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Priliminary Investigation on the Performance of a Privatized Insurance Company in Nigeria

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Abstract

Nigeria has had state involvement in economic activities for a very long time. The intervention was meant for economic development and progress hence lot of SOEs has been established. The SOEs developed problems which lead to the adoption of privatization policy. Many studies on performance evaluation of privatized enterprises are inconsistent. The paper used before and after research design with descriptive statistics and panel data of AIICO Nig. Plc. The performance result is generally significant.

Key words: Public enterprise, Ratios, Performance, AIICO Nig. plc.

1. Introduction:

Nigeria has witnessed the growing state involvement in economic activities. This involvement was viewed as an important strategy for fostering rapid economic growth and development. The view was reinforced by massive foreign exchange earned from the sales of crude. The Federal government spent $100 billion to establish Public Enterprises between 1975 and 1995 El-Rufai (2001). In fact; a lot more public enterprises of questionable commercial financial viability were established. Therefore Nigeria, like most developing countries, developed large public enterprise sector. The sector is composed of such economic activities as banking and insurance; oil prospecting, exploration, refining and marketing; cement, paper and steel mills; hotels and tourism; sugar estates; etc Zayyad, (1991).

A survey by the Technical Committee on Privatisation and Commercialization (TCPC) shows that there are nearly 600 public enterprises at the federal level and an estimated 900 at the state and local government levels. Likewise El-Rufai (2001) put 590 as the number of public enterprises at federal level as at the year 2000. Unfortunately, most of the enterprises were poorly conceived and economically inefficient. They accumulated huge financial losses and absorbed a disproportionate share of domestic credit. In fact state-owned enterprise had become an unsustainable burden on the budget Jerome, (2008). The estimated 1,500 public enterprises in Nigeria according to Zayyad (1991) account for between 30 and 40 per cent of fixed capital investments. These investments were valued at over N.36 billion at their historical book values TCPC (1989). The returns from these investments had never exceeded two per cent per annum, which is less than 25 per cent of the annual subventions from the government to the public enterprise sector Zayyad (1991).

The extent, scope and perseverance of failure of Nigeria's public enterprises have been astonishing. The reasons for the poor performance of Nigerian state-owned enterprises are well documented. The reasons include, the lack of outstanding profits, the presence of multiple and conflicting objectives, the prevalence of deficient contracts, the prevalence of government subsidies that shelter internal inefficiencies and perpetrate soft budget constraints. Others are the large scale corruption, political convenience rather than economic viability governing project parameters such as capacity planning, plant location, implementation timeframe, employment related policies, product or service pricing. There are some large-scale projects in industrial sector that have been on the drawing board for periods ranging from 10 to 35 years for instance Ajaokuta steel plant, which remained uncompleted over 30 years Jerome (2008).Jerome further explained inefficiencies were also perpetrated due to misuse of monopoly powers, especially in infrastructure, resulting in unreliable delivery and availability of services. Other contributing factors to this dismal picture have been excessive bureaucratic controls and government intervention; inadequate policy and regulatory frameworks that obstruct competition, discourage private entry and private investment; weak capacity to implement reform; and gross mismanagement. These were compounded by a control and management structure that was extremely complex, dense and prone to political capture. The result was that the country under-achieved its growth latent as a result of large public enterprise sector. For example, the unreliable power supply from the National Electric Power Authority (NEPA) is estimated to impose an additional cost of around US$1 billion annually on the economy Jerome (2008) concluded.

It is imperative to note that while the boom in the crude oil market lasted, no one complained about the wastes and inefficiencies of the public enterprise sector in Nigeria. It was in the wake of the economic recession that began in 1981 following the collapse of oil prices, the activities of public enterprises attracted more attention and underwent closer scrutiny, much of the attention centered on their poor performance and the burden imposes on government finance. The poor financial returns from these enterprises, against the background of severe macroeconomic imbalance and public sector crisis, precipitated the concern of government towards privatization.

