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THE IMPACT OF INSURANCE REFORM ON UNDERWRITING AND CLAIMS MANAGEMENT OF SELECTED INSURANCE COMPANIES IN NIGERIA

Onuoha, Chinedu Donatus [1], Ezeaku, Faith Onyedikachi [2]

Department of Department of Insurance [1& 2]

School of Financial Studies, Federal Polytechnic Oko, Anambra, Nigeria
E-mail: eduonuoha@yahoo.com. Phone Number: +23408064553995 [1]
E-mail:ezeakufaith06@gimail,com. Phone Number: +23408036167373 [2]

Abstract: This study assesses the pre and post 2006 recapitalization impact on the underwriting and claims management of selected insurance companies in Nigeria. The study is descriptive in nature and used secondary data contained in the annual reports and accounts of the selected insurance companies. Regression analysis was employed in analyzing the data. The findings from the study revealed that recapitalization has not impacted significantly on the underwriting and claims management of the selected insurance companies in Nigeria both before and after the 2006 recapitalization. Even though there are some indications for improvements in absolute average profit figures during the post recapitalization, the increase of the share capital base of insurance companies in Nigeria does not commensurate with the level of profitability achieved as a measure of underwriting and claims management by the companies. It is recommended that insurance companies should be more professional in designing insurance policies that will meet the need of average Nigerians with affordable cost and also be aggressive towards securing bigger and better insurance contracts so that the increased share capital base could be efficiently and effectively utilized. In addition, the insurance regulatory body in Nigeria should always consider the risks, uncertainties, and opportunities surrounding the insurance industry and employ scientific procedure in arriving at a particular recapitalization policy.
Keywords: Recapitalization, underwriting and claims management, selected insurance companies, share capital, reserves

Introduction

Financial services form a major basis upon which economic of a nation depends. Insurance is a financial service that performs risk transfer function which seeks to stabilize economic of a nation against fortuitous risks. The recapitalization of insurance sector was one of such strategies employed by government to ensure that adequate resources is available for the players in insurance industry towards expanding their risk underwriting capacity and meeting of their promise of prompt claims settlement as at when due. Nigerian government recapitalization reform in the insurance industry is aimed at restoring confidence of the public in the market and enhances international competitiveness of local operators (Ibrahim & Abubakar, 2013). The principal objective of the recapitalization of the insurance industry is to have emergence of bigger and stronger players in the industry with enhanced capacity (Chukwulozie, 2008). It is believed that when the capital base of an organization is increased, the potentiality of achieving efficiency and growth could also be increased which would have effect on underwriting and claims management of insurance companies.

The sellers and suppliers of insurance are the insurance companies and reinsurance companies. Nigerian insurance companies were established to provide insurance cover for life insurance and non-life insurance. While the Life insurance companies provide cover against risk of life, annuities and pension funds administration services, the non-life insurance on the other hand provides protection against risk of loss or damage to property (Hamadu and Majekwu, 2010). The Nigerian insurance industry has grown tremendously over the years, with the number of insurance companies standing at 181 by the end of 1997. The insurance industry is regulated and supervised by the National Insurance Commission (NAICOM).

The Nigerian insurance industry before the 2006 recapitalization was triggered by the decline in the industry's goodwill. This was exemplified by shrinking market share leading to significant fall in gross premium income of all insurance companies in Nigeria. The Nigerian insurance companies have lost much premium especially in 1999 to 2000, in the sense that the premium fell from N14.79 billion to N1.58 billion as at the end of 2000 (NIA, 2004).

Before the recapitalization periods of 2003 and 2005 the Insurance Industry was characterized by the following: Under capitalization of existing industry players; Dearth of appropriate human capital and professional skill; Poor returns on capital; Existence of too many fringe players; Poor asset quality; Prominence of unethical practices; Significant corporate governance issues; Insurance Premium Flight; Poor business infrastructural facilities especially in the area of ICT; Lack of Innovation in product development; Lack of awareness; Lack of trust and confidence on the part of consumers on the uses/suitability of insurance products; Low GDP per capita figures; and Poor Corporate governance structures. These factors proved significant in restricting the companies from achieving any potential development (Chukwulozie, 2008).

