

Effects of Financial Performance and Firm Size on Firms' Value: Empirical Study of Insurance Companies in Nigeria

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Abstract

The listed Insurance firms in Nigeria Stock Exchange (NSE) have been recording mixed results and that places a question on their financial performance and firm value. Over the last decades, this poor trend in the company's firm value of the listed firms justified a relook into the financial performance and firm value of the company. Therefore, this study evaluates the Effects of Financial Performance and Firm Size on Firms' Value of 21 quoted Insurance Companies on the Nigerian Stock Exchange as at the 31st December, 2020. The study covered the period of 8 years (2012-2019). Return on Assets and Return on Equity proxied financial performance; Natural logarithm of total assets proxied firm size while Tobin's Q proxied firms' value. Firm age serves as control variable which is defined as firms' incorporated period. The study uses ex-post facto research design and longitudinal panel which consists of time series and cross sectional data. The data were analyzed using descriptive statistics and regression with the aid of STATA 15 version. The study revealed that all explanatory variables, except return on assets, firm Size and Firm Age have positive significant effect on Tobin's Q. Specifically, Return on equity has insignificant effect on Tobin's Q. Therefore, the study recommends that the management of Insurance firms in Nigeria should only use return on assets and firm size by increasing the total assets to improve the firm's value.

Keywords: *Financial performance, firms' size, firm value, Tobin Q*

1.0 Introduction

One of the goals of any company is to create value by providing returns for the shareholders of the company. On one hand, the company's long-term goal is to maximize the shareholders' value which results from sustainable financial performance. On the other hand, the company's value is the key concern to

investors. Therefore, it is important to understand that shareholders and investors need assurance upon their funds which they have already invested and returns upon their investment. The company will try to maximize the value of all the stakeholders' investment, by increasing the company financial performance. Philipp and Nadine (2017) further maintained that the increase of company value is the reflection of shareholders' funds optimization, which is frequently valued by Price to Book Value (PBV). This ratio shows the willingness of investors to buy shares with the price at above or below the nominal value. The higher the value of a company the more prosperous the owners are. Thus, the value of company in investors' and creditors' view is very important that they become more selective in investing and providing credit for the company.

In contemporary business, value of the firm indicates the extent towards maximizing the investors' and stakeholders wealth. This is because they have interest in the return on their investment and this can be achieved if the resources of the organization is fully utilized properly (Bintara, 2018). Therefore, this will serve as the basis for upcoming investors and financial providers to invest more in the business. Specifically, Kartikasari and Merianti (2016) came up with the notion that, firm value is of dynamic significance for economic development. In this regard, investors need high returns on their investment and well-organized managers that monitored firm performance could bring long-term profits for its stakeholders, shareholders and investors. Importantly, firm value signifies as economic measure of firm performance through which the worth of business and economic resources can be ascertained. In finance literature, it is very clear that firm value represents the assets of the business that are readily provided by the two parties. That is, debt financiers and equity shareholders. Hence, it is more important to understand that, value of the firm will attract investors to patronize the company more. Unlike the firms' financial performance which is the effort of managers' from their own internal perspective. FV is used as the main focus in making decisions by investors to invest in a company (Bintara, 2018).

However, companies that are large do enjoy economic of scale because of their size. Specifically, some firms increase their size in order to have competitive advantages over other rivals. This practice will go a long way to increase companies' market share as they reduce the cost of production. Thus, large companies are in better position to produce items at much lower costs than smaller companies. Indeed, Danaei and Abdi (2015) asserted that firms that are large in nature increases because of some reasons which includes; market of large

capitalization; consistent in book value and high revenue. Investors tend to be more interested in companies with large scale. Therefore, all these factors will make large firms more stable in terms of operation. More importantly, firms' consistency entices investors to own portions of the total investment in the company. This will in turn serve as the basis of increase in share price in the capital market. Generally, size has an impact greatly on firm values and enhancing their standard of living. From these scenarios it is clear that size of the firm could contribute to firm value (FV) in many ways. Kartikasari and Merianti (2016) argue that FV has potential to enhance organizational performance through economy of scale, increasing efficiency and growth and financial performance.

