# TOWARDS THE IMPROVEMENT OF FINANCIAL PERFORMANCE OF THE INSURANCE SECTOR IN ALBANIA

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**Abstract**
This paper explores the impact of a company's performance on the economy, with a focus on Albanian insurance companies and their importance in the non-banking financial sector. The paper aims to analyze the profitability of these companies by examining various internal factors such as company size, capital volume, liabilities, liquidity, growth rate, and fixed assets, with a specific focus on their return on assets (ROA). To achieve this objective, the paper uses quantitative methods to study the relationship between these variables. The sample comprises 10 companies in the Albanian insurance market, including both life and non-life insurers, studied between 2014 and 2021. The results show that only company size has a positive impact on profitability, while not all other variables were significant, irrespective of their direction. Ultimately, the paper demonstrates that a company's good performance can positively affect the economy in which it operates.

**Keywords**
Insurance market, ROA, company size, capital volume, liabilities, liquidity, fixed assets, and profitability.

**JEL Classification**
C12, C23, G22, M21, L25

## Introduction

Insurance companies rely on contracts with individuals and organizations to provide compensation in case of unforeseen events. The funds collected through these contracts are the foundation of the insurance industry. A company's success in the market is crucial for the overall growth of the economy. However, assessing the performance of an insurance company is a challenging task in the financial world. Since the primary objective of management is to increase shareholders' wealth, profitability is a crucial factor in determining a company's performance. Therefore, measuring and evaluating

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the profitability of an insurance company is one of the most critical aspects of financial analysis. (Malik, 2011).

The main objective of this research paper is to investigate and present the factors that impact the profitability of the insurance market in Albania. The study aims to identify the relationship between these factors and the profitability of insurance companies. The research question is:

"What are the key factors that determine the performance of insurance companies in Albania?"

To answer this question, the paper employs quantitative methods to evaluate the effects of these factors on the profitability of insurance companies. The paper also includes a qualitative analysis of data and results, drawing on the experiences of other countries and the practices in Albania.

The paper is structured as follows: The introduction outlines the aims and objectives of the study, as well as its limitations. The second section reviews the literature on the concept of profitability and the factors that affect the profitability of insurance companies. The third section describes the research methodology, including the nature of the research and the hypotheses developed. The fourth section presents the analysis, evaluation, and interpretation of the research results and provides an overview of the insurance market in Albania. The final section summarizes the key findings and offers recommendations for the insurance market stakeholders and future research in this area.

## 1. Review of the scientific literature

### *1.1. Historical landmark*

During the extended period of economic transition, Albania has encountered various obstacles in adopting the best global practices to advance its economy and society. The insurance industry is recognized as a modern way of life, and Albania has faced numerous difficulties in progressing the sector amid the challenging pursuit of development. Although the insurance sector experienced considerable growth until 2019, it has since declined. Despite these fluctuations, Albania's insurance market is still considered underdeveloped compared to other countries in the region. This can be mainly attributed to citizens' lack of knowledge about insurance products and services.

In 1900, the insurance industry was introduced to Albania by several foreign agencies, including Lloyd's and Societa Assicurazione Generale Fiume, which had branches in Tirana and Durrës. These English, French, and Italian companies contributed to establishing a culture of insurance as a necessary practice. They focused their activities in the main cities, mainly on industrial, construction, accident, life, and natural disaster insurance. After World War I, additional foreign companies, primarily from Italy, entered the market, such as Assicurazione Generale and Reunione Adriatica. This period saw the emergence of new types of insurance, including mandatory state housing insurance, voluntary insurance for property, buildings, and real estate, voluntary insurance for crops and livestock, voluntary life insurance against disasters, and insurance for mandatory imported goods. Despite being a part of the financial market, the insurance market in Albania developed relatively late.

