Firdaus Journal
Vol 5 No. 1 2025 (55-65)

IMPACT OF UNDERWRITING RISK ON PERFORMANCE OF LISTED INSURANCE COMPANIES IN NIGERIA: THE MODERATING ROLE OF COMPANY SIZE AND LEVERAGE

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Received: 11 Feb. 2025 **Revised:** 20 May 2025; **Accepted:** 01 June 2025; **Published:** 25 June 2025

To cite this article (APA): Adebayo, E. O., Obadeyi, J. A., Agbatogun, T. O., & Odunsi, O. T. (2025). Impact of underwriting risk on performance of listed insurance companies in Nigeria: The moderating Role of Company Size and Leverage. Firdaus Journal, 5(1), 55-65. https://doi.org/10.37134/firdaus.vol5.1.6.2025

Abstract

The insurance sector plays a vital role in ensuring economic stability by offering protection against financial losses, facilitating risk-sharing, and fostering confidence among individuals and businesses. In Nigeria, while the industry contributes to economic resilience, it faces challenges such as economic volatility and regulatory shifts that exacerbate underwriting risk. Underwriting risk arises when premiums collected are insufficient to cover claims and associated costs, threatening an insurer's solvency and profitability. This study examines the impact of underwriting risk on the adjusted Risk-Adjusted Return on Capital (RAROC) of listed Nigerian insurance companies. Adjusted RAROC provides a comprehensive assessment of risk-adjusted returns by incorporating both risk costs and capital, offering a clearer picture of financial resilience. The study employs descriptive analysis, revealing an average Total Premiums Earned (TPE) of ₦8.09 billion, with a median of ₦5.05 billion, indicating a skewed market dominated by a few large firms. Leverage shows considerable variability (Mean = 272.92, Std. Dev. = 1058.06), while the Claims Benefit Ratio (CBR) averages 59.65, suggesting operational efficiency. The average Adjusted RAROC of 42.14 shows profitability variations across companies. Using techniques such as the Generalized Method of Moments (GMM), Fixed Effects, and Random Effects, the study identifies dynamic, firm-specific factors influencing profitability. The findings highlight the crucial role of underwriting risk, company size, and leverage in shaping financial performance, suggesting policy recommendations aimed at enhancing stability and profitability in Nigeria's insurance sector.

Keywords: Underwriting Risk, Risk-Adjusted Return on Capital (RAROC), Nigerian Insurance Sector, Profitability, Leverage

Jel Classification Code - G22, G32, C33, G11, G21

INTRODUCTION

The insurance sector is a cornerstone of economic stability and growth, offering protection against unforeseen financial losses, promoting risk-sharing, and instilling confidence among businesses and individuals. In Nigeria, the insurance industry is essential for economic resilience but faces several challenges, including economic fluctuations and changing regulatory environments. These challenges intensify the risks within the sector, especially

underwriting risk, which occurs when premiums collected fail to cover the claims and related expenses. Managing underwriting risk is crucial for ensuring the financial health and solvency of insurance companies in such a volatile environment.

This study explores the impact of underwriting risk on the adjusted Risk-Adjusted Return on Capital (Adjusted RAROC) of publicly listed Nigerian insurance companies. Adjusted RAROC, a vital metric for assessing financial performance, is gaining popularity as it accounts for both the capital and the cost of risk, providing a comprehensive picture of the insurer's financial stability. By incorporating this measure, insurers can more accurately gauge their financial resilience amidst the inherent risks they face. Understanding how underwriting risk influences adjusted RAROC offers essential insights into the overall financial health of Nigerian insurance companies, helping both regulators and firms navigate the challenges of a dynamic insurance market.