The 2005 recapitalization exercise changed the landscape considerably as many companies were forced to merge in compliance with the follow-up directive of NAICOM that the requirements were only to be met through mergers and acquisitions. Following the completion of the 2005/2006 recapitalization exercise, which also involved quite a number of consolidations, the number of insurance companies dropped to 27 as at the end of 2009.

Do the quoted insurance companies have significant increase in their underwriting capacity and claims management to justify their current level of recapitalization? In order to find answers to the questions raised above, this study assesses the impact of recapitalization on underwriting and claims management of selected insurance companies in Nigeria. The study evaluates the pre and post 2006 recapitalization impact on the underwriting and claims management (as it affected their net profit after tax) of insurance companies thereby taken 2006 as recapitalization year.

Conceptual Review

Recapitalization

Recapitalization is the process of restructuring a company's debt and equity mixture, often to stabilize a company's capital structure. It is implicit that the Nigerian financial system is the major sector that underwent several transformations and reformations especially from 1999 to the present. Due to many identified weaknesses and obstacles inherent in the Nigeria's financial system, many strategies and policies were formulated and implemented, which are aimed at overhauling the system in general. The insurance industry is one of the components of the Nigerian financial system and reforms were introduced to enhance the operational performance of the companies in the industry. Recapitalization is the most notable reform introduced in the

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insurance industry. The companies operating in the insurance industry have their share capital base increased for about three times from the year 1999. However, the last increase in the share capital base occurred in the year 2006 and since then insurance companies witnessed tremendous increase in their capital base (Fatula, 2007).

Table 1: Capital Base for Nigeria Insurance Institutions

Category of Insurance	Old Capital Base (2003)	New Capital Base (2005)	Increase in Percentage (%)
Life insurance	150 million	2 billion	1,233.0
General insurance	200 million	3 billion	1,400.0
Composite	350 million	5 billion	2,633.0
Re-insurance	350 million	10 billion	2, 757.0

Source: Nigerian Stock Exchange Facts Book (2010)

The table above shows the old and the new capital base of the Nigerian insurance institutions with the percentage increases. Out of the 104 insurance companies and 4 re-insurance companies in existence before the pronouncement, 49 insurance and 2 re-insurance companies were certified by the government in November 2007, based on the new capital, insurers are to raise their capital according to the risks they underwrite. This is to enable insurer to concentrate on business in which they have core competences

Underwriting and claims

An effective underwriting and claims management program encompasses prevention of losses by taking precautionary measures as a key element in reducing risks and also a key driver of profitability (Fernandez, 2009). A good claims management program should be proactive in dealing with genuine claims, maximizing on recovery opportunities from salvage, subrogation and third parties, reporting regularly, minimizing unnecessary costs and reducing loss adjustment expenses (Productivity Commission, 2002). It also includes handling claims expeditiously, reviewing of costs associated with litigation, and monitoring expenses and, future payments plans in order to reduce on disputes and delays so as to reduce the insurer's expense (SAS, 2012; Calandro & O'Brien, 2004; Leverty & Grace, 2012; Baranoff et al., 2000. Qaiser (2013) notes that claims management also involves giving good service to claimants, who should be treated courteously. This will result in higher customer satisfaction, retention and policy renewals that are fundamental to profit and better financial performance. Poor handling of claims may lead to lose of confidence by policyholders leading to damaged reputation and poor performance.

Theoretical framework

Pecking Order Theory

The theoretical framework of this study was centered on the Pecking Order Theory.