Generally, Nigeria Insurance Industry (NII) has contributed to the development of the Nigeria economy. However, from 2007 to 2014 the industry witnessed problem of stagnation and growth. It is evidently clear that the report on NII indicates that the industry was facing two main setbacks. Firstly, the report indicated that the industry accounted for only 0.4% to the Nigerian Growth Domestic Product (GDP). Suggesting that, despite many favorable changes in the economy especially in the Agricultural sector and downstream oil and gas sector, is not adequate. Secondly, as at 2011, the industry revealed only 0.03% to the contribution to the world global premium. More specifically, the NII's performance indicators seem to be poor. Indeed, this has called for the attention of Central Bank of Nigeria (CBN) and Nigerian Insurance Commission (NAICOM) on the performance of the firms in the industry. Also new guidelines were issued by the NAICON which include the need to recapitalize the industry (Nwagbara, 2017& Victor, 2013). In addition, insurance has remained one of the least purchased items in the Nigeria financial market and records revealed that only about 10% of Nigerian population has insurance of any kind (Ebitu, Ibok, &Mbum 2012). However, it is has been established that this low patronage of insurance products has become a problem not only to the insurance industry, but also has affected economic development in Nigeria (Atubi, 2015).

However, it was reported by Thisday Live (2018) revealed the position of performance of the NII. Thus, it was observed that by 2014, Banking Industry was already recapitalized to the tune of ₦25 Billion, yet the NII composite insurance firms was only having ₦5Billion as capital base. Recently, National Insurance Commission, (2020) reported that NII was capitalized with the tune of #30Billion. Though, there is improvement in the industry performance. From this scenario, there is need for reinvestment in the industry to go in line with need of Nigerian economy especially in the agricultural sector and downstream oil sector. This

prompts the need to understand factors determining the firm value of companies in Ninth organization as a system would be weak and could break down without those proper and functioning systems. Thereby, stressing the importance of financial performance, growth, and firm size to the progress of firm value. Therefore, the study evaluates the effect of financial performance and firm size on firm value of Insurance firms in Nigerian.

2.0 Literature Review

2.1 Empirical Review

The literatures were empirically reviewed in relation to the study variables. The review revealed both significant and insignificant effect and influence of the independent variables (financial performance and firm size) over the dependent variable (firm value). The study further examined signaling theory which underpinned the study and finally, the variables were conceptually discussed and conceptual framework of the study is figured out.

In a study in Indonesia, Rosikah, Dwi, Dzulfikri, Muh and Miswar (2018) investigated the relationship between return on assets, return on equity and earning per share and firm value of 32 Manufacturing Companies in Indonesian Stock Exchange over the period between 2006 and 2010. The findings of the study indicated that Return on Asset has a positive significant association with firm value measured by Tobin's Q, while Return on Equity has insignificant effect on Tobin's Q. Similarly, Marsha and Murtaqi (2017) reported positive significant effect of return on assets (ROA) on Tobin's Q after conducting a study of 14 Indonesia Firms in the Food and Beverages sector for period of 2010-2014. In the same vein, Sabrin, Buyung, Dedy, Takdir and Sujono (2016) examined the effect of profitability on firm value in manufacturing company at Indonesia Stock Exchange for the period of (2009 to 2014). The study reported positive significant effect of ROA on Tobin's Q for the six years of their empirical study. In the same direction the study of Sucuahi, and Cambarian (2016) demonstrated that firm's profitability positively and significantly influenced the firm value (Tobin Q). Thus, indicating that as the profitability of the firm increases company's value too increases as such firm value will attracts investors. In contrast, the study of Munawaroh (2014) whose objective was to find the relationship of return on assets on firms' value of Indonesia between 2014 and 2016 found that ROA had a negative effect on firm value.