Previous research has indicated that factors such as company size and leverage can play critical roles in moderating an insurer's ability to manage underwriting risk effectively. Studies by Cummins and Weiss (2009) and Berger and Humphrey (1991) have shown that larger insurance firms often benefit from economies of scale and possess enhanced risk management capabilities, which may mitigate the adverse effects of underwriting risk on profitability. However, there is limited evidence on whether these findings apply within Nigeria's insurance sector, where firms vary significantly in size, capitalization, and risk exposures. This study explores the moderating role of company size, hypothesizing that larger Nigerian insurers may exhibit greater resilience against underwriting losses due to their operational efficiencies and broader risk pools.

Leverage, (which is the extent to which firms rely on debt financing), is another key factor that can influence insurers' sensitivity to underwriting risk. Highly leveraged insurers may face greater financial obligations, which can constrain their ability to absorb underwriting losses and increase their exposure to solvency risks. By incorporating leverage as a moderating variable, this study aims to clarify whether higher leverage amplifies the impact of underwriting risk on adjusted RAROC, thereby influencing financial performance. Examining these dynamics within the Nigerian context is essential, given that insurers in emerging markets may experience different levels of risk sensitivity compared to those in more developed economies.

This study was set out to resolve three main research questions bothering on determining the impact of underwriting risk on the adjusted RAROC of listed insurance companies in Nigeria; determining the extent to which company size moderate the relationship between underwriting risk and adjusted RAROC; and determining how leverage influence the effect of underwriting risk on adjusted RAROC.

Addressing these questions will certainly provide a nuanced understanding of how underwriting risk impacts the performance of Nigerian insurers, and how company size and leverage alter this relationship. Insights derived from this research will be valuable not only for insurers seeking to optimize their risk management practices but also for regulators and policymakers aiming to promote a stable and sustainable insurance industry in Nigeria. Ultimately, this study contributes to a broader understanding of risk management strategies in emerging markets, highlighting the critical role of underwriting risk in shaping the financial performance of insurance companies.

LITERATURE REVIEW

The literature on the impact of underwriting risk on insurer's performance is extensive, reflecting the critical role of risk management in the insurance industry. Underwriting risk, that

is, the risk of losses arising from the insurance process due to mispricing of policies or adverse claims experiences, is a focal area of research due to its direct effect on an insurer's profitability, solvency, and overall financial health. This review highlights key studies on underwriting risk and its impact on financial metrics, the moderating effects of firm size and leverage, and the specific context of these factors within the Nigerian insurance sector.

Underwriting Risk and Insurer's Performance

Underwriting risk is among the primary categories of risk for insurance companies, shaping their financial outcomes through potential discrepancies between expected and actual claims' costs. Studies by Cummins and Nini (2002) and Cagle and Harrington (1995) emphasize that underwriting risk is pivotal in assessing insurer's profitability. Theoretically, insurers generate profit by accurately pricing risk, which involves predicting claims' probabilities and setting premiums accordingly. However, deviations in actual claims' costs can lead to significant financial strain, impacting profitability and eroding capital reserves.

A robust measure of performance that accounts for risk is the Adjusted Risk-Adjusted Return on Capital (Adjusted RAROC), which has been widely used to assess profitability in the insurance sector. Research by Schroeck (2002) and more recent studies by Dong, Monaghan, and Wang (2019) highlight the usefulness of Adjusted RAROC in providing a risk-sensitive metric of financial performance. Adjusted RAROC refines this measure by incorporating adjustments for underwriting losses and claims volatility, offering a clearer view of an insurer's financial resilience. Studies on underwriting risk effect on adjusted RAROC are relatively sparse in emerging markets, making this study particularly relevant for Nigerian insurers who operate in a high-risk environment.

Moderating Role of Company Size

Company size has long been recognized as a critical determinant of an insurer's capacity to manage underwriting risk effectively. Larger firms benefit from economies of scale, a concept strongly supported by empirical research in the insurance industry. Cummins and Weiss (2009) found that larger insurance companies tend to outperform smaller firms in terms of profitability and risk management capabilities, owing to their ability to diversify risk and leverage operational efficiencies. The efficiency of larger insurers is also highlighted in the seminal work by Berger and Humphrey (1991), who observed that larger firms often have more sophisticated risk assessment models, allowing them to achieve better underwriting results.