In the Nigerian context, the term "privatisation" is used not only for cases of full divestiture of Federal Government shareholdings but applies also to cases where the Federal Government intends to keep between 30 and 70 percent of the shares "partial privatisation", and to cases where Federal Government shares are sold to State Governments Rohdewohld, (1993). Enterprises fully privatized are those which are already incorporated into Nigerian stock exchange market. Such enterprises must show strong evidence of historical or future profits. Enterprises fully privatized would be owned 100 per cent by the private sector, i.e. by institutional, individual or core group investors, or a combination of such Zayyad (1991). Management decisions affecting the enterprises would derive from policy decisions reached by the boards constituted by the new owners. Government, having divested its entire equity holding and therefore would have no hand in the running of the enterprises or in the decision-making affecting the enterprises, except in the provision of the general infrastructural and legal framework and the maintenance of a political and economic environment conducive to the operation of business Zayyad (1991). The fully privatized enterprises would be expected to source their funds from the capital market, additional equity contributions or from reserves. Above all, they would be expected to pay reasonable dividends to the shareholders.

Enterprises partially privatized are those which the government consider strategic for economic development and growth. Government still exercise some influence over those industries to the extent of its representation on the board. It is hoped that under the new regime of privatisation, managers would be made accountable to the Board, even where government had substantial interest. Ministerial control, as was the case in the past, would be chased out, as boards would be expected to operate autonomously. Partially privatized enterprises would be expected to operate like the fully privatized enterprises in terms of accountability, management, profit motivation, expansion, and diversification of production Zayyad (1991).

2.0 Review of Theoretical and Empirical Studies

Privatisation of public enterprises has been an important policy issue in developing countries since the early 1980s. In the perspective of a broad-based approach towards deregulation of the economy privatisation debate has been influenced by pure economic necessities as well as by an ideological shift in the perception of suitable government policies towards economic development Cook and Mlinogue (1990). The unsatisfactory financial performance of many public enterprises and enormous debts often guaranteed by the government, imposed a constant demand on scarce budgetary resources which many governments in the developing countries were increasingly reluctant and unable to provide Short (1984), Nellis and Kikeri (1989). Disposal of the loss-making public enterprises appeared to be a logical solution. The debate on the economic role of the state and the subsequent reduction of the state's direct economic activities influenced the policy of international actors like the World Bank which in turn incorporated deregulation as integral element of their technical assistance and lending programmes therefore setting privatisation on the economic agenda of many developing countries. The underlying presumption that private enterprises are per se more efficient and economically viable than public enterprises has been dismissed by many and there is a strong argument that it is liberalization of the market i.e. the creation of competitive conditions rather than a change of ownership that really matters in bringing about economic efficiency.

2.1 Financial Performance

There is extensive theoretical and empirical literature concerning the impact of privatization on financial performance of privatized enterprises Megginson and Nelter, (2000). Shirely (2000) argues that two decades of experience have not settled the debate over the amount of ownership that influence financial performance of privatized enterprises.

The relative performance of public and private enterprises has been acknowledged by Boardman and Vining (1989) they indicate that private enterprises outperform both state-owned enterprises and mixed enterprises in competitive environment. Vikers and Yarrow (1991) concluded that private enterprises were more efficient than state-owned enterprises (SOEs) in a competitive environments and that competition may actually be a more important factor than ownership in determining performance. In the same vein Hemming and Mansoor (1988) opined that privatization of state-owned enterprises would not succeed in making them more profitable unless it is accompanied by economic and financial liberalization so that market forces are allowed to influence enterprise behavior.

Kikeri et al. (1992) are of the opinion that in developing countries without a market-friendly policy framework and well-developed regulatory capacity, privatization is less likely to yield benefits. Therefore most analysts concluded that increased exposure to competition accounts for most of positive change shown in privatized enterprises Tandon, (1995). In fact some studies suggested strongly that competition has been more important than ownership change in bringing about the financial gains Pollitt, (1997). The benefits of privatization therefore are not so obvious; in fact there are some studies that are more skeptical about positive influence of privatization Black et. al, (2000).

On the other hand the advocates of privatization argued that private ownership is more efficient than public ownership. Their arguments are based on the premise that the change in enterprise's ownership redefines the enterprise objectives and the manager's incentive to reduce cost and increase profit Shirely and Nellis, (1991). There seem to be a consensus that privatized enterprises perform better than SOEs and they are more competitive when compared to previous conditions of government control Megginson et al., (1994); Andrews and Dowling, (1998); D'Souza and Meggison, (1999).