Aveh, Awunyo-Vitor and McMillan (2017) reported positive significant effect of return on equity on Tobin's Q after conducting a study of all companies listed on

the Ghana Stock Exchange for a period of seven years. Similarly, Issah and Ngmenipuo (2015) reported a positive significant effect of return on equity on Tobin's Q as a result of a study conducted of companies listed on Ghana Stock Exchange from 2009-2013. In the same vein, Sharif, Purohit and Pillai (2015) conducted a study on the factors influencing share prices of 41 companies listed on the Bahrain Stock Market over the period of 5 years (2006-2010). The study reported positive significant effect of return on equity and Tobin's Q. However, In Indonesia Stock Exchange, Benyamin and Hotniar (2016) revealed that Return on Equity has negative insignificant effect on firm value after conducting an empirical study of 18 Insurance and Banking companies for the period of 2010-2013. In the same vein, Talamati and Pangemanan (2015) reported that return on equity has no significant relationship with Tobin's Q.

Majid and Benazir, (2015) examined the impact of growth on firm value of 36 companies listed on Indonesia Stock Exchange during the period of seven years (2007-2013). The study found that company's growth has a positive and significant effect on both firm value and Tobin's Q. Sucuahi and Cambarihan (2016) determined the relationship between growth, size, and capital structure decisions and the firm value of selected 86 diversified companies in the Philippines Stock Exchange (PSE) for the period of 2014. Multiple regressions were used for the analysis. The results reveal that out of the three factors expected to influence value of the firm using the Tobin's Q, only profitability shows significant positive impact on the firm's value while growth has a negative significant relationship with Tobin's Q. In more recent times, Ardi and Murwaningsari (2018) examined the financial performance determination, earnings quality, intellectual capital and company value of 90 manufacturing companies in Indonesia Stock Exchange. Their empirical research demonstrated that company growth has a negative and significant influence on firm value measured by Tobin's Q. Also, Rasyid, (2015) reported that growth has a negative and significant influence on firm value using Tobin's Q as dependent variable in his study. In addition, the study of Tristan and Huy-Cuong (2015) whose objective was to examine the "Capital Structure and Firms' Performance of 147 companies listed on Vietnam Stock Exchange" during the period of 9 years (2006-2014). Specifically, the study revealed that firm size and growth have positive significant effect on Tobin's Q.

In a study of Indonesia Stock Exchange from 2010-2014, Yuanita, Budiyo and Slamet (2016) carried out an empirical research on the "Influence of capital structure, size and growth on profitability and corporate value". It was

demonstrated as positive significant effect of firm size on Tobin's Q were observed. Elsewhere, Kumar and Kaur (2016) studied the relationship between size and profitability in the Indian automobile industry from 1998 to 2014. The study reported mixed results as a positive relationship exist between firm size and Tobin's Q while the same result does not support the existence of positive relationship between firm size, profitability and Tobin's Q. In support of the result of Kumar and Kaur (2016), Kartikasari and Merianti (2016) reported a significant positive effect of firm size which was measured as natural log of total assets with Tobin's Q. Their study focused on the "effect of leverage and the size of a company on its profitability". Specifically, 100 qualified manufacturing companies listed on the Indonesia Stock Exchange were used as the sample of the study for the period of 2009-2014.

In an attempt to establish more relationship on firms' size and firm value, Asad and Cheema (2017) have found evidence that firm size positively has effect on Tobin's Q, but absent for large firms when associated with Tobin Q. More importantly, in a study of 30 listed companies on the Indonesian Stock Exchange (IDX) for a period of five years. Rizky, Nur and Siti (2017) reported positive significant effect of firm size on Tobin's Q. In contrast, a different result was obtained from the study of Purwohandoko (2017) whose study centered on the firm's size influence, profitability, growth on firm value and capital structure as the mediator. The samples of the study were 14 Agricultural firms registered on the ISE for a period of 4 years (2011-2014). Their empirical study demonstrated insignificant influenced of firm size on Tobin's Q.

