“Risk indicators and related aspects in insurance companies in Palestine”

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RISK INDICATORS AND RELATED ASPECTS IN INSURANCE COMPANIES IN PALESTINE

Abstract

The purpose of this paper is to identify the impact of risk indicators of insurance companies listed on the Palestine Stock Exchange on earnings per share over the period 2010–2017. The sample consists of seven insurance companies listed on the Palestine Stock Exchange. The data was analyzed using the OLS regression technique. This helps to determine the relationship between the independent variable (earnings per share) and the dependent variables (liquidity risk, capital risk, rate of risky assets). The results show that the liquidity risk has a positive impact on earnings per share, while capital risk and rate of risky assets have a negative impact. This means that insurance companies listed on the Palestine Stock Exchange can achieve an acceptable balance between the liquidity risk index and the earnings per share in a way that does not prevent them from fulfilling their obligations. The findings of this study are demonstrated using figures and diagrams. The study recommends that insurance companies need to pay extra attention to risks and identify effective policies to deal with risks and reduce their impact, especially capital risk and the rate of risky assets. This is because these factors negatively affect earnings per share. The results of this study will be useful to relevant stakeholders in the sector.

Keywords insurance companies, liquidity risk, capital risk, strategic management risk, earnings per share

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INTRODUCTION

The history of the insurance idea goes back hundreds of years. But organizing insurance work in specialized companies is an idea that was born in the twentieth century. Countries have enacted several laws to regulate insurance business, with the aim of monitoring insurance business by the state, due to its great importance in generating state revenues (Khamis, 2018). Developed countries have worked to provide an appropriate environment for insurance to cope with the tremendous modern technology developments and continuous developments in the world of business administration by providing successful administrative and financial competencies, and in addition, the major insurance companies in the world have tended to strengthen their market position. This happened through capital increases or through a merger, and this is what allowed it to provide high-end and high-end insurance services at competitive prices, suitable for the variables of the economic environment (Zerman, 2015).

In 1993, in Palestine like all other countries, the Palestinian National Authority began its supervision of the insurance industry, expanding the geographical scope of its responsibility for the sector in 1994, and this sector suffered from a lack of legislation and special mechanisms, which in turn enhanced the role of government supervision and

control and worked to reduce and limit work chaos. At the end of 2004, the Palestine Capital Market Authority was established and became a legally authorized body to supervise, regulate and control the sector's business. The issuance of Insurance Law No. 20 of 2005 helped to reorganize the insurance sector (Palestine Capital Market Authority, 2021). At the end of 2017, the number of insurance companies licensed to operate by the Authority reached seven companies. The insurance sector in Palestine achieved growth during the year 2017 from its predecessor, amounting to about 18.7%, and the total insurance portfolio amounted to USD 255.4 million at the end of 2017, while the total investment rate of the insurance sector was 2% of the GDP, at constant prices at the end of the year (Palestine Capital Market Authority, 2021).

The Palestine Stock Exchange suffers from deficiencies in developmental and financing tasks, and weak regulatory and legislative frameworks have exacerbated this problem, which in turn led to an increase in the intensity of fluctuations in stock prices and increased investment risks in the market. The volume of initial issuances is also characterized by shares of modern companies, and the reason may be due to the limited financial awareness of investors, and the absence of promotion and underwriting companies. These markets also suffer from low demand for securities, due to the low rates of available cash income, weak individual saving, and investors' preference for possession of fixed assets (Fakron, 2013).

The importance of this study lies in clarifying the privacy of insurance companies in the Palestinian economy and knowing the nature of their complex technical activity that is mainly based on bearing the risks threatening various economic activities. This study also gains its importance from the process of monitoring technical activity in insurance companies as it is a tool that controls all the risks threatened. It reveals all possible errors and deviations in a way that increases the credibility of its financial statements and the information they contain with a high degree of transparency, in order to enhance their financial adequacy to ensure their survival and continued performance of their role by fulfilling its future obligations and providing the ideal protection for the interests of the parties concerned. Based on the above, this study sought to identify the relationship between the most important risk indicators (risky assets, liquidity risk, capital risk) and the stock return of insurance companies listed on the Palestine Stock Exchange.

