ASSESSMENT OF INSURANCE COMPANIES PROFITABILITY - CASE OF ALBANIA

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Abstract: *Profitability is one of the most important objectives of financial management. The objective of this paper is to assess the impact of internal factors, growth rate, liquidity, liability, fixed assets, company size and volume of capital, on the profitability of insurance companies in Albania. The purpose of our paper is to provide a useful tool for the insurance companies operating in our country in making their decisions based on economical and statistical implications.*
We have taken under study 7 insurance companies during the period 2008- 2013. The methodology used to achieve the paper's objective is based on the multiple regression tools with panel data. According to the analysis result, 56% of the variation in the profitability of insurance companies in our country is determinate from the variables mention above, while 44% of the variation in profitability is explained by external variables not included in the study.

Key words: *profitability, insurance, regression, panel, assess, growth rate*

INTRODUCTION

Good performance of a company determines the performance of the company in the market in which it operates the growth and consolidation of the market in general, giving as result the development of the economy as a whole. For this reason, the measurement and evaluation of performance of each company is one of the most elaborated financial literature. The importance of this topic is further multiplied when dealing with companies operating in the insurance market and this fact because: insurance companies transferring risk in the economy; provide a mechanism to promote savings and enhance investment activities in the economy.

Three key performance metrics of a company are profitability, size and continuity of the company. Profitability shows the company's ability to provide a rate of return on its assets and investments. Company size is an indicator of the success of the company to grow by reinvesting profits and using borrowed funds. Continuity of the company shows its ability to have a sustainable activity, even at a time when the economy or the industry in which it operates is not experiencing growth stages [1] (Al-Shami, 2013). In this paper, we will focus on the study of profitability, as one of the indicators of the performance of insurance companies.

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A number of factors, which can be classified as internal factors, factors of industry and macroeconomic factors, might affect the profitability of insurance companies. In most financial literature that addresses the topic of profitability of insurance companies, profitability studied in view of internal factors. The variation between profits of insurance companies over the years, within a country, makes you think that domestic factors or firm-specific factors play a major role in determining profitability. It is therefore important to define what these internal factors are and what is the nature of their impact, in order to help insurance companies to take measures to increase their profitability. In our previous paper, 'Factors affecting the profitability of insurance companies in Albania' [2] (Kripa & Ajasllari, 2016), we concluded that insurance companies in Albania should avoid high levels of liabilities, liquidity and fixed assets, because these factors were negatively correlated with their profitability. We also saw that company size and the volume of capital were positively correlated with profitability, but their impact was statistically insignificant. Growth rate was positively correlated with profitability, as an increase on the amount of written premiums causes an increase on the profitability of insurance companies in our country.

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It is important to emphases the importance of financial institutions in the economy of a country and specially the importance of insurance companies in financing and insuring economic activity. Being aware of this fact, we have decided to further develop our study according factors affecting the profitability of insurance companies in Albania. In this further research, we will seek to assess the impact of the above mention internal factors on the profitability of insurance companies operating in our country. The methodology used to reach the objective of this paper, is using multiple regression analysis tools, with panel data.

LITERATURE REVIEW

In our country, few studies have addressed the profitability of insurance companies and the factors that affect it. Even in the international literature, such studies are less argued compared with studies of the same nature about other financial institutions, such as banks for example. Studies about the profitability of the insurance companies can be divided into two categories, studies that have been focused on life insurance companies and studies that have been focused on non-life insurance companies. In both cases, the researchers had used as factors affecting the profitability of insurance companies, internal factors such as company size, growth rate, liabilities, the volume of capital, fixed assets and liquidity. Results of different studies, conducted in different countries, have been contradictors between them, and this is explained by macroeconomic changes, or external factors, which are specific for each country.

