performance, for which ROA will be used as a proxy. ROA is measured as the ratio of profit after tax (PAT) to total assets. IP is insurance premium defined as the total premium contributed by oil firms for insurance policies purchased. IB is insurance benefits measured by indemnity obtained by oil firms as a result of calamities suffered. Indemnity is used as proxy for insurance benefits because it is the most quantifiable component of insurance benefits. Based on existing literature on micro level factors which can influence the financial performance of oil and gas firms, the study includes three control variables. These are firm revenue (REV); size of the firms (SIZE) and the corporate governance of the firm. REV is measured as the value of total revenue for each period, SIZE is the value of total asset, while corporate governance is measured using board independence (BIND) and is the been a ratio of non-executive directors to total number of board members.

Taking cognizance of the above factors, the functional model in equation 1 above becomes;

$ROA = f(IP, IB, REV, SIZE \text{ and } BIND)$………………………………………………… (2)

All variables are as earlier defined above. In order to render the above model amenable to empirical investigation, equation 2 is re-specified in its empirical form as;

$ROA_{i,t} = \alpha_0 + \beta_1 IP_{i,t} + \beta_2 IB_{i,t} + \emptyset_1 REV_{i,t} + \emptyset_2 SIZE_{i,t} + \emptyset_3 BIND_{i,t} + \varepsilon_{i,t}$ ……………… (3)

Where i and t represents the individual oil and gas company at the given time period within the panel data framework, α_0 is the coefficient of the mean or constant, $\beta_1$and β_2 are the coefficients

of the primary explanatory variables of interest, for insurance sub-sector activities. And $\emptyset_1$- $\emptyset_3$ are the coefficients of the control variables / other explanatory variables. Based on theory and extant literature, the a priori expectation of the signs of the coefficients of the explanatory variables are presented as; $\beta_1 \gtrless 0$; $\beta_2 > 0$; $\emptyset_1 > 0$; $\emptyset_2 \gtrless 0$; and BIND > 0.

Suffice it to say that insurance premium contributed by the oil and gas firms and the insurance benefits which they enjoy serve as proxy for the insurance sector. ROA is used to proxy financial performance of oil and gas firms because we are inclined to think that oil and gas firms typical subscribe to insurance policies and products which protect their assets (examples includes insuring their assets against fire, vandalism, theft, etc.). In other words, this study uses ROA because of its direct link with insurance premium. Panel least square estimation technique is adopted for the empirical analysis due to potential endogeneity problem that may arise if the OLS technique is employed in the estimation.

Results and Discussion

The focus of this section is on the presentation, empirical analysis and discussion of results based on the empirical techniques adopted for the study.

Hausman Test

The standard test for the method of panel analysis is to adopt the Hausman test for cross-sectional random/ correlated effects to select the best method. The results of the Hausman test is presented in table 4.1.

Table 4.1: Summary of Hausman Test for Cross-Section Random Effects

Test cross-section random effects

Model	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Return on Asset	9.778	3	0.03

Source: *Author's computation using Eviews 9, 2020.*

Using the Hausman test, the Chi-Square statistic for the random sections argument is 9.778 and passes the statistical significance test at the 5 percent level, given a probability value of [0.03]. This implies the rejection of the null hypothesis that a random effect exist in the cross sections of the data. This effectively makes the fixed-effect the best method to estimate the relationship, as the random effect strategy will produced estimates that are biased and untenable for policy formulation. The analysis and inferences are thus based on the fixed effect model. The result of the fixed estimation is reported in the table 4.2.

Return on Asset Results (Fixed Effects Model)

The empirical results of the impact of insurance on oil and gas companies are presented and analysed below.

Table 4.2: Fixed Effect Model

Dependent Variable: ROA

Variables	**Coefficient**	**T-Ratios**
Constant	-0.170	-0.016
IP	0.114	2.742
IB	0.127	2.052
REV	0.302	1.324
SIZE	0.257	1.869
BIND	0.027	2.030

$R^2 = 0.764$		
	F = 22.46	DW = 1.715
Adjusted $R^2 = 0.731$		

Source: *Author's computation using Eviews 9, 2020.*

An examination of the results shows an adjusted coefficient of determination of 0.73. Thus, over 73 percent of the systematic variations in the performance of oil and gas firms in Nigeria are explained by insurance and other control variables. The overall goodness of fit statistic indicated by the F-value of 22.5 is significant at 1 percent level. Thus, the hypothesis of a significant linear relationship between insurance and oil and gas firm performance is validated. The Durbin Watson Statistic of 1.72 shows absence of auto correlation in the model. This makes the estimated model fit for policy formulation and implementation.