1. LITERATURE REVIEW

Insurance is a vital necessity that protects the individual from material losses arising from the investigation of accidents. It is considered in its simple concept to obtain safety in the face of a certain risk in order to avoid its harmful consequences, or to limit it to the narrowest possible scope (Zohour & Nassima, 2014). Insurance has an important role in modern societies, which is related to achieving economic protection. It also contributes to accumulating savings necessary to finance development plans in developing societies and to invest in multiple economic vessels in developed societies (Qazat, 2009). The earnings per share express the efficiency of insurance companies in using and managing assets. It measures the profitability strength of the share and is used by investors in evaluating the company's past business, in estimating future profits and identifying investment opportunities (Arab Forex Forum, 2016). Therefore, many studies attempted to link risk indicators and stock returns (Ansari & Fola, 2014; Owolabi, 2017; Razia et al., 2017). Other studies focused on investigating risk management and related aspects in Palestine (Razia et al., 2019). These studies fail to address the impact of risk indicators of insurance companies listed on the Palestine Stock Exchange on the earnings per share.

Insurance firms with inadequate risk management accumulate claims from customers, resulting in increased losses and poor financial results (Magezi, 2003). Managerial risk behavior has an effect on risk management practices. A solid risk management framework can assist companies in lowering their risk exposure and improving their financial results (Iqbal & Mirakhor, 2007). It is believed that the choice of specific risk instruments is linked to the firm's calculative culture and the observable attitudes of senior decision makers regarding the use of risk management models. Although some risk

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roles are concerned with comprehensive risk measurement and risk-based performance management, others are concerned with a qualitative dialog and the mobilization of expert perceptions regarding emerging risk aspects (Mikes & Kaplan, 2014). The primary function of an insurance organization is to spread risk among various participants (Merton, 2005). It is argued that risk management is the business of today's insurance firms (Saunders & Cornett, 2008). They indicate that insurance firms carry on risk bearing and control roles on behalf of their clients by pooling risks and selling their risk-management services. This suggests that risk management should be at the forefront of insurance firms' operations.

Sager and Baranoff (2002) investigated the relationship between capital and risk in the life insurance sector in the period after adopting the regulation of life risk-based capital (RBC) using a partial-adjustment model with simultaneous-equations. They found a positive relationship between capital and asset risk and a negative relationship between capital and product risk. Risk management is related to several processes, including identification, assessment, and prioritization of risks. This is usually followed by the coordinated and economic use of resources that assist in reducing and controlling the likelihood and/or effect of uncertain events in order to optimize the realization of opportunities (Wenk, 2005). It is argued that effective hazard management may deliver far-reaching benefits to all companies, regardless of their sizes and types (Razia et al., 2019). These benefits link with achieving effective strategies, better decisions, better contingent management, efficient use of resources, as well as improving innovation and minimising waste. Creating a strategy based on well-defined risk management principles and then embedding them is the first step in ensuring that a business makes cost-effective use of managing risk (Dorfman, 2007).

These principles are operational management, strategic risk management, and financial risk management. This study examines the factors affecting earnings per share in insurance companies. This can be done by diagnosing risk indicators; including liquidity risk, capital risk, and the rate of risky assets. The research hypothesis can be formulated based on different study questions as explained in the following section.

Earnings per share, or EPS, is a key financial metric that measures a company's profitability. However, the profitability level of general insurance companies and market participants in Palestine fluctuates over time. Several studies examined risk factors and uncertainties that affect different industries, especially in Palestine, including; construction, health, education, banking and insurance companies (Khamis, 2018; Razia et al., 2019). Other studies focused on exploring the factors that affect the profitability of insurance companies (Fakron, 2013; Palestine Capital Market Authority, 2021). But a small number of studies has focused on the impact of risk indicators of insurance companies on earnings per share particularly in Palestine. For this reason, the levels of profitability of insurance companies in Palestine might be affected by multiple factors such as earnings per share, liquidity risk, capital risk and rate of risky assets. Therefore, this study aims to identify the impact of risk indicators of insurance companies listed on the Palestine Stock Exchange on earnings per share over the period 2010–2017.