The Pecking order theory was first suggested by Donaldson in 1961 and it was modified by Myers and Majluf (1984). Pecking order theory states that firms prefer to finance new investment, first internally with retained earnings, then with debt, and finally with an issue of new equity (Adekunle, 2009). It is argued that an optimal capital structure is difficult to define as equity appears at the top and the bottom of the 'pecking order'. Internal funds incur no flotation costs and require no disclosure of the firm's proprietary financial information that may include firm's potential investment opportunities and gains that are expected to accrue as a result of undertaking such investments

Empirical Literature

Oyekanmi (2015) focused on examined the perceived effects of Reform (Recapitalization) and product development on the patronage and retention of insurance products. He adopted descriptive and inferential in nature making use of frequencies and weighted scores for the research questions and Pearson coefficient of correlation and regression for the research hypotheses. His findings from the study revealed that reform and product development have significant influence on customers' patronage and retention of existing insurance customers.

Aduloju, Awoponle and Oke (2008) studied recapitalization, mergers and acquisitions of the Nigerian insurance industry. Survey sampling was adopted for the study while the data collected via the questionnaires was presented in a tabular form and analyzed with the use of simple percentage to make comparison of data easy. The Chi-square statistical procedure was used to test the true position of the issues raised in the hypotheses. The study found out that insurance and reinsurance companies that are perceived as safe and well managed in the market place is likely to obtain more favourable terms and conditions in its relationship with investors, creditors and other parties than one that is perceived as weak and riskier.

Narjess, Georges and Thouraya (2008) investigated consolidation and value creation in the insurance industry. Ex post facto was adopted as research design for the study while regression was used as the analytical technique. The study discovered that merger and acquisition create value in the long run as buy and hold abnormal returns are positive and significant after 3 years. While tender offers appear to be more profitable than mergers, the multivariate evidence does not support the conjecture that domestic transactions create more value than cross-border transactions. Furthermore, positive returns are significantly higher for frequent acquirers and in countries where investor protection is weaker.

Amachi (2011) carried out the impact of consolidation on the performance of the industry in Nigeria using PHB and NICON insurance plc as case studies. He used analysis of variance (ANOVA) statistical tool. This result showed that consolidation of the insurance industry has increased the sectors underwriting capacity and profitability.

Yusuf (2011) carried out on evaluation of the impact of the consolidation of insurance companies on economic growth and development in Nigeria. The main objective is to evaluate the impact of the insurance company's consolidation on the Gross Domestic product (GDP) in Nigeria. The econometric technique method of analysis was used and econometric model was based on capital assets pricing model (CAMP). This result showed that the gross domestic product (GDP) of the economy would increase by about 55 percent variation for a unit change in the consolidation policy, while holding other economic variables constant.

Methodology

This study is descriptive in nature and secondary sources of data were solely used as basis to the analysis of the impact of recapitalization on the underwriting and claims management of insurance companies in Nigeria. The population of the study comprises the twenty-seven (27) quoted insurance companies that were in operation as at 31st December, 2009. We only consider the insurance companies whose financial statements are available.

The selection of the number of quoted insurance companies to make up the sample size of the study was drawn scientifically using the Ralph, Holleran and Ramakrishnan (2002) formula as follows:

$$n = \frac{\log p}{\log \beta}$$

where: n = sample size

p = level of precision (i.e 100% *minus* confidence level)

β = Ratio of quoted insurance companies as at 2009 to the number of insurance companies prior to recapitalization.

In order to reduce the level of statistical error and attain the highest level of accuracy possible, 99% confidence level is selected, which gives a precision level of 1% (i.e. 0.01).

Therefore; $\beta = \frac{27}{71}$

$= 0.38$

In view of the above values computed, the sample size of this study is computed as follows:

$$n = \frac{\log p}{\log \beta}$$

$$= \frac{\log 0.01}{\log 0.38}$$

$$= \frac{-2}{-0.42}$$

$$= 4.76 \approx 5$$

From the above computation, five quoted insurance companies in Nigeria were selected at random and they are: AllCO, Standard, Crusader, Lasaco and Oasis.

