



Impact Of Ownership And Firm Specific Variables On The Performance On Nepalese Insurance Companies

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Abstract

The study is conducted to examine the impact of Ownership, age and size of the firm on the profitability of insurance companies of Nepal. The indicator of profitability is taken as return on assets and return on equity. The study shows that size and age has insignificant impact on return on asset and return on equity. Foreign ownership has insignificant and positive impact over the return on assets and return on equity. The study used secondary data during the period of nine years starting from 2007/8 to 2015/16 of 13 Nepalese insurance companies. To justify his objectives of the study panel data analysis and hausman test were done.

Introduction

Profitability is the one of the major determinants of success or failure of the business. It is main reason for the investment. The study of risk and performance of firms is of great relevance, since firms decisions are argued to influence economic growth and stability (Levine, 1996). Major decision of the organization are based on the profitability and riskiness business. Ownership influence interest of decision making in the organization. Separation of ownership and control may create a conflict of interests between owners and managers (Berle & Means, 1932). Government owned organization are run by the personnel with highly political interest. Such ownership control might not be feasible for the organization in long run. While government owned firms are technically “controlled by the public”, these firms are run by bureaucrats who can be thought of as having “extremely concentrated control rights, but no significant cash flow rights” (Shleifer & Vishny, 1997).



Along the ownership, there are various activities are involved such as supervision, control, regulation etc. Issues of ownership is one of the major area of focus. Market of financial institution has been changed in the last few years and ownership structure has also changed in the same way. Along with then change in the ownership structure capital structure of the business is also changing. Ownership structure has been changed to the common stock which show the risk taking behavior of the organization. Foreign owned banks exhibit a higher performance than other banks, particularly in developing countries (Micco, Panizza & Yanez , 2007). Berger & Humphrey(1997) proclaimed that the whole idea of measuring bank performance is to separate banks that are performing well from those which are doing poorly.

The studies investigates the firm specific factors and macroeconomic determinants of life insurance companies profitability. The findings indicate negative and significant influence of premium growth and risk based capital on profitiability and significant positive influence of equity capital, liquidity ratio, leverage ratio and size of the company on profitiability. Additionally, results reveal that inflation rate is not significantlty influence the profitiability of life insurance companies. The profitiability is taken as ROA (Irma, priyarsono, andati, 2017).

Ahmed & Souad (2016) Study used regression on panel data analysis. The performance of insurance companies is not statistically significnat with such variables as leverage, tangibility, liquidity and risk. Study sates that relationship between managerial ownership and firm perform is appropriatley described by estimators (Himmerlberg, 2001). The study used simultaneious equation model. He reveals that positive relationship exists between the debt assest ratio and financial performance (Bonaccorsi, 2002). The study used sample of 167 countries during the period of 1989 to 2003. He used panel data analysis to investigate effects between capital structur and corporate performance. He state that capital structure of the firm has significantlty nagative impact over the firm's performance. He further investigates that short-term debt to total assets level has a significantlty positve effect on the market performance measure (Jordan, 2007).



The study concluded that leverage, liquidity has positive relationship with profitability and tangibility has opposite relation with profitability. Return on equity was indicator of firms performance i.e. dependent variable and independent variable were leverage, liquidity and tangibility. The study used data of sixteen insurance companies of Ghana over the period from 2005 to 2010. He used panel data and ordinary square to regression model to reach his objective of the study (Boadi, 2013).

The studies the determinants of profitability of insurance in ethiopia. He used panel data analyse to draw the conclusion. He revealed that profitabiliity of insurance companies is positively influened by liquidity, company size and premium growth and negatively influenced by inflation (Suheyli, 2015). The study revealed that risk and size of the firm has positive impact over the financial performance of the company and negatively impacted by leverage and capital. He used dependent variable as risk, size, leverage and capital. Futher more he used data of thirteen insurance companies over the period of ten years. He used linear regression model to draw the conclusion (Dry, 2015)

He concluded that performance of the firm is positively influenced by age whereas negatively influenced by size of the firm. He used panel data analysis and regression analysis to conclude his results. Dependent variable is return on assets where as independent variables are size and age (Darbali, 2014). The used data of forty one insurance companies during the period of 2008 to 2012 which operated in Romania. He used panel data analysis to achieve objectives of the study. He concluded that size, age, solvency ratio and premium growth was positivley realted to the performance of the company where as leverage was negatively influence the performance (Burca & Batrica, 2014).