Between 1948 and 1965, Albania introduced new insurance types, including mandatory insurance for state-owned housing rented to tenants, compulsory passenger insurance, voluntary insurance for property, real estate, crops, livestock, disasters, household items, former agricultural cooperatives, citizens' organizations, living things, and compulsory insurance for imported goods, ships, and transshipment (formerly international transport enterprise). During this period, the only financial institution dealing with citizens' savings and insurance for cooperatives and import-export enterprises was the State Institute of Savings and Insurance Banks. After the primary pluralist parliament was created on July 31, 1991, two new financial institutions were established: the Savings Bank and the Insurance Institute (INSIG), separating from the State Institute of Savings and Insurance Banks. This was when Albania transitioned from a centralized economy to a free-market economy, with private property and the principle of free economic initiative prevailing.

### *1.2. Insurance in the literature*

The profit of insurance companies is primarily determined by operational performance (losses and expenses, which are dependent on product prices, risk assumed, complaints management, and expenses administrative and marketing); and secondly by investment performance, which depends on asset allocation and asset management (Swiss Re, 2008). The term profit can be used both in the economic concept and in the accounting concept, to show the excess of income over expenses for a certain period. There are several ways to measure profitability such as return on assets (ROA), return on equity (ROE), and return on investments (ROI). Malik (2011) suggests that although there are different ways to measure profitability, it is better to use ROA.

The profitability of insurance companies can be affected by a large number of factors, which can be classified as internal factors, industry factors, and macroeconomic factors. Many foreign authors have studied the factors that affect the profitability of insurance companies, both life, and non-life companies. Kozak (2011), Angoff & Brown (2007), Al-Shami (2013), Swiss Re (2008), etc. have examined the variables impacting the performance of non-life insurance companies. Others, Wright (1992), Sandra, Lianga, and Desheng, (2007), Adams, Hardwick, and Zou (2008), etc. have considered the factors influencing the performance of the insurance market. Most of these researchers, both for life and non-life insurance companies concentrate on firm-specific factors, with an emphasis on the size of the company, the ratio of liabilities, the age of the company, the rate of growth, capital size, asset sensitivity, and liquidity ratio. Çekrezi (2015), on the influences that affect the profitability of insurance firms in Albania, the influences taken into the study were the level of debt, stable assets, monetary assets, the size of the company, and company risk. The study concluded that the level of debt and risk of the company have a statistically significant negative relationship with profitability; the volume of fixed assets has a statistically significant positive relationship with the profitability and size of the company, and monetary assets do not statistically impact the profitability of insurance companies in Albania.

Numerous factors, such as total assets, the number of employees, or the number of branches, can be used to describe the size of the business. The majority of scholars in the field (Swiss Re, 2008); (Omondi & Muturi, 2013); (Al-Shami, 2013); (Çekrezi, 2015) (Burca & Batrinca, 2018); use total assets to indicate firm size (Malik, 2011). The size of the organization is taken into consideration when researching because studies have shown that bigger businesses are more advantageous because of their stronger market positioning and ability to take advantage of economies of scale (Flamini, McDonald, & Schumacher, 2015). The majority of researchers have found a statistically significant positive association between company size and profitability, as measured by the Return on Assets (Swiss Re, 2008; Malik, 2011; Al-Shami, 2013). The ideal size of the business, which favorably impacts profitability, is a topic of discussion. Due to increased bureaucracy, size over the ideal company size might have detrimental impacts (Yuqi, 2007).

For insurance companies, liquidity indicates the ability of the insurer to pay short-term obligations. Cash flows from net premiums, investment returns, and asset sales are the key sources of liquidity. (Chen & Wong, 2014). Many studies use the current ratio (current assets/current liabilities) to measure liquidity as a factor impacting profitability. Regarding the relationship between the liquidity and profitability of insurance firms, the conclusions of many studies have been inconsistent. Numerous studies have found no statistically significant relationship between the liquidity and profitability of insurance companies (Naveed, Zulfqar, & Ahmad, 2021), whereas other research demonstrates a statistically significant inverse link between profitability and liquidity (Chen & Wong, 2014).