The data used for this study were obtained from the annual reports and accounts of the quoted insurance companies for 2002 to 2009. The data so collected were analyzed using regression analysis via the use of SPSS statistical technique. The regression was used in the analysis in order to determine whether recapitalization has any significant impact on the underwriting and claims management of the selected Nigerian insurance companies. Four (4) years (2002, 2003 2004, and 2005) were considered as period prior to the recapitalization; while four (4) years (2006, 2007, 2008, and 2009) were considered as post recapitalization period. The study considered share capital and reserves as surrogates for recapitalization (independent variables); while profit after tax is used to represent underwriting and claims management (dependent variables). The regression equation is formulated thus:

$$PAT_0 = \alpha + \beta_1 SC_0 + \beta_2 RV_0 + e \quad \textit{(prior to recapitalization)}$$

$$PAT_t = \alpha + \beta_1 SC_t + \beta_2 RV_t + e \quad \textit{(after recapitalization)}$$

Where: PAT = Profit after tax

α = Intercept (constant)

SH = Share capital

RV = Reserves

β = beta coefficient

e = Statistical error

Data Presentation and Analysis

The following table presents the statistical data on profit after tax, share capital and reserves of the selected insurance companies in Nigeria; and the values therefrom for 2002 to 2009.

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Table 2: Statistical Data on Profit After Tax, Share Capital and Reserves

Companies	Year	Profit After Tax N'000	Share Capital N'000	Reserves N'000
AIICO	2002	133,089	150,000	1,374,184
	2003	183,221	350,000	2,301,465
	2004	72,519	350,000	2,612,860
	2005	81,810	700,000	3,570,071
	2006	483,702	1,332,765	4,537,199
	2007	304,709	1,873,757	4,437,220
	2008	4,051	3,485,337	7,143,092
	2009	231,347	3,520,082	7,609,170
STANDARD	2002	66,621	200,000	103,146
	2003	79,926	350,350	283,305
	2004	87,444	350,000	1,082,283
	2005	164,118	490,000	1,179,509
	2006	262,381	735,000	906,118
	2007	333,576	3,571,587	2,766,865
	2008	864,196	5,996,587	17,069,182
	2009	(5,859)	5,996,587	10,435,981
CRUSADER	2002	39,546	152,312	182,655
	2003	88,810	352,546	121,595
	2004	180,596	425,635	241,660
	2005	277,783	492,234	1,365,737
	2006	315,057	492,234	5,656,254

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	2007	1,446,931	1,994,710	6,378,870
	2008	(208,253)	2,054,822	2,566,361
	2009	(27,183)	2,260,304	2,333,696
LASACO	2002	86,519	105,000	436,293
	2003	108,558	210,000	407,663
	2004	97,552	360,065	835,451
	2005	141,389	500,000	840,304
	2006	171,531	604,910	910,538
	2007	678,111	3,601,717	2,484,380
	2008	364,931	3,601,717	2,320,027
	2009	487,638	3,661,717	2,385,548
OASIS	2002	37,362	100,000	56,031
	2003	56,327	350,000	82,618
	2004	114,639	350,000	155,257
	2005	123,438	545,415	121,420
	2006	113,548	545,415	189,614
	2007	138,165	2,501,753	958,224
	2008	(849,677)	2,501,753	620,977
	2009	(95,537)	2,501,753	525,440

Source: Annual Reports and Accounts of the Selected Insurance Companies; and Nigerian Stock Exchange Fact Book 2005, 2007 & 2009.

In table 1 above, years 2002, 2003, 2004 and 2005 are considered as period before recapitalization and presented based on company by company basis. Also, year 2006-2009 are the period after the recapitalization. The SPSS regression results obtained are presented in table 2 below:

Table 3: Regression Results Computed using SPSS

Variables	Prior to recapitalization	After recapitalization
R	0.430	0.454
R square	0.185	0.206
Adjusted R square	0.089	0.113
t statistics: SC	1.713	-0.953
RV	-0.018	2.034
Significant: SC	0.105	0.354
RV	0.986	0.058
Mean	111,063.4	250,668.3
SD	24,752.89	206,028.04

Source: SPSS Computed Results from Table 1

The results for both periods before and after recapitalization indicated weak correlations between recapitalization and underwriting and claims management of the selected insurance companies (since computed R in each case is < 0.875). However, there is an insignificant increase in the correlation coefficient during the period after recapitalization (0.024). The adjusted coefficient of determination (R^2) is computed as 8.9% and 11.3% for before and after recapitalization respectively. This means that 8.9% of the variations in the Nigerian quoted insurance companies' profitability as a result of underwriting and claims management are explained by the recapitalization.