The stock exchange plays a vital and important role in the process of economic development, as it forms a channel through which funds flow from units with financial surplus to units that suffer from a financial deficit. It is also considered a source of financing for institutions and, on the other hand, a place to establish investments, whether it is related to individuals or institutions, or the government sector, through the trading of stocks, bonds and other securities on the stock exchange, and investors depend in their investment in this environment on the exchange between return and risk, achieving the highest possible return in light of the lowest possible level of risk. In the process of investing in stocks, an investor encounters the problem of choosing the institutions that he owns shares that allow him to maximize his returns while reducing risk to acceptable levels, even though the institutions differ among themselves in the size component, and thus it is assumed that the shares of large-sized institutions generate greater returns than small-sized institutions (Fakron, 2013). In general, the concept of insurance is the conclusion of a contract by a party with an insurance company in order to compensate for a specific loss, if it occurs on his behalf, either for him or for a third party called the beneficiary, in return for a spec-

ified premium or periodic extended-term instalments linked to others (Khamis, 2018).

2. AIM, HYPOTHESES AND MODEL

The aim of this study is to investigate the role of risk indicators using three main factors that were selected for the test and the nature of their relationship to earnings per share. This is also related to identifying the relationship between those variables. As a result, the research hypotheses can be formulated as follows:

H_1: *There is a positive relationship between liquidity risk and earnings per share.*

H_2: *There is a positive relationship between capital risk and earnings per share.*

H_3: *There is a positive relationship between the rate of risky assets and earnings per share.*

To test the hypotheses, the following regression model will be adopted:

$$EPS_{i,t} = \alpha + \beta_1 LR_{i,t} + \\ + \beta_2 CR_{i,t} + \beta_3 RRA_{i,t} + \varepsilon, \quad (1)$$

where $EPS_{i,t}$ (dependent variable) – is the ratio of net income to the number of shares outstanding for company i in year t; α – the constant; b_1, b_2, and b_3 – are the slope of the independent variables; $LR_{i,t}$ (independent variable) – is the ratio of current assets to total liabilities for company i in year t; $CR_{i,t}$ (independent variable) – is the ratio of capital paid to risky assets for company i in year t; $RRA_{i,t}$ (independent variable) – is the ratio of risky assets to total assets for the company i in the year t; ε_i – random error.

3. DATA AND METHODS

The study population and its sample consist of all the Palestinian insurance companies listed on the Palestine Stock Exchange, the number of which is 7 companies, as shown in Table 1. Their financial disclosure period is from 2010 to 2017.

Table 1. Palestinian insurance companies listed on the Palestine Stock Exchange in 2010–2017

Source: Palestine Capital Market Authority (2021).

Number	Company name
1	National Insurance Company
2	The National Insurance Group
3	Global United Insurance
4	Palestine Insurance Company
5	Al-Mashreq Insurance Company
6	Al-Takaful Insurance Company
7	Trust International Insurance Group

The selection of variables depends on examining previous experimental studies. Table 2 shows the concepts of variables and how they are measured.

Table 2. Variable concepts and measurements

Variable	Label	Measurement and definition
Dependent variables		
Earnings per share	EPS	It means that the earnings per share represents what a unit of currency earns during a specific period of time (Al-Zubaidi, 2004). It is measured by the following equation: *EPS = Net income / Number of shares outstanding*
Independent variables		
Liquidity Risk	LR	It is the ability of a project to fulfil its short-term obligations in an immediate manner (Matar, 2010). It is reduced by the following equation: *Liquidity risk = Current assets / Total liabilities*
Capital Risk	CR	It refers to the distinct importance of capital gain because it plays an important and fundamental role in achieving security for the insured and creditors, and supports their confidence in the insurance company. In line with the increase in this confidence, the company is able to attract more insurance and absorb any unexpected losses by relying on capital (Khalaf, 2006). It is measured by the following equation: *Capital Risk = Paid in capital / Risky assets*
Rate of risky assets	RRA	Risky assets are "all assets, except for liquid assets, including cash and balances with banks and financial institutions (Razia et al., 2019). It can be measured by the following equation: *Risky assets = Total assets – (Cash from the fund and at banks' checks for collection + Cash receipts + +Deposits with banks)* *The rate of risky assets = Risky assets / Total assets*