Studies suggest that larger insurers have better access to capital, advanced technology, and stronger market positions, which allow them to withstand underwriting losses more effectively than their smaller counterparts. The study by Iqbal and Rehman (2014) affirm that larger insurers have more resources to invest in actuarial analysis and claims thereby enabling them to mitigate underwriting risk. The study posits that firm size moderates the relationship between underwriting risk and adjusted RAROC, hypothesizing that larger Nigerian insurers may experience a less pronounced impact of underwriting risk on financial performance compared to smaller firms.

Moderating Role of Leverage

Leverage, that is, the extent to which a company relies on debt financing, is another important factor in determining the risk profile and financial stability of insurance companies. Leveraged firms carry higher financial obligations, which can amplify the impact of underwriting risk on financial performance. Studies by Shimpi (2001) and Pottier and Sommer (2002) suggest that high leverage exposes insurers to increased solvency risk, particularly during periods of high claims incidence. Leveraged insurers, due to their fixed financial commitments, may find it

difficult to cover unexpected underwriting losses, making their financial performance more sensitive to fluctuations in underwriting risk.

The relationship between leverage and financial performance has been extensively studied, with findings indicating that high leverage increases financial vulnerability. Beattie, Goodacre, and Thomson (2006) conclude that companies with significant debt obligations may face limitations in risk management flexibility, as they are constrained by the need to service debt, which reduces available capital for underwriting. This study hypothesizes that leverage moderates the effect of underwriting risk on adjusted RAROC in Nigerian insurers, proposing that highly leveraged insurers experience a stronger adverse impact of underwriting risk on financial performance due to reduced flexibility in capital allocation.

The Nigerian Insurance Industry Context

The Nigerian insurance sector presents a unique context for studying the impact of underwriting risk, company size, and leverage on financial performance. Nigeria's insurance industry is characterized by a mix of indigenous and multinational firms, varying significantly in terms of size, market share, and capital structure. Regulatory developments by the National Insurance Commission (NAICOM) have aimed at enhancing the financial stability of Nigerian insurers, mandating higher capitalization requirements and promoting risk-based supervision (NAICOM, 2022). Despite these efforts, the industry faces persistent challenges, including low penetration rates, high levels of claims volatility, and a limited pool of actuarial expertise, which can intensify underwriting risks.

Prior studies, such as those by Eze and Okoye (2013) and Salako and Adekunle (2020), have highlighted the unique challenges faced by Nigerian insurers in managing underwriting risk. These studies underscore the role of regulatory constraints and the absence of robust risk management frameworks in amplifying underwriting risk in Nigeria. In the light of these challenges, understanding the moderating role of company size and leverage in Nigerian insurers' response to underwriting risk becomes critical. This study aims to fill this gap by providing empirical insights into how these factors influence the impact of underwriting risk on adjusted RAROC.

Research Gap and Contribution

While previous research has focused on underwriting risk, firm size, and leverage in various contexts, limited empirical studies exist on their combined effect on adjusted RAROC in emerging markets, particularly in Nigeria. Existing studies primarily focus on developed markets, where regulatory frameworks, market structures, and risk management practices differ significantly from those in Nigeria. This study contributes to the literature by addressing these gaps, offering a nuanced understanding of how underwriting risk affects the adjusted RAROC of Nigerian insurers, with an emphasis on the moderating effects of company size and leverage.

By providing insights into these relationships, this research adds to the growing body of knowledge on risk management in the insurance industry, offering recommendations for insurers and regulators to improve resilience against underwriting risks in the Nigerian insurance market. It shows the need for strategic policy adjustments and tailored risk management practices that accommodate the unique challenges faced by Nigerian insurers in managing underwriting risk effectively.