The results shows that indicator of performance for foreign banks are different then domestic banks. He further conclude that local controlled banks are more profitable than foreign controlled banks. Return on equity was taken as indicator of profitability and tangibility, capital, liquid ratio and age as the firm specific variables (Azam & siddiqui, 2012).



Soundness of the institution is determined with the profitability and efficiency of management. To ensure sound financial performance banks should focus on the factors likely to affect profitability and extent of their influence (Yesmine & Bhuiyah, 2015). Major objective of the insurance company is to increase the return which is possible only with increase in risk. Performance of private owned company and state owned company is possible only due to existence of capital market. Mester (1993) revealed that public-owned banks and mutual banks have slight cost and profit advantages over their private banks.

Panta & Bedari (2015) showed that foreign banks are less cost efficient relatively than medium and small banks. The entry of foreign bank enhanced competition which might have forced bank to reduce cost, diversify products through innovation, provide better services to client, and broaden the client base to minimize risk and to retain clients. In the context of Nepal, Bista (2014) showed that foreign ownership has significant and positive impact on bank performance. It shows that, foreign ownership brings improvement in the performance of domestic institution. Bhusal (2015) found that leverage has a positive relationship with the performance of the commercial bank. Firm growth, foreign ownership structure and debt to equity has negative relationship with return on equity. In the similar way, (Rajbahak ,Shrestha, KC, Rijal & Shrestha, 2014) showed that there is a significant impact of corporate governance on return on equity and return on assets in Nepalese commercial banks. Size of the board and firm and growth of the institution has significant relationship with return on assets but insignificant relationship with equity. Neupane (2013) found that efficiency is significantly related to debt to equity and capital ratio. (Rai, Ojha, Singh, Gyawali & Gupta ,2015) concluded that quality of assets, efficiency of management and capital adequacy ratio are the most major variables that influence the return on equity, return on interest and return on assets.

The study concluded that size of the firm and foreign ownership have positive and significant impact on the return on asset and return on equity. The study was conducted to examine the impact of firm specific variables on the performance of Nepalese insurance companies (Bhandari, 2016). The research investigates the relation between ownership structure and the performance of the bank. Indicators of profitability was taken as ROA

and ROE. The study concluded that neither private or foreign shareholders are performing better (WEN WEN,2010).

Conceptual framework

Conceptual framework explain about the ideas in the set of presentation. This section is divided into the identification of the variable and stating relationship between those variables. This section explain about the ownership structure and performance of bank in the theoretical prespective. Various research are found in the foreign context and positive relationship is found between ownership structure and insurance companies. The main objective of the study is to analyze the relationship between ownership structure, firm specific variables and financial performance of insurance companies in Nepal. Two dependent variable along with three in independent variable are tested. Figure 2.1. depicts the conceptual framework.

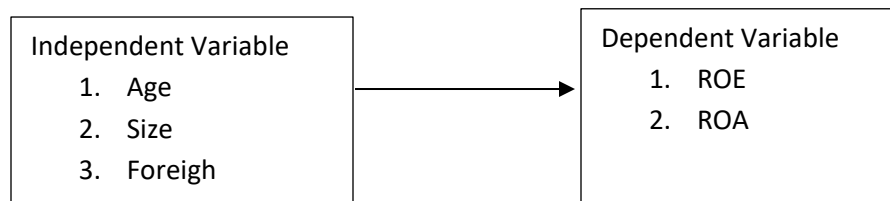


Figure 1.1. Schematic diagram of factors influencing insurance companies' performance

Method of Data Analysis

Main purpose of the study is to explain the relationship between profitability of the bank with age, size and liquidity of the insurance companies. Statistical models are used to analyze the relationship. So, Statistical methods are used to explain the relationship between the variables.

Model 1

$$ROA_{it} = \alpha_0 + \alpha_2 AGE_{it} + \alpha_3 SIZE_{it} + \epsilon_{it}$$

Where, ROA_{it} = Return on Asset, AGE_{it} = age of insurance company, $SIZE_{it}$ = natural logarithm of assets, ϵ_{it} = error term.

Model 2

$$ROE_{it} = \alpha_0 + \alpha_2 AGE_{it} + \alpha_3 SIZE_{it} + \epsilon_{it}$$

Where, ROE_{it} = return on equity, AGE_{it} = age of insurance company, $SIZE_{it}$ = natural logarithm of assets, ϵ_{it} = error term.