Ibrahim (2017) reported that the firm age has positive significant relationship with the firm value in Nigerian Manufacturing Industry. Contrarily, the study of Lu, Tsai and Yen (2010) whose objective was to find whether the relationship between financial performance (FP) and firm value exist in some selected companies in Taiwan. Empirically, it was reported that insignificant relationship between FP with firm value.

2.2 Theoretical Framework

This study is anchored on Signaling Theory. This is because the theory has captured the information related to firms' financial information, dependent variables and independent variable (firm value). In other words, Signaling theory is

fundamentally concerned with synthesizing information between two parties (Suazo, Martinez, & Sandoval, 2009).

According to the theory is a way of conveying information in terms of financial performance of the firm and firm value, which will in turn encourage investors and shareholders to invest more in the organization (Bird & Smith, 2005). It suggests that managers, depending on their definition of firm value, tend to rely on the right information asymmetry provided which will inform the basis of their decision in an organization (Gao, Darroch, Mather, & MacGregor, 2008). Brian, Trevis, and Duane (2011) examined Signaling Theory on firm performance and found that low performance firms are those that have poor information asymmetry, while high performance firms are those that have right information at their disposal. Importantly, the signal theory is related to the study variables as all the information needed by the investors before they commit their resources will be made available to them. As such, it is from the disclosure of this information that investors and shareholders will have a clear picture of firm's value which will attract them to patronize the company more.

2.3 Conceptual Framework

2.3.1 Firm Value

Firm value as the dependent variable in this study is one of the significant factors found to influence firm performance. Firm value is the investors' appreciation of the results of the management work in managing the business (Ardi & Murwaningsari, 2018). The best indicator which investors normally want the management to use in measuring firm value is Tobin's Q. Thus, it is measured as: $\text{Tobin's Q} = \frac{\text{Market value of equity}}{\text{Total debts} + \text{Total assets}}$.

2.3.2 Financial Performance

The concept of financial performance (FP) is difficult to explain in finance literature because of their different measures. However, it is defined as the ability of a firm to use its resources effectively and efficiently in such a way to achieve its objective (Al-Quad, 2017). In this study, return on assets ratio (ROA) and return on equity (ROE) are used to measure FP. ROA is measured as: Profit before tax/total assets of the company, while ROE is measured as: Profit after tax/shareholders equity.

2.3.3 Firm Size

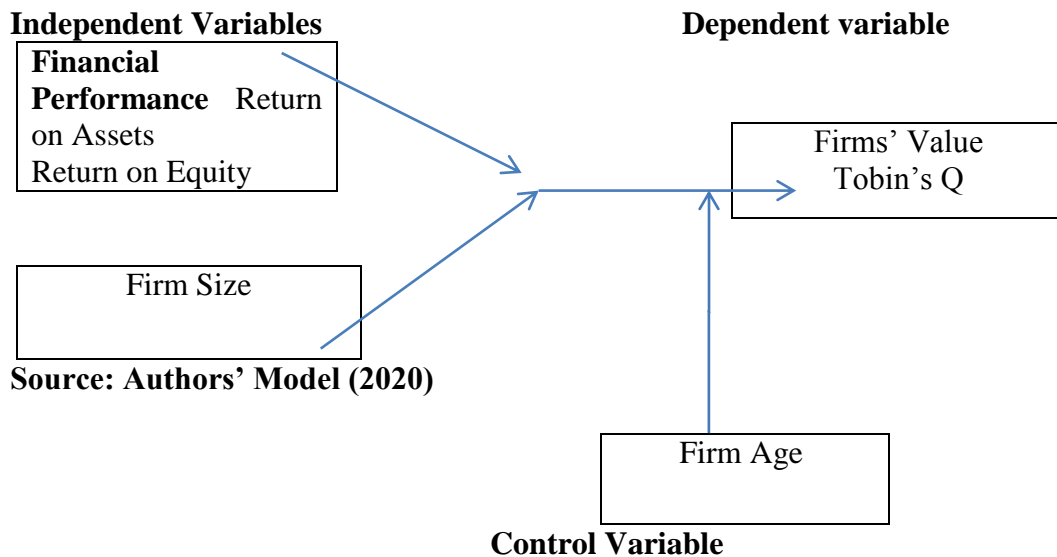
The concept of firm size is defined as the quantity and collection of production capability and potential a firm possesses or the quantity and diversity of services a firm can make available to its customers (Shaheen & Malik, 2012). In addition, Babalola (2013) emphasize that the larger a firm is, the more the influence it has on its shareholders and so large firms tends to enjoy economies of scale and outperform small firms. In this study, firm size is measured as: The natural log of total assets.