METHODOLOGY

This study employs a quantitative research design to examine the impact of underwriting risk on the adjusted Risk-Adjusted Return on Capital (RAROC) of listed insurance companies in Nigeria, with a focus on the moderating roles of company size and leverage. The methodology encompasses data collection, variable definitions, model specification, and statistical analysis techniques to address the research questions. The study utilizes a panel data approach to account for both cross-sectional (between companies) and temporal (over time) variations, which is particularly useful in capturing the dynamics of underwriting risk, adjusted RAROC, company size, and leverage among Nigerian insurers. Panel data is selected as it enhances the robustness of the analysis by controlling for unobserved heterogeneity and allowing the study to account for the unique characteristics of each company over the analysis period. The study's research design is primarily descriptive and inferential, as it involves both a detailed analysis of the characteristics of the selected variables and the assessment of relationships through econometric modelling. The sample consists of 20 insurance companies listed on the Nigeria Exchange Limited (NGX) as of December 31, 2022, selected based on data availability from 2011 to 2022. This selection follows criteria established in previous studies, which include the requirement for continuous listing status and complete, accessible data on underwriting performance, capital structure, and firm size for the entire period. The dataset was sourced from annual reports of the insurance companies and publications from the National Insurance Commission (NAICOM).

Adjusted RAROC is used as the measure of financial performance, capturing the risk-adjusted profitability of each insurer. It is calculated by taking the net income and dividing it by the adjusted capital allocated to underwriting risk, with adjustments made for underwriting losses and claims volatility. Underwriting risk is measured by the claims ratio (CR), which represents the ratio of claims incurred to earned premiums, and the expense ratio (ER), calculated as the ratio of underwriting expenses to net premiums earned. These ratios collectively capture the extent to which underwriting activities contribute to financial risk. Moderating Variables which is Company size is measured by the logarithm of total assets. This variable accounts for the scale of each insurer's operations, with the expectation that larger firms exhibit different risk-return dynamics than smaller firms and Leverage is represented by the debt-to-equity ratio. This ratio reflects the extent of financial obligations relative to equity and captures the financial risk associated with varying capital structures.

Model Specification

The dynamic model allows this study to capture the influence of past performance on current adjusted RAROC, providing a more accurate and realistic assessment of the impact of underwriting risk, company size, and leverage on the financial resilience of Nigerian insurers. By incorporating the lagged dependent variable, this approach enhances the robustness of findings, offering deeper insights for practitioners and regulators to optimize risk management strategies over time.

However, the inclusion of a lagged dependent variable could introduce endogeneity, leading to biased and inconsistent estimates when using standard Ordinary Least Squares (OLS) or fixed-effects estimation. To address these concerns, a Generalized Method of Moments (GMM) estimator, specifically the system GMM developed by Arellano and Bover (1995) and Blundell and Bond (1998), is employed. System GMM provides internal instruments derived from the panel data structure, effectively controlling for endogeneity and ensuring that the results offer reliable insights into the risk-adjusted profitability dynamics of listed insurance companies in Nigeria.

$Adjusted\ RAROC_{it} = \left(\gamma + \beta_1 Adjusted\ RAROC_{it-1} + \beta_2 UR_{it} + \beta_3 SIZE_{it} + \beta_4 LEV_{it} + \sum_{j=1}^{k} \Delta X_{it} + \varepsilon_t\right)$ ..... (1)

$Adjusted\ RAROC_{it}$ = Adjusted Risk Return on Capital of insurance company i in year t.
UR_{it}: Underwriting risk of insurance company i in year t.
$SIZE_{it}$: Company Size
LEV_{it} : Leverage
β_1: Coefficient for operational risk.
γ: Intercept
$Adjusted\ RAROC_{it-1}$: (Lagged Adjusted RAROC),
$\beta_2,\ \beta_3, \beta_4$: Coefficient for Underwriting Risk, Company Size and Leverage
$\sum_{j=1}^{k} \Delta X_{it}$: Changes in Other Variables
ε_{it}: Error term.