The regression equation is reproduced using the t statistics coefficients as obtained from the analysis. For the period before the recapitalization, the regression equation is represented thus:

$$PAT_0 = 1.888 + 1.713\ SC_0 - 0.018\ RV_0$$

The regression equation above shows that the underwriting and claims management of selected insurance companies is positively related to share capital and negatively related to reserves during the period before recapitalization. During this period, a unit increment in the share capital tends to increase the profit after tax by 1.713; while a unit increment in the reserve value tends to decrease the profit by 0.018.

The results for the period after recapitalization indicated a reverse relationship. The regression equation after recapitalization is represented as:

$$PAT_t = 1.019 - 0.953\ SC_t + 2.034\ RV_t$$

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From the equation, a unit increase in share capital in the post recapitalization period tends to reduce the profit of selected insurance companies by 0.953; while a unit increment in reserve value tends to increase the profit by 2.034. Looking at the aggregate effect of the two variables, the profit after tax of the selected insurance companies is more positively affected in the pre-recapitalization. This means that when the share capital and reserves are altered concurrently by the same proportion, the aggregate effect is better in the pre-recapitalization period than during the post recapitalization period.

Comparing the t statistics with the significant values; both share capital and reserve (as represented by underwriting capacity and claims management) showed insignificant impact at 5% level of significance during the post recapitalization period. However, reserve is the only variable that showed significance at 10% level of significance. This could be explained in terms of the quantum of reserves (mostly share premium as a result of increased underwriting capacity) that accumulated from the new issue of shares by the insurance companies to meet the recapitalization requirements. Although the average and standard deviation of profit after tax during the post recapitalization period showed significant change in absolute terms, the change is not commensurate to the change in the share capital and reserve. This is why the overall results are not looking so good.

Conclusion and Recommendations

The Federal Government of Nigeria utilizes the process of recapitalization to strengthen the operating performance of the insurance industry. The 2005/2006 recapitalization exercise aimed at strengthening insurance companies' financial picture in anticipation of an expansion that will make the companies stronger overtime at performing their financial services functions which include underwriting and claims management, among others. The findings from this study revealed that recapitalization has not impacted significantly on the profitability of quoted insurance companies in Nigeria both before and after the 2005/2006 recapitalization. Even though there are some indications for improvements in absolute average profit figures during the post recapitalization, the increase of the share capital base of insurance companies in Nigeria does not commensurate with the level of underwriting and claims management achieved by the companies. Thus, the findings from this study do not confirm the predictions that recapitalization will significantly impact on the underwriting and claims management of insurance companies as contained in the studies of Ibiwoye and Adeleke (2008), Omobola (2008), and Ewedemi and Lee (2008).

Although we are aware of the significant effects of the global financial crisis on the operating results of companies during the 2008 and 2009, the study concluded that recapitalization has not impacted significantly on the underwriting and claims management of selected insurance companies in Nigeria. This conclusion contrasts that of Fatula (2007) who concluded that recapitalization will enable the insurance companies to secure more lucrative contracts and make significant profits.

In order to ensure that quoted Nigerian insurance companies continue to grow significantly and to achieve the aim of recapitalization in the industry, the following recommendations are proffered based on the findings of the study.

a. Insurance players should design insurance products that would meet the need of average Nigerians in order to increase their premium income and at the same time increase professionalism in business transaction through prompt claims settlement.

b. The regulatory bodies of insurance business in Nigeria should always consider the risks, uncertainties, and opportunities surrounding the insurance industry and employ scientific procedure in arriving at a particular recapitalization policy.

c. Insurance companies should be more aggressive towards securing bigger and better insurance contracts through effective and efficient marketing techniques so that the increased share capital base could be efficiently and effectively utilized.

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