2.3.4 Firm Age

Firm age signifies reputation of a business for it being capable to acquire experience in doing business. It increases the capacity of business to gain more investment from debt to equity (Ibrahim, 2017). In sum, this can result to the good name a firm has built up over the years.

Figure 1 Conceptual Framework of the Study

From the theoretical, conceptual and empirical literature reviews, the following conceptual framework of the study is developed by the researchers.



Hypotheses Development

Accordingly, three hypotheses were formulated and tested in order to find out the degree to which the independent variables affect the dependent variable.

H01 Return on assets does not significantly influenced firms' value of Insurance Companies in Nigeria.

H02 Return on equity does not significantly influenced firms' value of Insurance Companies in Nigeria.

H03 Firm size does not significantly influenced firms' value of Insurance Companies in Nigeria.

3.0 Methodology of the Study

The nature of this study is quantitative research which has employed Ex-post-facto research design as the suitable method of the research. The data were analyzed using descriptive statistics, correlation and multiple regressions. To arrive at best analysis comparisons were made between OLS, FEM, REM and hausman tests. The data used were sourced from the annual reports and financial statements of Insurance firms quoted on the Nigerian Stock Exchange as at 2010 to 2019. Specifically, each of the statistical tools employed in this study hope to establish whether the relationship between independent variables and the dependent variable exist or not. Therefore, census sampling technique was used to arrive at the working population of 21 firms quoted on the Nigerian Stock Exchange as at 31st December, 2019. The explanatory variables are firms' financial performance and firm size while Tobin's Q is the dependent variable of the study. Meanwhile, firms' age serves as a control variable. STATA 15.0 was used for the analyses.

Regression Model Specification

$TQ = f(FFP, FS, Age)$

$$TQ = \alpha + \beta_0 + \beta (FFP) + \beta (FS) + \beta (Age) + e \dots \dots \dots 1$$

Where TQ= Tobin Q ratio for the firms in the industry α = an intercepts. β = Coefficient of the model-variable FFP=Firm Financial Performance, FS= Firm Size, Age= Firm Age and e= error term.

Table1. Variables and Measurements

Variable/Dimensions	Measurement	Source
Tobin's Q	$Q \text{ ratio} = \frac{\text{market value of equity} + \text{book value of debt}}{\text{total assets}}$	Marsha and Murtaqi (2017) and Rosikah, Dwi, Dzulfikri, Muh and Miswar(2018)
Firm Financial Performance: Return on Assets (ROA), and Returns on Equity (ROE)	ROA=Profit after tax divided by total assets. ROE= Profit after tax divided by shareholders' equity.	Sabrin, Buyung, Dedy, Takdir and Sujono (2016), Munawaroh (2014), Aveh, Awunyo-Vitor and McMillan (2017) and Benyamin and Hotniar (2016)
Firm Size	Firm size (FS) Natural logarithm of total assets.	Asad and Cheema (2017) and Purwohandoko (2017)
Firm Age	AGE = Number of years in which the firm was incorporated.	Ibrahim (2017) and Lu, Tsai and Yen (2010)

Source: Authors' compilation (2020)

4.0 Results and Discussion

The data is analyzed and its characteristics are herewith presented. Specifically, before the analysis, the data is subjected to validation test after which the test of correlation and regression are conducted. The results are used in testing the hypotheses developed from the model.