According to sources of Swiss Re [3] (Swiss Re, 2008) the profit of insurance companies, is determined primarily by operational performance (losses and expenses, which are dependent on insurers' services prices, the nature of risk accepted by the insurer, the management of claims and administrative and marketing expenses); and secondly from investment performance, which depends on asset allocation and asset management. Term profit, can be

used as both the economic concept and the accounting concept, to show the excess of income over expenditure for a certain period. On the one hand, profit is the main reason for the continuation of any business organization. On the other hand, the profit is one of the main objectives of the financial management of the organization, because one of the purposes of financial management is to maximize company owner's wealth [4] (Nguyen, 2001). Term profitability is a relative gauge where profit is expressed as a ratio, and generally in percentage (%). Profitability expresses the ratio between profits to several factors. Other researchers like William H. Greene and Dam Segal [5] (Greene & Segal, 2004) had argued that the financial performance of insurance companies can be measured by indicators such as annual income, return on investments, net premiums earned, return on equity, who are considered as a measure of investment performance. However, [6] (Koller, 2011) has argued that profitability is the most important indicator because it shows the ability of insurance companies to raise the level of their income.

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There are several ways to measure profitability as return on assets (ROA), return on equity (ROE), return on invested capital (ROIC). ROA indicates how profitable a company is relative to its total assets. ROA shows how efficient has been running a company in using its assets to generate profit, and ROE shows how much profit the company generate from the its shareholders equity. ROIC is an indicator, which assesses a company's efficiency in allocating capital to profitable investments. This indicator shows how well a company uses its funds to generate higher returns. Comparison of ROIC with the average cost of capital of the company (WACC) indicates whether the company's capital is being used efficiently or not. Most researchers, who have dealt with the topic of profitability of insurance companies, stated that the most important factor used to express profitability is ROA, which itself is expressed as the ratio of profit after tax (EAT) to total assets. Researchers like Hifz Malik [7] (2011) are among those who suggest that although there are different ways to measure profitability is better to use the ROA. "In addition to ROE as a performance measure of banks' [8] (ECB, 2010) is a study of the European Central Bank to analyze the capacity of banks to have sustainable profitability. This study favors the use of ROA rather than ROE, because ROE gives a limited view about profitability and performance.

When insurance companies create more revenue than expense, they are profitable. There are many authors who have studied the factors affecting the profitability of insurance companies, life and non-life insurance companies. Different authors have argued that factors such as liabilities and liquidities have a negative impact on the profitability of insurance companies [7]-[12]-[18]-[19]-[20] (Chen & Wong, 2004); (Malik, 2011); (Burca & Batrinca, 2014); (Onaolapo & Kajola, 2010); (Titman & Wessels, 1988). We conclude at the same point in our paper Factors affecting the profitabiltiy of insurance companies regarding the impact of liquidity and liability on the profitability of insurance companies in [2] (Kripa & Ajasllari, 2016). As for the growth rate our conlusion was consistent with the conclusio reached by international researchers; growth rate has a positive impact on the profitability of insurance companies in Albania [2]-[7]-[9]-[10] (Malik, 2011); (Yuqi, 2007); (Naveed, Zulfqar, & Ahmad, 2011) (Kripa & Ajasllari, 2016). Authors such as [11]-[12]-[1]-[3]-[7] (Omondi & Muturi, 2013); (Burca & Batrinca, 2014); (Al-Shami, 2013); (Swiss Re, 2008); (Malik, 2011) had argue that there is a positive relationship between the company size and the volume of

capital and the profitability of insurance companies. We reached at the same result, but the impact of company size and volume of capital were statistically insignificant [2] (Kripa & Ajasllari, 2016). As for fixed assets, authors had argued that fixed assets affect positively the profitability of insurance companies [7] (Malik, 2011). However, in our paper, 'Factors affecting the profitability of insurance companies in Albania', we reached the result that fixed assets have a negative impact on the profitability of the insurance companies in Albania [2] (Kripa & Ajasllari, 2016)

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THE ACTIVITY OF INSURANCE COMPANIES IN ALBANIA

Our country is facing many challenges during the period of economic transition, in an effort to adapt the best global practices in the development of economy and society in general. Insurance are considered as the modern ways of living. Albania has faced numerous problems in the development of the insurance sector. The insurance sector is a sector that has undergone significant growth in recent years. Despite this growth, Albania is still considered to have an underdeveloped insurance market, if compared with other countries in the region, which can be attributed largely to the citizens' lack of information about insurance products and services.