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4. RESULTS

For this part of the study, data were collected from the PSE database. The data collected were then converted to an Excel sheet for variable definition. SPSS software was used to analyze the research model and verify the research hypotheses. At this stage, two main issues were discussed such as descriptive statistics and hypothesis testing.

4.1. Descriptive statistics

Table 3 provides descriptive statistics for the earnings per share, liquidity risk, capital risk, and the rate of risky assets.

Table 3. Descriptive statistics

Variables	Mean	Std. deviation	Min	Max
Earnings per share	0.15516	0.249057	–0.340	1.081
Liquidity risk	0.80336	0.272144	0.016	1.300
Capital risk	0.25923	0.201035	0.055	1.467
Rate of risky assets	0.82709	0.109226	0.308	0.966

There are several vital comments that can be noticed from Table 3, namely: The average rate of liquidity risk of the sample companies amounted to 80%. This means that current assets cover only 0.80 of total liabilities. This is to be considered as a good indicator for insurance companies, indicating the balance between fulfilling obligations and achieving profit. While the highest value was 1.30 and the lowest value was 0.016. As for the capital risk index of the sample companies, it reached 25%. This means that the paid-in capital contribution to covering risky assets is 0.25, which is generally acceptable according to the Palestinian environment. While the highest value was 1.46 and the lowest value was 0.055. As for the average rate of risky assets in the sample companies, it reached 82%, which is a high percentage of the total assets. Therefore, insurance companies' departments must redistribute investments in assets to achieve the required return and reduce the degree of risk, while the highest value reached 0.96 and the lowest value 0.30. Finally, the average return per share of the sample companies was 0.15, the highest value was 1, and the lowest value was –0.30.

5. HYPOTHESES TESTING

The hypotheses test the impact of risk indicators, including liquidity risk, capital risk and the rate of risky assets, on earnings per share of all the Palestinian insurance companies listed on the Palestine Stock Exchange. The OLS test was used to test the proposed hypotheses. Table 4 presents the OLS regression results.

Table 4. Regression results

Variables	Label	β	Std. error	T-test	Sig.
Constant	α	.068	.0312	1.821*	.044
Liquidity risk	*LR* (β_1)	.261	.0103	2.331*	.015
Capital risk	*CR* (β_2)	–.291	.0148	–1.960*	.032
Rate of risky assets	*RRA* (β_3)	–.682	.0296	–2.302*	.025
R	.536[a]				
R Square	.287				
F-Test	6.856				
Sig. (F-Test)	.001[b]				

Note: * and ** denote significance at the 0.05 and 0.01 levels, respectively; *t*-Critical: at df 55, and the confidence level of 99% is 2.390, the level of 95% is 1.671, and the level of 90% is 1.296; *F*-Critical (df for denominator $n - \beta - 1 = 56 - 3 - 1 = 52$) and df for numerator = β =3, and the confidence level of 99% is 2.730 and the confidence level of 95% is 2.040.