In terms of the contribution of the individual variables, emphasis is laid on the signs of the estimated coefficients and their t-ratios. The coefficient of insurance premium is positive in line with theoretical expectation and is statistically significant at the 1 percent level. Thus, huge insurance premium paid by oil and gas companies have enhance their financial performance. The coefficient of insurance benefit (captured by indemnity) is positively signed and significant at the 5 percent level. Without doubt, high insurance premium payment and the associated insurance benefit (indemnity) tend to stimulate the performance of oil and gas firms in Nigeria, as it enables them transfer risk to their insurer.

The coefficient of oil firm revenue is positive but not significant at the 5 percent level. Thus, increase revenue does not automatically translate to higher financial performance for oil and gas firms; this may be due to the fact that the cost efficiency strategies and managerial capacity determine performance. Even with high revenue, without sound cost efficiency strategies and

good corporate governance, the performance may not correspond with realized revenue. The coefficient of size is positive and significant at the 10 percent level. This is in harmony with the findings by Akuno and Kariuki (2019). Thus, it appears that economies of scale tend to enhance performance of the firms. Invariably, large oil and gas firms are able to reap economies of scale and other opportunities that will enable them outperform the smaller ones. Through efficient deployment of such resources, larger oil firms do well and have further growth opportunities than smaller ones. The coefficient of board independence (a measure of corporate governance) is positive and statistically significant at the 5 percent level. This implies that strong corporate governance structures have the capacity to stimulate the performance of oil firms, since it instils sound institutional mechanism on the activities and operations of oil firms.

In order to specifically investigate whether the null hypotheses stated in section 1 are accepted or rejected, the study revisits the t-test. Based on the empirical results, the t-ratio of the coefficient of insurance premium of 2.742 (in absolute value) is significant at the 5 percent level. Similarly, the t-ratio of the coefficient of insurance benefit is 2.052 (in absolute value) and is significant at the 5 percent level. The study therefore rejects the null hypotheses and accepts the alternative hypotheses.

Discussion of Findings and Policy Implications

The empirical findings of this study have important policy implications. First, given the positive and significant effect of insurance premium and insurance benefit on the performance of oil and gas firms in Nigeria, it is clear that that insurance has provided great opportunity for risk diversification through spreading of risks of the firms. Through this, the firms have greater

opportunity to pursue performance yielding initiatives and other profitable ventures, with associated probable risks covered for.

Second, against the backdrop of the positive and significant impact of firm size on the performance of oil and gas firms in Nigeria, it becomes apparent that increase in size, coupled with sound managerial capacity and other efficiency-enhancing strategies will stimulate the performance of the firms.

Finally, the coefficient of board independence (a measure of the quality of corporate governance) is positive and significantly related to return on asset of the firms. This is in consonance with the findings by Eke *et al*., (2019). The implication of this is that sound and effective corporate governance structure will enhance the performance of oil and gas firms in Nigeria.

Conclusion and Recommendations

The importance of the stability of insurance to the sustenance, performance and growth of any economy cannot be under-estimated. Insurance helps to provide financial cover against probable losses to oil and gas firms through spreading of risk and the consequent indemnity. Clearly, the ability of the firms to minimize their vulnerability to loses lies largely in strong and efficient insurance industry, supported with huge premium payments and capital.

Without doubt, a strong, vibrant and virile insurance industry is critical to efficient performance of oil companies in Nigeria. In the light of this, the Nigerian government and the regulatory authorities, particularly The National Insurance Commission (NAICOM) have greater role to play in the efficient regulation and supervision of insurance firms in Nigeria, in helping the oil and gas industry achieve desired performance and growth.

Policy Recommendations

Based on the empirical findings from the study, the following policy recommendations are made:

- Increased subscription to relevant insurance policies and premium payments by oil firms to insure their risk, in order to enhance their performance;
- Strategies to increase the revenue of oil firms should be developed by management of oil firms to enable them have a large pool of resources to leverage on;
- Size-increasing policies and strategies through increased investment are imperative in the oil industry; and
- Strong corporate governance structure and culture should be instituted in oil firms in Nigeria. This will ensure that the firms are managed in the best interest of shareholders and other stakeholders.

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