The insurance market plays an important role in the financial services industry in almost all developed and developing countries, contributing to economic growth, allocating efficient resources, reducing transaction costs, creating liquidity, promoting investments and distribution of financial losses [13] (Das, Davies, & Podpiera, 2003). Albanian insurance market is still small and underdeveloped, where gross premiums signed amount to about 0.66% of the Gross Domestic Product (GDP) [14] (The World Bank, 2014). The development of this sector has encountered obstacles due to shortcomings in the regulatory framework of the insurance, low available income, poor performances in compensation cases and lack of public trust in insurance companies. To support this argument, it is sufficient to mention that UK spent an average of $ 7,000 per capita on insurance, while in Albania GDP per capita is only $ 8.200 [15] (Madani, Muharremi, Ramaj, & Pelari, 2014). Other indicators such as high unemployment rate of 12.5%, the fact that around 25% of the population are close to the poverty reinforce the idea that the main factor of development of non-life insurance sector is the level of economic development.

Activity of insurance companies in Albania is based on Law No. 8081 "On the insurance and reinsurance activity" dated 07.03.1996 [16] (AMF, 2013). However, the program of evaluation of the financial sector developed by the International Monetary Fund (IMF) in Albania, has concluded that the legal and regulatory framework for insurance companies in our country is only partially adapted to the requirements of the International Board of Surveillance of Insurance Companies. This gap has led to a price "war" between local companies for basic products. This fact leads to a decline in the volume of written premiums, increased exposure to risk and that has a negative impact on profitability. In addition, all these affect the treatment of the insurer in cases of damage [14] (The World Bank, 2014). At this point, it would be important that at least the general conditions, which include the rights and obligations of the parties, be standardized [17] (Sharku, Leka, & Bajrami, 2011). However, the insurance sector in our country is also facing a number of difficulties such as:

1. The insurance market in our country is incomplete, small, where insurance companies cannot provide high rates of return or an increase in the number of clients. In addition, the Albanian market is a small market and there it has not sufficient capacity to collect huge funds, and lack of capital market decreases investment opportunities.
2. The insurance sector is one of the sectors where is mostly noticed the absence of rating agencies, which are specialized in risk assessment and risk classification. Given that the incomes and savings of the majority of the population are low, it is difficult for a person who manages to spare to think about these policies as investment opportunities, also because of the lack of estimates for their reliability. It is almost impossible for one individual to have knowledge of the financial position of insurers and therefore, the presence of the rating agencies is necessary.
3. Lastly, but no less important, is the mentality of Albanian investors, which differs greatly from the mentality of European investors. Albanians does not like to think about an investment, which will be linked to a possible disaster that could happen in their future life.

MULTIPLE PANEL REGRESSION ANALYSIS

In order to achieve the objective of this paper, we have used multiple regression tools. We will test multiple regressions models, so we can define which model best assess the impact of growth rate, liability, liquidity, company size, volume of capital and fixed assets on the profitability of insurance companies, represented by ROA. Before showing the result of the regression analysis, we should highlight some features of this regression. The fact that the panel data used in this paper is unbalanced also affects the construction of the model. An unbalanced panel presents some limitations in estimating the regression since it cannot be used random- random and fix-random alternations. However, we choose to work with an unbalanced panel to maintain the efficiency of the data, without balancing them artificially. The estimates of panel regression are shown below.

Normality of data

Before we test the regression model, we will test the normality of the data. Normality of data indicates whether they have a normal distribution. Normality of data is very important, because if the data do not answer the these lawfulness they cannot be subject to the normal distribution tests like Fisher test, the student test or hi square test [21] (Lane, 2010). Below we present a table summarizing the normal testing of the data used in this paper through the unitary roots test. Unitary root test provides some statistics to assess the normality of data distribution.