Descriptive Statistics

The descriptive statistics used in this study consists of minimum, maximum mean, and the standard deviation associated with variables under consideration. Therefore, descriptive statistics enables to present the data in a more meaningful way, which allows simpler interpretation of the data. The descriptive statistics of dependent variables (return on assets and return on eqUICty) and independent variables (Foreign ownership, age, size) is presented in Table 4.5 for 14 sampled insurance companies of Nepal from 2007/08 through 2015/16.

Table 1: Descriptive statistics

Variables	Min	Max	Mean	S.D
ROE	-32.23	35.16	11.81	10.95
ROA	-20.22	12.96	4.87	4.57
Age	2	28	14.01	5.77
Size(log)	4.89	10.3	6.98	1.32
FO	0	1	0.17	0.38

Note: Authors calculation through Excel.

Table 1 depicts descriptive statistics of the variables of the Nepalese insurance companies over the period of 2007/08 to 2015/16. Return on assets (Net earnings by total assets) and Return on equity (Net earnings by shareholders's equity) are dependent variables. Foreign ownership (FO in percent), Age (it is explained as the total number of years of established), size (total size of the insurance companies taking the natural logarithm of total assets, rupees in million). The result shows the descriptive statistics of dependent and independent variables for the selected insurance companies. The table clearly shows that return on assets has a minimum of -20.22 percent and a maximum of 12.96 percent with average of 4.87 percent. The average return on equity of selected insurance companies during the study period is noticed to be 5.06 percent with a minimum amount of -32.26 percent and a maximum of 35.16 percent. The size varies from a minimum of Rs. 278.88 million to a maximum of Rs. 14175.41 million, leading to an average Rs. 3090.61 million. The table also shows that the average foreign ownership of selected insurance companies during the study period is noticed to be 0.17 with a minimum of 0 and a maximum of 1.

Panel Data Analysis

This table shows the panel data analysis of dependent and independent variables of insurance companies for the period of 2007/08 to 2015/16. Dependent variables are ROA (Return on assets defined as Net income divided by total Assets, in percentage), ROE (Return on equity defined as Net income divided by shareholder's equity, in percentage) and independent variables are foreign ownership (FO in percentage) defined as proportion

of foreign ownership, SIZE (size measured as the total assets measured as taking the natural logarithm of total assets, in million rupees) and AG (Age defined as number of year from the date of establishment, in years Hausman test examines the presence of endogeneity in the panel model. The use of panel data gives considerable advantages over only cross-sectional or time series data, but the specification of the model to be used is of great importance for obtaining consistent results. One of the tests used to determine an appropriate model is Hausman test, which specifies whether fixed or random effects panel model should be used. As one of the most used tests in panel data analysis, the study of its properties should represent a great interest (Teodara, 1990). When performing a statistical hypothesis test an issue that must be considered is the accuracy of the test. There are two properties that define the accuracy of a hypothesis test: its size and power. The size is the probability of rejecting the null hypothesis, when it is the correct one and in social sciences tests are usually run at significance level 5%, which guarantees that if the null hypothesis is correct and a number of tests are made based on different samples of the same population, in 95% of the cases the null hypothesis won't be rejected. The power represents the probability of correctly rejecting the null hypothesis. Values of the power of 80% or above are considered "good" when corresponding to size of 5% (Cohen, 1988).

Fixed effects model with ROA:

Table 2: Fixed effects model with ROA

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-5.82038	8.183943	-0.7112	0.4785
AGE	0.675178	0.489861	1.378306	0.1709
SIZE_LOG_	0.04375	2.093626	0.020897	0.9834
FO	4.892588	2.301105	2.12619	0.0357
R-squared	0.464326			

Note. Authors calculation through Eviews.

Table 2 shows the results of the fixed effects model. It can be noticed that the variables number of years since the company operates in the Nepalese insurance market and size of

the balance (total assets) are not statistically significant, because the probabilities associated is higher than the significance level of 0.05. Foreign ownership is positive and significant, because it significance is less than 0.05. The value of R-squared shows that the independent variables explain 46.43% of the entire panel's variations.