In contrast, another group of researchers consider SOEs superior to the private ones. They argued that SOEs could be efficient in net financial position if their control system is suitable and are having clear goals and objectives. Claessens and Djankov (1998) believe that SOEs perform better than privatized enterprises. By their opinion private sector ownership is no guarantee of good performance. It is noted that private sector firms , in every corner of the world, go bankrupt every day; and that there are, in fact SOEs that perform quite well Wortzel, (1989), Finsiger and Pauly, (1985).

Another view finds no difference between the performance of both types of enterprises Carmake and Zaim, (1992); Martin, (1993). These researchers argued that any attempt to evaluate the performance of SOEs must take into account the multiplicity of objectives that is economic, social and political pursued by state-owned enterprises as compared to simple profitability objective that characterize most private enterprises.

2.2 Empirical Studies

Baboukri and Cosset (1998) analyzed the financial performance of 79 newly privatized enterprises in 21 developing countries between 1980 and 1992 and found significant increase in profitability, operating efficiency, capital investment, employment and decline in leverage. The change in profitability and efficiency were more in middle-income countries than in low-income countries. Another research conducted by D'Souza et al. (2001) indicate that numerous studies have empirically examined whether privatization has worked in yielding post–divestiture performance improvements. These studies of Djankov and Murrel (2000), Dyck (2000), Havrylyshyn and Mcgehigan (2000), Megginson and Nelter (2001) and Shirly (1999) etc. examined a single industry or a single country, while seven are multi–national, multi–industry studies. Six of the single–industry, single country findings show significant performance improvements Barberis et al. (1996), Ramanurti et al (1997) and D'Souza (1998), while two shows negative results Martin and Parker (1995) and Newbery and Pollilt, (1997). Six of the seven multi–industries, multi–national studies show significant performance improvement after privatization Galal et al (1994), Frydman et al (1997), Boubakri and Cosset, (1998). The seventh i.e. Dewnter and Malatesta (1997) found negative impacts of privatization on financial performance of privatized enterprises.

Megginson et al. (1994) in a large scale and more comprehensive research compared the pre and post–privatization performance of 61 enterprises in 18 countries, out of which 12 were from developed countries and 6 from developing ones, in 32 industries that experienced full or partial privatization through public share offerings during the period 1961–1990. The results of their work show that most of the enterprises experienced increase in profitability, efficiency, capital investment spending, employment and dividends payment, while they witnessed a significant decrease in leverage. In transition countries, a great number of works confirmed the positive effects of privatization Claessens and Djankov, (1998), (1999); Megginson et al. (1994); Grigrian, (1998). In developing countries, most of the findings on assessment of financial performance before and after privatization concluded that privatization improves the financial performance of the enterprise Kikri and Nellis, (2004). In the same vein Pinheiro (1996) studied the impact of privatization on financial performance in Brazil. The study analyzed the financial performance of 50 privatized enterprises before and after privatization, the researchers use data ranging from 1990 to 1994. The result confirmed that privatization brings a significant improvement on the financial performance of the privatized enterprises.

It is evident that the impact of privatization on financial performance is mixed. While some studies indicated that privatization could lead to an improvement in profitability, efficiency, outputs, capital investment spending, and debt ratio, there are some studies which reveal contrary results. Yet some other studies found that no difference in financial performance between privatized enterprises and those enterprises still owned by the state. Therefore it may not be out of place investigating more in the area.

3. Research design: The research design used in the paper is known as "before-and-after" design. According to Osman (2011) before and after design can be described as two sets of cross section observations on the same population to ascertain the nature of the change in the variable between two points of time. He continued; the change is measured by comparing the difference in the variables at the periods before and after. Such design is commonly used to examine financial performance of privatized enterprises for instance Megginson et al. (1994), Nellis and Losers (2002), Baboukri and Cosset (1998), D'Souza and Megginson (1999), Hakro and Akram (2009) and Osman (2011).