Tested hypotheses:
H0: Data have unitary root (non-normal distribution)
H1: Data does not have unitary root (normal distribution

	Levin, Lin& Chu t	**P**
ROA	-46.6487	0.0000 *
Company size	-3.69825	0.0001 *
Volume of capital	-5.58992	0.0000 *
Liabilities	-6.66060	0.0000 *
Fixed assets	- 5.04333	0.0000 *
Liquidity	-6.05929	0.0000 *

Growth rate	-13.1648	0.0000 *

Source: Generated from E-views 7
* 1% reliability

Table 6: Unitary root test results

From the table above we notice that H0 is rejected for all variables, so they have a normal distribution with a reliability level of 1%. Once we provide for normal distribution of data, we can continue with further evaluation.

Fixed Panel effects Model
The first model is the estimated fix-fix model. The following table presents the main features of this model.

Variable	**Coefficient**	**Standard deviation**	**t- statistic**	**P**
C	-2.159038	2.210830	-0.976574	0.4008
Company size	-0.466551	1.217497	-0.383205	0.7271
Volume of capital	0.592852	1.227833	0.482845	0.6622
Liabilities	-0.018908	0.319551	-0.059170	0.9565
Liquidity	-0.011707	0.009925	-1.179575	0.3232
Growth rate	-0.134778	0.125917	-1.070365	0.3629
Fixed assets	0.108536	0.867498	0.125114	0.9083
R^2	0.946501		**Adjusted R^2**	0.661170
Fisher	3.317212		**P. Fisher**	0.176120*****

Source: Generated from E-views 7
*****20% reliability

Table 7: Fixed effect model

As we can see from the table above, the model is statistically significant (F = 3:32) and has a very high determination of 94.7% (R2 = 94.7). However, all independent variables result to be insignificant. This phenomenon where the model is significant, but most of the variables are statistically insignificant is an indication that the model suffers from multicollinearity. In order to determine if our model suffers from multicollinearity we will use the VIF statistic. The table below contains the results of this test.

Variable	**Variance coefficient**	**VIF**
Company size	0.089481	1343.826
Volume of capital	0.094281	1222.982
Liabilities	0.011987	93.45002
Liquidity	7.63e-06	7.120137
Growth rate	0.004587	1.661733
Fixed assets	0.021968	2.815110

Source: Generated from E-views 7

Table 8: VIF test of multicollinearity.

VIF value indicates the presence of multicollinearity. VIF value of less than 10 indicates that the model is free from multicollinearity and VIF value greater than 10 indicates that the model

suffers from multicollinearity [22] (Schewrt, 2010). Variables such as company size, the volume of capital and liabilities has high VIF value, which proves that our model suffers from multicollinearity. Multicollinearity is a problem, which we expected to appear in the model, as the correlation analysis showed a strong correlation between some of the independent variables (company size and volume of capital) [2] (Kripa & Ajasllari, 2016). Through successive tests we will try to find, the model, which best explains the relationship between independent variables and ROA.

Random effects model

The model above had high determination and was statistically significant, but suffered from multicollinearity. To create a better model, we removed from the model the two variables, which had an almost perfect positive correlation with each other (company size and the volume of capital, 0.95) [2] (Kripa & Ajasllari, 2016). The second model features appear below.

Variable	**Coefficient**	**Standard deviation**	**t- statistic**	**P**
C	0.135407	0.035295	3.836457	0.0016*
Liabilities	-0.058071	0.014954	-3.883327	0.0015*
Liquidity	-0.004857	0.002261	-2.148429	0.0484**
Growth rate	0.083176	0.055848	1.489344	0.1571*****
Fixed assets	-0.252063	0.099796	-2.525795	0.0233**
R^2	0.555818		**Adjusted R^2**	0.437369
Fisher	4.692485		**P (Fisher)**	0.011751**
Durbin Watson	1.947997			