Random effects model with ROA:

Table 3: Random effects model with ROA

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.664237	2.880141	-0.23063	0.818
AGE	0.236746	0.112282	2.108502	0.037
SIZE_LOG_	0.33785	0.498353	0.677933	0.4991
FO	-0.714947	1.467403	-0.48722	0.627
R-squared	0.067052			

Note. Author's calculation through Eviews.

Table 3 shows the results of the random effects model. It can be noticed that the variables Foreign ownership and size of the balance (total assets) are not statistically significant, because the probabilities associated to coefficients are higher than the significance level of 0.05. It can be noticed that the variables number of years since the company operates in the Nepalese insurance market is statistically significant, because the probabilities is less than 0.05. The value of R-squared shows that the independent variables explain 6.70% of the entire panel's variations.

Hausman test for ROA:

Table 4: Hausman test for ROA

Correlated Random Effects - Hausman Test			
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.

Cross-section random	23.22193	3	0
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Note. Author’s calculation through Eviews.

Table 4 shows that fixed effects model is relevant to our analysis, confirming the absence of the crosssectional effects. In this case, the performance of the insurance companies in the Neplease Insurance market, measured through the return on total assets ratio. Hypotheses tested, H1 is valid; H2 and H3 are rejected. So, the analysis investigated that in order to gain higher profitability higher foreign ownership has to be chosen.

Fixed effects model with ROE:

Table 5: Fixed effects model with ROE

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-14.2046	17.51765	-0.81087	0.4192
AGE	1.566152	1.048543	1.493646	0.1382
SIZE_LOG_	0.257638	4.481386	0.057491	0.9543
FO	11.95778	4.925494	2.427733	0.0168
R-squared	0.570731			

Note. Author’s calculation through Eviews.

Table 5 shows the results of the fixed effects model. It can be noticed that the variables number of years since the company operates in the Nepalese insurance market and size of the balance (total assets) are not statistically significant, because the probabilities associated is higher than the significance level of 0.05. Foreign ownership is positive and significant, because it significance is less than 0.05. The value of R-squared shows that the independent variables explain 57.07% of the entire panel’s variations.

Random effects model with ROE:

Table 6: Random effects model with ROE

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-2.97474	6.912072	-0.43037	0.6677
AGE	0.725087	0.288697	2.511587	0.0133
SIZE_LOG_	0.667296	1.260645	0.529329	0.5975
FO	-0.16221	3.482788	-0.04657	0.9629
R-squared		0.097526		

Note. Author’s calculation through Eviews.

Table 6 shows the results of the random effects model. It can be noticed that the variables Foreign ownership and size of the balance (total assets) are not statistically significant, because the probabilities associated to coefficients are higher than the significance level of 0.05. It can be noticed that the variables number of years since the company operates in the Nepalese insurance market is statistically significant, because the probabilities is less than 0.05. The value of R-squared shows that the independent variables explain 9.75% of the entire panel’s variations.

Hausman test for ROE:

Table 7: Hausman test for ROE

Correlated Random Effects - Hausman Test			
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	25.74571	3	0

Note. Author’s calculation through Eviews.

Table 7 shows that fixed effects model is relevant to our analysis, confirming the absence of the crosssectional effects. In this case, the performance of the insurance companies in the Nepalese Insurance market, measured through the return on total assets ratio.



Hypotheses tested, H1 is valid; H2 and H3 are rejected. So, the analysis investigated that in order to gain higher profitability higher foreign ownership has to be chosen.

Conclusion

The study shows that size and age has insignificant impact on return on asset and return on equity. Foreign ownership has insignificant and positive impact over the return on assets and return on equity. The study concludes that the most influencing factor for determining the profitability of Nepalese insurance companies is the foreign ownership followed by firm size and age.

Recommendations

The study observed a positive and significant relationship between foreign ownership and profitability of insurance companies. Foreign ownership has negative and significant impact on ROA and ROE. Hence, the insurance companies willing to increase ROA, and ROE should increase the share of foreign ownership proportion to achieve better performance.

The study observed a negative relationship between size and profitability of insurance companies. Size positive and insignificant impact on ROA and ROE. Hence, the insurance companies willing to increase ROA, and ROE should decrease the proportion of size of the balance sheet.

The study observed a negative relationship between age and profitability of the Nepalese insurance companies. Age has positive and insignificant impact on ROA and ROE. Hence, the insurance companies with higher age doesnot mean yielding higher profitability.

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