4.1 Data Validation

The test of multicollinearity has been conducted and the result has shown that the Mean of Variance Inflation Factor (VIF) is 3.30 which is less than 10. Thus, this indicates the study does not have multicollinearity problem. The Hausman Specification test is conducted. The Hausman rule states that to select the most efficient result between Random Effect (RE) and Fixed Effect (FE) of GLS regression is determined by the coefficient of probability ($\text{Prob} > \chi^2$) i.e less than 0.1. A significant probability suggests that Fixed effect model should be analyzed while an insignificant probability suggests that Random effect model should be

analyzed to determine the findings of the study. This study based its analyses on Random effect model since the Hausman specification test is significant at (Prob>chi2 = 0.0000).

Table 2 Descriptive Statistics

. summarize TOBINQ ROA ROE FS FIRMAGE

Variable	Obs	Mean	Std. Dev.	Min	Max
TOBINQ	168	9.24556	2.481196	0	12.84094
ROA	168	.0191276	.135816	-.5621621	1.131005
ROE	168	.138835	.9604349	-.9996737	12.22872
FS	168	1.005154	.0225454	.9335992	1.117588
FIRMAGE	168	39.2619	18.70292	10	98

Source: Authors' compilation from STATA 15.0 output

The data characteristics presented in Table 2 show that there are 168 observations. Tobin's Q, a measure that combines market performance with book values, shows 9.24. This means that the return on investment to the investors, shareholders and other interested parties are guarantee as the firms value is greater than 1 (Marsha & Murtaqi, 2017). As such it to meet up with market benchmark 1 which will attracts investors and other parties to invest more. As such it fails to meet up with market benchmark 1 which attracts investors. The maximum and minimum Tobin's Qs are 12.84 and 0 respectively. This shows that Insurance firms listed on the Nigerian Stock Exchange had small variation in market values relative to book values.

The firm performance of the industry, however, shows that the firms have reported positive returns (ROA= .019 and ROE= .138) for the period under study. This implies that ROA position is that at every 1 invested in Insurance firm in Nigeria, maximum of #1.13 profit can be made and possible minimum of 5.6 kobo can be lost. The Return on Assets reflected how well a company management was using the company real investment resources to generate profits. Also, it was widely used to compare the efficiency and operational performance of the company as it looked at the returns generated from the assets financed by the company (Sabrin, Buyung, Dedy, Takdir & Sujono, 2016).

The descriptive report shows that firm size average is 1.00 billion with the minimum of .93 sizes and maximum of 1.11. The data analysis also shows that the minimum age of Nigerian insurance firm is 10 years and the oldest firm is having age of 98 years. This indicates that the firms are able to gain considerable stay in the business. Evans (1987) said that younger firms were more vibrant and unstable in their growth experience than older firms.

Table 3: Correlation Matrix Model

Variables	TOBIN	QROA	ROE	FSIZE	FAGE	VIF
TOBIN	1.0000					
QROA	0.2372	1.0000				1.03
ROE	-0.3021	-0.0450	1.0000			1.03
FSIZE	0.5799	0.1400	0.1329	1.0000		5.60
FAGE	0.1856	-0.0984	0.0446	0.0753	1.0000	5.53
Mean VIF						3.30

Source: Authors' compilation from STATA VERSION 15.0 output (2020)

* Indicate 1% level of significance.

Correlation coefficients were calculated to ascertain the relationship between dependent variable and explanatory variables and also to identify both the direction and the degree of the relationship. As a rule, the correlation coefficients between 0 and 0.30 marks a weak correlation, from 0.30 to 0.70 a moderate correlation, and between 0.70-one an elevated correlation (Vintilă, Nenu, & Gherghina, 2014). Hence, correlation greater than 0.9 indicates multicollinearity (Swain 2008). As shown in table 3 in this study, the correlation coefficients of dependent variable and explanatory variables are not greater than 0.9 indicating the absence of multicollinearity.