3. Technique of Analysis

The researcher intends, to use descriptive statistics such as means of some ratios and difference of two means. The data is processed for measuring AIICO performance before and after deregulation. The period of analysis covered some years before and some years after privatization. The average performance was calculated using various performance ratios. The ratios are divided into efficiency and profitability.

Performance Ratios of AIICO Nig. Plc from 1995 – 2004

BEFORE PRIVATIZATION							AFTER PRIVATIZATION					
MEASUREMENT YEAR	**1995**	**1996**	**1997**	**1998**	**1999**	**AV**	**2000**	**2001**	**2002**	**2003**	**2004**	**Mean**
TAT	**0.27**	**1.72**	**1.20**	**0.53**	**1.17**	**0.98**	**2.27**	**3.72**	**4.20**	**4.17**	**4.53**	**3.78**
FAT	**0.03**	**0.23**	**0.24**	**1.29**	**0.20**	**0.40**	**2.29**	**3.03**	**2.23**	**4.20**	**5.24**	**3.40**
GPM	**0.83**	**0.02**	**1.05**	**0.39**	**0.51**	**0.55**	**3.83**	**4.20**	**4.21**	**4.21**	**5.39**	**4.37**
NPM	**0.02**	**0.51**	**0.83**	**1.21**	**1.21**	**0.76**	**2.85**	**3.21**	**4.50**	**3.37**	**4.80**	**3.75**
ROA	**0.1**	**0.60**	**0.8**	**0.73**	**1.02**	**0.65**	**3.7**	**4.12**	**5.83**	**5.0**	**6.12**	**4.95**
ROCE	**0.1**	**0.5**	**0.3**	**0.81**	**1.05**	**0.55**	**2.5**	**3.5**	**4.2**	**6.0**	**6.02**	**4.44**
ROSE	**1.2**	**0.05**	**1.2**	**1.3**	**1.3**	**1.01**	**3.5**	**4.6**	**6.0**	**5.82**	**9.25**	**5.83**

Source: Collected from the raw data of Company's annual report.

The table represent the performance ratio of AIICO Nig Plc from 1995 to 2004. The performance shows that the average TAT of the company was 0.98 before privatization, and it increased to 3.78 after privatization with a growth rate of 2.61 FAT equally grows from 0.40 averages before privatization to a mean of 3.40 after privatization thus depicting an incremental rate of 3. GPM averages 0.55 before privatization and 4.37 after privatization, a profitability growth rate of 3.82 on gross earnings. NPM equally showed mean net earnings of 0.76 before privatization and increased to 3.75 after privatization, a growth rate of 2.99. ROA increased from 0.65 before privatization to 4.95 after privatization, an incremental rate of 4.3 returns rate. ROCE showed a return increase of about 3.89, from a mean of 0.55 before privatization and 4.44 after privatization within the periods covered. Shareholders' equity (ROSE) also rose from an average of 1.01 before privatization to 5.83 after privatization, thus giving the shareholders an increase in the return rate of 4.82

Performance Indicators IICO Nig. Plc

	Mean value before privatization	Mean value after privatization	Mean value due to privatization	T test for significant change at 0.05	Comments
TAT	0.98	3.78	2.80	5.833	significant
FAT	0.40	3.40	3.00	-4.839	significant
GPM	0.55	4.37	3.82	-11.936	significant
NPM	0.76	3.75	2.99	-6.795	significant
ROA	0.65	4.95	4.30	-8.776	significant
ROCE	0.55	4.44	3.39	-5.257	significant
ROSE	1.01	5,83	4.82	4.844	significant

4 Conclusions

This paper investigated the impact of privatization on the financial performance of privatized enterprises in Nigeria during the period 1995 to 2004. Seven financial performance indicators are calculated as average of five years before, and five years after, privatization. The seven indicators are grouped profitability and operating efficiency indicators. A simple t-test of the difference between means is conducted. The overall the results show statistically insignificant improvement in the financial and operating performance of the privatized enterprises. In order to authoritively generalised the performance improvement of the privatized enterprises in Nigeria, there is the need to further empirical analysis, using an appropriate methodology to cover all the privatized enterprises.

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