

A Study on Impact of Investment Income and Inflation to Profitability of Insurance Industry in Sri Lanka Composite Insurance Companies

R.D.T.R. Subasinghe and Y.M.C. Gunaratne
Uva Wellassa University, Badulla, Sri Lanka

Introduction

Insurance Industry has become one of the booming industries in Sri Lanka since 2003 when the Insurance Board of Sri Lanka was established. Profitability of Insurance Companies basically contain two components namely underwriting profit and Investment Income. Generally, Insurance Companies manage their profits with Investment Income. According to World Insurance Report 2011, insurance companies around the globe are re-focusing on their core operations. Some lost investment income during the crisis; others face changing customer preferences; most must tackle a newly stringent regulatory environment.

Hence, the above question is significant when the inflation materially affects the country's economic activities. Further, there is a negative relationship between Investment Income and Inflation (D'Arcy, 1981). Accordingly, inflation can be a significant factor to the Insurance companies' profitability.

Methodology

According to the objectives of the research it requires secondary data from Composite Insurance companies in Sri Lanka. To extract Composite Insurance companies, researcher used Stratified Sampling Technique and Company Annual Reports for Secondary Data Collection.

Data was analyzed according to the research objectives and Net Combined Ratio was used to identify the Insurance Companies which face problem of making profits without Investment Income.

$$\text{Net Combined Ratio (Formula)} = \frac{\text{Net Claims Incurred} + \text{Other Expenses}}{\text{Net Earned Premium}}$$

To identify the relationships of each Inflation and Investment Income and Investment and Profitability, a simple regression was used and the correlation was measured by using MINITAB Statistical software.

Results and Discussion

Net Combined Ratio calculation reveals that all most all the Insurance Companies which were covered in the study are facing the difficulty of earning profits without investment income since all those Insurance Companies' calculated Net Combined Ratios are closer to 100 and few of them have exceeded its value beyond the 100. In 2009, the lowest Net Combined Ratio has been made by HNB Assurance PLC (85.61%) while Sri Lanka Insurance Corporation has made the highest NCR (116.54%). Similarly, in 2010, HNB Assurance has taken the lowest NCR (86.09%) and Sri Lanka Insurance Corporation has achieved the highest NCR (104.2%).

The findings show that, the profitability of an organization highly depends on investment income. Sri Lanka Insurance Corporation is still in a critical situation since they are not making reasonable Investment Income. Further, the results revealed that almost all the

insurance Companies have made underwriting profits in year 2010 than the underwriting profits of the year 2009.

Underwriting profit margin versus Inflation rates

The regression equation is: $UPM = 6.96 - 27.2 \text{ Inflation rates}$

Predictor	Coef.	SE Coef.	T	P
Constant	6.959	5.182	1.34	0.022
Inflation rates	-27.25	41.82	-0.65	0.035

R-Sq = 25.7%

Investment Income returns versus Inflation rates

IIR = 0.374 - 1.14 Inflation rates

Predictor	Coef.	SE Coef.	T	P
Constant	0.3739	0.2389	1.56	0.000
Inflation rates	-1.143	1.928	-0.59	0.000

R-Sq = 14.8%

The analysis has revealed that underwriting profits and inflation are negatively correlated since the Coefficient [- 27.2] applied to the inflation variable is negative. According to R^2 , the observed relationship is essentially meaningless.

Further, it was revealed that the investment income return and inflation are negatively correlated. Moreover, the R^2 is significantly lower (14.8%) and it can be the result of insurance companies becoming more sophisticated in managing their investment portfolios with respect to inflation and other sources of volatility.

Conclusion

Insurance Companies' profit comprise of both Underwriting Profit and Investment Income. The researcher has found that Sri Lankan insurance Companies highly depend on the Investment Income. Through this research, the researcher has proposed the solutions to increase the Underwriting Profits of Sri Lankan Insurance Companies.

Based on the study, it is clear that Sri Lankan Insurance Companies are highly depending on Investment Income. Further, the underwriting profitability of those companies is not in a satisfactory level. In addition, the underwriting profits and inflation are negatively correlated since the Coefficient [- 27.2] applied to the inflation variable is negative. Further, the output displays that investment income return and inflation are negatively correlated.

The findings of this study encourage the insurance companies to investigate the means of improving the underwriting profits since they are highly depending on investment income.

References

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