Source: Generated from E-views7

* 1% reliability, **5% reliability, ***** 20% reliability

Table 9: Random effects model

The above model is statistically significant (F = 4.69) and there has very high determination of 56% (R2 = 0:56). The coefficient of determination shows that 56% of the variation in the profitability of insurance companies in our country is explained by the variation of the independent variables in the model. Independent variables such as fixed assets, liabilities and liquidity have a statistically significant negative relationship with profitability. Variable such as growth rate has a positively statistically significant relationship with profitability of insurance companies in our country. The model above shows that an increase in liabilities, liquidity and fixed assets will cause a decrease in the profitability of insurance companies, and an increase in the growth rate of the companies will cause an increase in their profitability. Respectively, an increase of 1% on liabilities will bring a reduction of 5.8% on ROA; an increase of 1% on liquidity will induce a decrease of 0.5% on ROA, an increase of 1% on fixed assets of insurance companies would cause a 25% reduction of their ROA and an increase of 1% in the growth rate will cause an increase of 8.3% on the profitability of insurance companies.

Before we accept this model as the best exponent of the profitability of insurance companies in our country, we will conduct some tests. These tests will show whether our model suffers from multicollinearity, heteroscedasticity and autocorrelation.

Multicollinearity

To test the presence of multicollinearity, we will use again VIF and the results are shown in the table below.

Variable	Variance coefficient	VIF
Liabilities	0.000130	2.584063
Liquidity	0.016048	2.175824
Growth rate	0.004129	1.557554
Fixed assets	0.016048	1.442117

Source: Generated from E-views 7

Table 10: Multicollinearity Test

From the table above we see that VIF value, for all the independent variables, is less than 10, so we can say that our model is free form multicollinearity.

Heteroscedasticity

Heteroscedasticity presence indicates that one of the basic assumptions of linear regression model, constant variance, is not respected, therefore, that assessments made based on this model are not true. The presence of heteroscedasticity therefore no constants variance is a significant problem for a regression model. Below we will test our model through heteroscedasticity test. The tested hypotheses are:
H0: Model does not suffer from heteroscedasticity
H1: The model suffers from heteroscedasticity

Test	F- Statistic	Prob F
Breusch- Pagan	0.229795	0.9174
Gleiser	0.211708	0.9279
White	1.304283	0.4111

Source: Generated from E-views7

Table 11: Heteroscedasticity test

From the table above we notice that the three tests conclude that H0 cannot be rejected, so our model does not suffer from heteroscedasticity.

Autocorrelation

Autocorrelation is another important problem of linear regression, in which models residual are dependent on their selves with time delays. From the data of the table below, we see that the Darvin- Watson statistics (DW) has a value of 1.95, which is close to 2, so this shows that our model does not suffer from autocorrelation. Another test used to prove that our model is free from autocorrelation is Breusch- Godfrey test. Its results together with the hypotheses tested appear below.
H0: Model does not suffer from autocorrelation
H1: The model suffers from autocorrelation

Time lag	F Statistic	Prob F
1 lag	3.27e-05	0.9955
2 lag	2.260743	0.1437

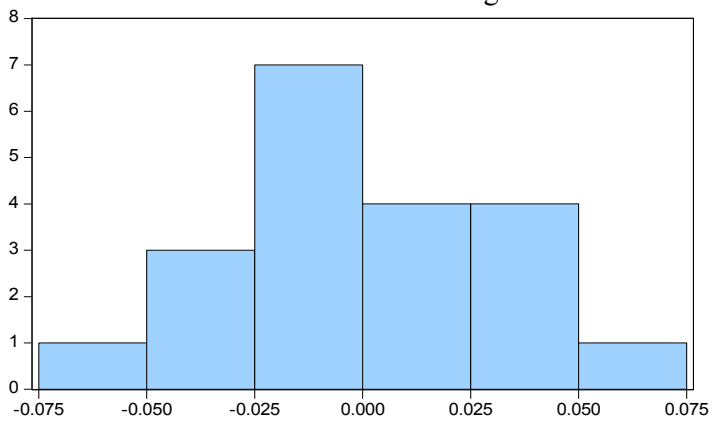
Source: Generated from E-views 7

Table 12: Autocorrelation Test

From the results above, we see that H0 cannot be rejected, so our model does not suffer from autocorrelation.