Table 4 shows the values of the three correlation coefficients, which is the simple correlation coefficient R. These values reached 0.536. The determination coefficient R2 is equal to 0.287, which means that the independent variables (capital risk, liquidity risk, and Rate of risky assets) were able to explain 28.7% of changes in earnings per share. Moreover, the remaining is attributed to other factors. The study model can also be formulated as follows:

$$EPS = 0.68 + 0.261LR - \\ -0.291CR - 0.682RRA. \quad (2)$$

H_{1a1}: *There is a positive relationship between liquidity risk and earnings per share.*

Table 4 confirms that t-test of the liquidity risk variable was positive. This indicates that there is a positive relationship between liquidity risk and earnings per share. To test the previous hypothesis, the value of Sig. is less than 0.05. This leads to accepting the alternative hypothesis and rejecting

the null hypothesis. It is also essential to indicate that the relationship between liquidity risk and earnings per share in Palestine Stock Exchange is positive. To better understand this, the higher liquidity risk, the higher earnings per share. In other words, companies with greater liquidity risk achieve higher returns. This is due to exploiting its financial liquidity in additional investments while maintaining the fulfilment of obligations.

H_{1a2}: *There is a positive relationship between capital risk and earnings per share.*

Table 4 shows that the value of t-test for the capital risk variable was negative. This indicates that there is a negative relationship between capital risk and earnings per share. To test the hypothesis, the value of Sig. equals 0.05, which leads to rejecting the alternative hypothesis and accepting the null hypothesis. This also indicates that the relationship between capital risk and earnings per share in Palestine Stock Exchange is negative. To better understand this, the higher capital risk leads to the lowest earnings per share. In other words, the higher the percentage of the paid-in capital contribution to covering risky assets, the lower the confidence in the performance of the company among the investors, and consequently the lower the valuation earnings per share.

H_{1a3}: *There is a positive relationship between the rate of risky assets and earnings per share.*

Table 4 shows that t-test for the rate of risky assets variable was negative. This indicates that there is a negative relationship between the rate of risky assets and earnings per share. To test the previous hypothesis, the Sig. is less than 0.05, which leads to rejecting the alternative hypothesis and accepting the null hypothesis. Therefore, the relationship between the rate of risky assets and earnings per share in Palestine Stock Exchange is negative. To better understand this, the higher rate of risky assets leads to the lowest earnings per share. For example, the higher the ratio of risky assets to total assets without achieving a balanced return commensurate with the degree of those risks, the more negatively this is reflected on the estimated earnings per share. Ultimately, it was essential to test the effect of the three variables together on earnings per share. The calculated F was greater than the critical. This means that these three variables are considered to the most important variables affecting earnings per share.

Based on the findings, this study provides an overview of the impact of risk indicators on insurance companies in Palestine. The study found a positive relationship between liquidity risk and earnings per share. A negative relationship was also found between capital risk, the rate of risky assets and earnings per share. This means that insurance companies can achieve an acceptable balance between the liquidity risk index and earnings per share in order to fulfil their obligations. This also helped reduce risky assets to total assets, or re-evaluate the return of these investments to impact earnings per share.

CONCLUSION

The importance of this study lies in clarifying the privacy of insurance companies in the Palestinian economy. Thus, it aims to identify the impact of risk indicators of insurance companies listed on the Palestine Stock Exchange on earnings per share over the period 2010–2017. The results show that liquidity risk has a positive impact on earnings per share, while capital risk and the rate of risky assets have a negative impact. This means that insurance companies listed on the Palestine Stock Exchange can achieve an acceptable balance between the liquidity risk index and the earnings per share in a way that does not prevent them from fulfilling their obligations. This study is considered limited due to the small sample taken from the Palestine Stock Exchange. Therefore, the results cannot be generalized to apply in similar situations. Three variables were examined, including liquidity risk, capital risk, and the rate of risky assets. Thus, there is potential for future studies that will focus on other variables associated with additional companies listed on the Palestine Stock Exchange. This study also provided an opportunity for other industries (e.g., construction, education) to expand it and apply further research.

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AUTHOR CONTRIBUTIONS

Conceptualization: Bahaa Razia.
Data curation: Bahaa Razia, Bahaa Awwad.
Formal analysis: Bahaa Awwad.
Software: Bahaa Awwad.
Supervision: Bahaa Razia.
Validation: Bahaa Awwad.
Visualization: Bahaa Awwad.
Writing – original draft: Bahaa Razia.
Writing – review & editing: Bahaa Razia.

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