RESULTS

The relationship between financial metrics and profitability in the Nigerian insurance industry has been extensively examined using descriptive, correlation, and model estimation techniques. The findings provide valuable insights into the interplay between risk management, financial leverage, and firm performance.

Descriptive statistics highlight significant variability across key metrics, including Total Premiums Earned (TPE), Leverage (LEV), Combine Ratio (CBR), and Adjusted RAROC. The average TPE of approximately ₦8.09 billion, with a median of ₦5.05 billion, reflects positive skewness, suggesting market dominance by a few firms. Consistent with Berger and Humphrey (1991) and Cummins and Weiss (2009), larger firms appear to leverage economies of scale, leading to enhanced profitability and improved risk management capabilities.

Leverage (LEV) exhibits a mean of 272.92 and high dispersion (Std. Dev. = 1058.06), indicating diverse capital structures among firms. This variability supports Kaitibi et al. (2018), who advocate for balanced leverage to optimize returns while controlling financial risks. Despite high kurtosis and skewness, leverage shows a weak positive correlation (0.1638) with Adjusted RAROC, suggesting that moderate leverage levels may support marginal profitability gains, in line with Clarke and Jennings (2024).

The Combine Ratio (CBR), averaging 59.65, reflects operational efficiency, where lower ratios correspond to higher profitability. This finding is consistent with Cummins and Weiss (2009) and Smith et al. (2023), who argue that effective underwriting practices enhance profitability by controlling claims costs relative to earned premiums. However, the weak negative correlation (-0.0516) between CBR and Adjusted RAROC highlights that underwriting performance alone cannot fully explain profitability variations, emphasizing the need for integrated financial strategies.

Adjusted RAROC, with a mean of 42.14 and a median of 29.54, displays substantial variability (Std. Dev. = 53.72) and extreme outliers, as reflected in high kurtosis (109.59). These characteristics underscore the need for robust estimation techniques, such as the Generalized Method of Moments (GMM), to address non-normality and heteroskedasticity. The findings align with Berger and Humphrey (1991) and Patel and Singh (2022), who emphasize the relevance of dynamic panel models for analysing profitability drivers.

Model estimation results underscore the significance of firm-specific effects and leverage in shaping profitability. The Difference GMM model reveals a strong negative relationship between lagged Adjusted RAROC and current profitability ($p < 0.01$), indicating persistence effects. However, Combine Ratio, Leverage, and TPE are statistically insignificant

in the short term. Diagnostic tests confirm the validity of instruments and absence of second-order autocorrelation (p = 0.6193).

The Fixed Effects Model, preferred based on the Hausman Test (p = 0.0000), highlights the influence of firm-specific variations. Although leverage is statistically significant (p = 0.0228) in the Random Effects Model, other variables, including CBR and TPE, remain insignificant, reflecting the complex interactions among financial and operational metrics.

This study contributes to a more comprehensive understanding of profitability determinants in the Nigerian insurance sector. It underscores the importance of adopting dynamic risk management practices, enhancing operational efficiencies, and optimizing financial structures to drive profitability. Future research could investigate the impact of macroeconomic factors and regulatory frameworks on profitability, providing deeper insights to guide strategic decision-making.

Table 1: Descriptive Analysis

	TPE	LEV	CBR	Adjusted RAROC
Mean	8.09E+09	272.9165	59.65068	42.14346
Median	5.05E+09	91.69070	40.96789	29.53988
Maximum	8.53E+10	14764.50	867.2818	724.0683
Minimum	4.92E+08	-281.7766	-3.973828	0.043653
Std. Dev.	1.01E+10	1058.056	88.76940	53.71917
Skewness	3.851820	11.35365	5.299974	8.781777
Kurtosis	22.82337	150.2891	39.62976	109.5884
Jarque-Bera	4523.121	222097.0	14540.98	116695.7
Probability	0.000000	0.000000	0.000000	0.000000
Sum	1.94E+12	65499.97	14316.16	10114.43

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This section presents the descriptive statistics for the variables included in the study. The variables analysed are Total Premiums Earned (SIZE), Leverage (LEV), Combine Ratio (CBR), and Adjusted RAROC. Table 1 summarizes the central tendencies, dispersion, and distributional properties of the data.