Residuals Normality

Another important characteristic of the linear regression model is a residuals normality. If residuals are not normally distributed, they cannot be subject to the normal distribution tests (Fisher, student t, etc.). Another problem that occurs when residues are not normal distributed is that this is also an indication that the dependent variable or one of the independent variables are not appropriate for the normal distribution tests. To test the normality of residuals for our regression model will test the residual histogram.



Source: Generated from E-views 7

Figure 14: Residuals Histogram

As we can see from the picture above, even from the histogram, even from S and K statistics, residuals are normal distributed.
Overall, our multiple linear regression model with panel data is a good model, because it has a high determination, is statistically significant and doesn't suffers from multicollinearity, autocorrelation, and heteroscedasticity.

Hausman test

Hausman test is used to select which of the panel data models, fixed effects model or random effects model, is the most appropriate, to determine the variation of the dependent variable (ROA) through the variation of the independent variables. Hausman test is always conduct on a random effects model, and therefore in our case Hausman test was conducted on the model (2). Tested hypotheses are:
H0: random effects model is more appropriate
H1, fixed effects model is more appropriate.

Test	**H square statistic**	**Probability**
Cross section random	10.320083	0.0354**

Source: Generated from E-views7
** 5% reliability

Table 13: Hausman test

Hausman test results show that H0 cannot be accepted ($p < 0.05$), suggesting that the fixed effects model is more appropriate to determinate the variation of the profitability of insurance companies in our country. However, despite that fixed effects model has higher level of

determination (R2 = 0.81), it presents problems that violate the basic assumptions of the regression model; so the model that best represents the variation of profitability of insurance companies in our country through the variation of the independent variables is the random effects model.

CONCLUSIONS

The objective of this work was to assess the impact of 6 internal factors; company size, volume of capital, fixed assets, liquidity, liabilities, growth rate; which affect the profitability of insurance companies in Albania. To achieve the objectives of the paper we used multiple regression analysis, for 7 companies operating in the Albanian insurance market during the period 2008- 2013.

Besides external factors, which influence the development of insurance companies in Albania as the poor culture of people regarding to the insurance market, lack of opportunities, there are also other factors, which depend on the decisions of the insurers and their behavior in the market. Albanian insurance companies are sometimes involved into price "wars", which distorts the market and undermines fair competition. On the other hand, the insurance market in Albania has a high degree of concentration, more noted in life insurance and less noted in the non-life insurance, which affects the efficiency of the sector and its profitability.

In this paper was studied the influence of factors such as company size, volume of capital, liabilities, liquidity, fixed assets and growth rate on the profitability of insurance companies in Albania (represented by ROA). The results of the multiple regression indicated that there was a statistically significant relationship between growth rate, liquidity, liabilities and fixed assets to the profitability of insurers, while the impact of factors of company size and the volume of capital was not statistically significant.

The coefficient of determination of 56% indicates that 56% of the variation in the profitability of insurance companies in our country is determinate from the variables explained above, while 44% of the variation in profitability is explained by external variables not included in the model.

Negative link between the level of liquidity and liabilities with ROA and the positive relationship between growth rate and ROA, demonstrated by this paper are consistent with the hypothesis raised at the beginning of the paper.

High level of liquidity reduces investments, which can be realized with these funds, negatively affecting the profitability of insurers. High level of liabilities exposes the insurer facing solvency risk, negatively affecting its profitability.

Growth of gross subscribed premiums, which represent the growth rate of the insurance companies, has positive impact on the profitability. The growth of written premiums, strengthens insurers position in the market, makes it more competitive and better able to take advantage of new opportunities, affecting positively on their profitability.

The result of the paper did not confirm the hypothesis rose that fixed assets positively affect the profitability of insurance companies in our country. The regression model showed that fixed assets had a negative correlation with ROA of insurance companies in our country.

Despite that statistically insignificant, variables such as company size and the volume of capital had a positive impact on the profitability of insurers in our country, which is consistent with the hypothesis raised at the beginning of the paper.

Insurance companies in Albania must consider the impact of internal factors in their profitability. Internal factors depend on the decisions of the company itself, and thus by optimizing their decisions, companies can maximize their profitability.

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