Table 3 presents the correlation coefficients which ranges from -1 to +1. This implies that when the relationship is positive, direct relationship exist which shows increase-increase relationship. However, when the relationship is negative, indirect relationship exist which shows increase-decrease relationship. Specifically, Tobin's

Q has positive correlation with return on assets (0.2372), firm size (0.5799) and firm age (0.1856). This implies that an increase in any of these variables increases the Tobin's Q. On the contrary, return on equity which is measured by profit after tax to the shareholders equity was found to be negatively correlated with the firm value at (-0.3021). This means that return on equity decrease the firm value.

Accordingly, the Variance Inflation Factor which is more reliable than the correlation matrix is further employed to validate the correlation matrix which is based on a rule of thumb. Again, table 3 shows the VIF mean (3.30) which is less than 10 and imply absence of multicollinearity (Rajkumar & Hanitha, 2015). The VIF results further validate the Pearson correlation results that the variables do not suffer from the problem of multicollinearity. In addition, hausman specification test result which reveals Prob>chi2 = 0.0000 in favor of the benchmark of 0.1, the test shows that Fixed Effect (FE) is more efficient and as such discussed together with OLS regression results

Table 4 Regression Models (OLS)

Variables	POOLED OLS	Fixed Effect Random Effect	
ROA	0.86 (0.389)*	1.10 (0.273) *	1.48 (0.139) *
ROE	-8.23 (0.000) ***	-7.87 (0.000) ***	-7.60 (0.000) ***
FS	4.51 (0.000) ***	2.77 (0.006) ***	5.15 (0.000) ***
FAGE	3.53 (0.001) ***	-1.65 (0.100) **	1.24 (0.215) *
-CONS	-3.91 (0.0000) ***	-0.97 (0.336) *	-3.79 (0.000) ***
F-Statistics	26.27 (0.000)	(0.0000)	(0.0000)
R-Squared	52.96	R ² = 0.334 (within) R ² = 0.296 (within)	
Adjusted R ²	51.81	R ² =0.009 (Between) R ² =0.746 (Between)	
		R ² =0.041 (Overall) R ² =0.504 (Overall)	

Source: Authors' compilation from STATA 15.0 output, 2020

* Significant at 10%, ** Significant at 5%, ***Significant at 1% levels respectively

Tables 4 presents the regression result of OLS and fixed effect which were decided the best for the analyses. The coefficient of determination (R2) indicates that 52.96% of the variation in Tobin's Q can be explained by the variation on the explanatory variables in the model, while other factors not captured in the model

constitute 47.04%. The Fixed effect result has produced 41.00% which means only 59.00% changes of firm value is explained by other variables.

Also, the pooled regression analysis has demonstrated that the firm size which is measured as the natural logarithm of total assets is a good predictor of Tobin's q at 4.5% with a significant level of 0.000. This shows that one per cent increase in Firm Size, firm's value increases by 4.5%. The study is consistent with Asad and Cheema (2017) and Yuanita, Budiyo and Slamet (2016) but, inconsistent with Purwohandoko (2017) and Kumar and Kaur (2016). Furthermore, the analysis also indicated that the age of a firm significantly has a positive influence on firm value (Tobin's q) 3.53% at a significant level of 0.001. The finding is inconsistent with Ibrahim, (2017) Rosikah, Prananingrum, Muthalib, Azis and Rohansyah (2018) but inconsistency with Lu, Tsai and Yen (2010).

5. 0 Conclusion and Recommendations

The aim of the study is to evaluate the effects of financial performance and firm size on firms' value of insurance companies in Nigeria. In view of the findings, this study concludes that the independent variables have both positive and negative effects on the firms' value of Insurance firms in Nigeria. Therefore, recommends that the management of Insurance firms in Nigeria should focus on increasing firm return on assets through expansion of the business. Finally, the management needs to increase firm size to enhance firm value through improvement on the total assets of the company.

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