The total amount of borrowed money that a company has utilized to finance its operations is known as its liabilities. When analyzing the profitability of insurance companies, researchers express the liabilities element using the liabilities-to-capital ratio. We assume that liabilities and profitability have a positive relationship since debt has an impact on profits. Incentives from the government force businesses to use liabilities. The profitability of businesses rises as liabilities rise up to an ideal point, according to theories of optimal capital structures, and subsequently declines as liabilities rise past this point. Beyond a certain point, increasing liabilities increases the company's risk and lowers its value. (Chen & Wong, 2014). Nevertheless, Malik (2011), Omondi & Muturi (2013), Chen & Wong (2014), and Burca & Batrinca (2018) prove that the profits of insurance firms and their liabilities have a statistically significant inverse relationship. Titman & Wessels (1988) determined that the profitability of US insurance companies and the amount of liabilities had a statistically significant inverse relationship. This result is justified by the fact that greater debt ratio insurance businesses have lower Returns on Assets but higher Returns on Equity, in accordance with capital structure theories. (Harrington, 2015). Numerous kinds of research on the elements influencing the profitability of insurance firms demonstrate a favorable correlation between corporate performance and the amount of capital (Malik, 2011; Al-Shami, 2013).

The ratio of fixed assets to total assets serves as an indicator of long-term assets. The findings about how fixed assets affect insurance businesses' success are contradictory. Fixed assets and the profitability of insurance firms are statistically related, according to Malik (2011) in his study on the factors influencing insurance company profitability in Pakistan 2011. According to him, the insurance firm will be larger and more profitable the higher the proportion of long-term assets to overall assets. However, a study done by Yuqi (2007) found no statistically significant link between fixed assets and insurance company profitability.

The percentage change in the company's total assets from one year to the next is how firms measure their growth rate. The percentage change of the total premiums written by insurance firms is how insurance companies measure their growth rate. According to empirical research, there is a statistically significant link between a company's growth rate and its profitability (Curak, Pepor, & Poposki, 2017; Malik, 2011; Yuqi, 2007). The fact that a corporation always has more resources to perform better is another argument for this connection. A strong growth rate, however, may occasionally expose a company to a higher level of risk and necessitate increasing technical reserves, therefore the relationship between the company's growth rate and the need to do so may not be as favorable as initially thought (Burca & Batrinca, 2018).

## 2. Research methodology

The methodology utilized in a research study is crucial for achieving its objectives. To attain the objectives of this paper, an analysis of the factors that impact the profitability of insurance companies in Albania will be conducted using quantitative data and the creation of an econometric model through the Eviews10 program. The data used in this research study are secondary data, obtained from reliable sources such as the National Business Center and annual reports of insurance companies. The timeframe for this study ranges from 2014 to 2021. To reach the objectives of this paper, a regression model using panel data will be created to demonstrate the relationship between the profitability of insurance companies in Albania and the variables that affect it. The dependent variable in this model is the profitability of insurance companies, represented by ROA. The independent variables are company size, capital volume, liabilities, fixed assets, liquidity, and growth rate, which represent the factors that impact the profitability of insurance companies. The regression model is as follows:

$$ROA = \alpha + \log size + \log cap.vol + \frac{D}{E} + \frac{FA}{TA} + Liq + gr.rate + \mu \qquad (1)$$

where:

ROA- Net Income to total assets
α- constant
Size - the size of the company expressed by total assets in logarithmic value
Cap. vol - the volume of capital expressed by the accounting value of capital in logarithmic value
D/E - liabilities as expressed by the ratio of liabilities to equity

FA/TA - fixed assets expressed by the ratio of fixed assets to total assets
Liq - liquidity expressed by the current ratio
Gr.rate- growth rate expressed by the change in the percentage of gross signed premiums
$\mu$ - the error term

The following hypotheses are raised to answer the research question:

H1: There is a significant statistical positive relationship between the size of the insurance companies in Albania and profitability

H2: There is a significant statistical positive relationship between the volume of capital and the profitability of insurance companies in Albania

H3: There is a significant statistical negative relationship between liabilities and profitability of insurance companies in Albania

H4: There is a significant statistical positive relationship between fixed assets and the profitability of insurance companies in Albania

H5: There is a significant statistical negative relationship between the liquidity and profitability of insurance companies in Albania

H6: There is a significant statistical positive relationship between company growth rate and profitability of insurance companies in Albania.

The rationale for ROA:

The profitability of a bank is usually evaluated using the ROA indicator, which measures how efficiently a company uses its assets to make profits. Several factors can contribute to a bank's low ROA, such as ineffective allocation of financial resources and projects, asset depreciation, and high general expenses (Cristea et al., 2021). However, this study has some limitations, primarily due to the lack of sufficient data. The first limitation is the incomplete financial information on insurance companies operating in Albania. The second limitation is the scarcity of scientific literature in this area in Albania that could be used as a reference or comparison. The third limitation is that this study only focuses on internal factors influencing the profitability of insurance companies and does not consider macroeconomic factors. Future studies should take external and macroeconomic factors into account to provide a more comprehensive analysis.

## 3. Results and discussions

Table 1 presents the results of descriptive statistics for the factors affecting the profitability of insurance companies and for profitability itself, represented by ROA, taken in total both for the cross section and for the period.

**Table no. 1. Descriptive statistics**

| | CAPITAL | COMP. SIZE | DURABLE ASSETS | LIABILITIES | LIQUIDITY | ROA | THE GROWTH RATE |
|---|---|---|---|---|---|---|---|
| **Mean** | 8.973782 | 9.431953 | 0.239390 | 0.558527 | 1.527944 | 0.071339 | -0.114331 |
| **Median** | 8.915224 | 9.449392 | 0.169962 | 0.568391 | 1.414952 | 0.085846 | -0.070588 |
| **Maximum** | 9.625944 | 10.01517 | 0.944877 | 0.865882 | 6.071289 | 0.337471 | 0.349266 |
| **Minimum** | 7.717704 | 8.846147 | 0.000000 | 0.088857 | 0.096694 | -0.249843 | -0.812196 |
| **Std. Dev.** | 0.336500 | 0.305245 | 0.204019 | 0.173119 | 0.818609 | 0.101291 | 0.209482 |
| **Obs.** | 80 | 80 | 80 | 80 | 80 | 80 | 80 |

*Source:* Authors' calculations through EVIEWS 10 software.

The average annual profit margin of insurance businesses in our nation for the previous eight years was 0.07%, with a standard deviation of 0.1. The data show that there is a high variation in the profitability of the insurance companies studied. Table 2 also presents the data for the average value, the minimum and the maximum, the standard deviation, and the median, for the factors considered to influence the profitability of insurance companies in Albania. The average of 0.239 for fixed assets indicates that fixed assets constitute on average 23.9% of the total assets of the insurance companies studied. The standard deviation of 0.20 indicates that the variation of fixed assets among the companies studied is somewhat sensitive. For the liabilities factor, the average of 0.558 shows that for the insurance companies studied, the liabilities exceed approximately 0.6 (0.558) times the capital. The standard deviation of 0.17 indicates that there is a moderate variation among the companies studied for this factor. The company size factor has an average of 9.4, which shows that the total assets are on average 12,481 ALL, and a standard deviation of 0.3, which shows that there is a substantial fluctuation between the companies under study for this factor. The capital volume factor has an average of 8.97, which shows that the average capital volume of insurance companies is 7,893 ALL, and a standard deviation of 0.33, which shows that this factor also has a significant variation among the companies studied. The liquidity factor has an average of 1.5, which shows that the companies in the study cover on average 1.5 times their short-term liabilities from short-term assets. The standard deviation of 0.8 indicates that there is moderate variation among the insurance companies considered for this factor. The growth rate factor has an average of - 0.11, which shows that the gross premiums of the insurance companies under consideration have decreased by an average of 11% during the period 2014-2021, while the maximum increase reaches 34% and the minimum decrease to 81 %. The standard deviation of 0.2 indicates that there is a somewhat great difference among insurance firms for this variable.

The developed model explains the variations of the dependent variable by 16.8%, as seen in the table 2, and is statistically significant across the board ($F=2.4$ and $p<0.05$). Considering this, the model can be used to make predictions.

**Table no. 2. Regression outcomes**

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| **C** | -0.984788 | 0.365567 | -2.693869 | 0.0088 |
| **CAPITAL** | -0.036864 | 0.068482 | -0.538298 | 0.5920 |
| **COMPANY SIZE** | 0.149476 | 0.073137 | 2.043777 | 0.0446 |
| **DURABLE ASSETS** | -0.138472 | 0.08111 | -1.707207 | 0.0920 |
| **LIABILITIES** | -0.031711 | 0.139745 | -0.226922 | 0.8211 |
| **LIQUIDITY** | 0.01728 | 0.023825 | 0.7253 | 0.4706 |
| **THE GROWTH RATE** | -0.013496 | 0.053988 | -0.249984 | 0.8033 |
| **R-squared** | 0.167943 | | Adjusted R-squared | 0.0995 |
| **F-statistic** | 2.455729 | | Prob(F-statistic) | 0.0321 |

*Source:* Authors' calculations through EVIEWS 10 software.

If we analyze the variables, we see that only company size is significant and positively impacts ROA. Hence, H1 is accepted. All the other variables' results are insignificant, meaning that their impact on ROA is not statistically significant. This rejects the H2, H3, H4, and H5.

The insurance market in Albania is a diversified market, where several companies operate that have a wide reach throughout the territory of the country (Zyka & Stringa, 2010). Also, the products and services offered by insurance companies are diverse, including about 23 categories of services such as life insurance, property and vehicle insurance, fire and natural forces insurance, accident insurance, etc. (Petraj, 2013). Despite this fact, according to the descriptive analysis, the insurance companies under study had average profitability between 2014 and 2021 of 0.7%. So, the average profitability of insurance companies in Albania is negative when the maximum profitability for the period does not exceed 34% and where the minimum profitability for the period is -25%, an extremely negative result. However, the standard deviation of 0.1 indicates that there are no appreciable disparities in the profitability of the Albanian insurance businesses included in the study due to the small variation in profitability among them. The fundamental cause of this outcome is that Albania's insurance industry is still modest, immature, and mostly focused on mandatory insurance (Sharku, Leka, & Bajrami, 2015). The insurance market in Albania is still suffering from unfair competition, administrative costs for legal processes that are too high, setting prices below cost to artificially increase market share, and abusive marketing, which express their impact and negative profitability of insurance companies (Petraj, 2013).

## Conclusions

This paper aimed to examine the impact of internal factors on the profitability of insurance companies in Albania by utilizing panel techniques to analyze data from 10 companies operating in the Albanian insurance market between 2014 and 2021. The study revealed that the profitability of insurance companies in Albania has been unstable due to various factors, including external factors such as low citizen engagement with insurance, a small market with limited opportunities, and internal factors such as the behavior of insurance companies in the market. Furthermore, the Albanian insurance market has a high level of concentration, particularly in life insurance, which affects the sector's efficiency and profitability.

The purpose of this study was to investigate the effects of various factors, such as company size, capital volume, liabilities, liquidity, fixed assets, and growth rate, on the profitability of insurance companies in Albania. The profitability was measured using ROA. After analyzing the data using multiple regression analysis of the panel, it was found that only the size of the company had a positive impact on profitability. The remaining variables, regardless of their direction, were not found to be significant.

It is recommended that insurance companies in Albania should avoid having extremely high levels of liabilities, as they negatively impact their financial performance and can lead to bankruptcy. Having the appropriate amount of liquidity is also crucial, as excessive liquidity can harm their profitability. The study found that the level of gross premiums has a positive impact on the profitability of insurance companies, but it should not be the result of a price war between competitors. Instead, it should be accompanied by an increase in the investor's capacity, providing suitable products, educating and advising the public on the importance of insurance. The study examined seven internal factors that explain the profitability of insurance companies in Albania, but considering external and macroeconomic factors would provide a more comprehensive perspective on the factors affecting their profitability.

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