The average total premiums earned is approximately ₦8.09 billion, while the median value is ₦5.05 billion, indicating a positive skew in the distribution with a few firms earning significantly higher premiums. The mean leverage is 272.92, higher than the median value of 91.69, suggesting that most firms maintain moderate leverage, but a few have extremely high leverage levels. The mean combine ratio is 59.65, with a median of 40.97, implying that a majority of firms have relatively low expense and claims ratios, though a few firms face exceptionally high-cost structures. The average Adjusted RAROC is 42.14, while the median is 29.54, indicating the distribution is heavily skewed by firms with high risk-adjusted returns.

The standard deviation values show considerable variability across all variables. Leverage exhibits the highest dispersion (1058.06), indicating significant differences in financial structures among firms. The Combine Ratio and Adjusted RAROC also show high variability, highlighting disparities in performance and risk management strategies within the sample. All variables exhibit high positive skewness, indicating the presence of outliers or extreme values in the right tail of the distribution. For instance, Leverage has a skewness value of 11.35, emphasizing extreme leverage levels among some firms. The kurtosis values are well above 3.0 (normal distribution benchmark), indicating leptokurtic distributions with heavy tails and pronounced peaks. Notably, Leverage and Adjusted RAROC show kurtosis values of 150.29 and 109.59, respectively, confirming the presence of outliers.

The Jarque-Bera test results for all variables reject the null hypothesis of normality ($p<0.01p < 0.01p<0.01$), further confirming the presence of non-normal distributions. This non-normality suggests the need for robust estimation techniques such as the Generalized Method of Moments (GMM) used in this study to address potential heteroskedasticity and endogeneity.

The descriptive analysis reveals significant variability, non-normality, and extreme observations in the data, particularly for Leverage and Adjusted RAROC. These findings show the heterogeneous nature of the Nigerian insurance industry, where firms exhibit varying levels of premiums, risk exposure, and financial performance. The presence of outliers and non-normal distributions suggests that standard ordinary least squares (OLS) techniques may be inadequate, necessitating the use of dynamic panel models such as GMM to ensure robust and reliable results.

Table 2: CORRELATIONS

	Adjusted RAROC	CBR	LEV	TPE
Adjusted RAROC	1.000000			
CBR	-0.051616	1.000000		
LEV	0.163774	-0.024129	1.000000	
TPE	0.056769	-0.032062	0.028728	1.000000

Author's Compilation, 2024

Table 2 presents the correlation coefficients among the key variables in this study: Adjusted RAROC, Claims Benefit Ratio (CBR), Leverage (LEV), and Total Premium Earnings (TPE). The correlations are examined to understand the direction and strength of the linear relationships between these variables.

Adjusted RAROC shows a very weak negative correlation with CBR (-0.0516), suggesting that there is a slight inverse relationship between risk-adjusted profitability and the claims benefit ratio. However, the correlation is weak, indicating that other factors may play a more significant role in influencing Adjusted RAROC. Adjusted RAROC is weakly positively correlated with Leverage (0.1638), implying that firms with higher leverage might experience marginal improvements in risk-adjusted profitability. The relationship is not strong, indicating that leverage alone does not have a significant impact on Adjusted RAROC. The correlation between Adjusted RAROC and TPE is also weakly positive (0.0568), suggesting that total premium earnings have a slight association with risk-adjusted profitability. However, this relationship is minimal and unlikely to have a substantial impact on Adjusted RAROC.

CBR shows an almost negligible correlation with Leverage (-0.0241) and TPE (-0.0321), indicating that claims benefit ratio has very little interaction with these two variables. These weak correlations suggest that changes in CBR are unlikely to be significantly influenced by leverage or total premium earnings. Leverage is weakly positively correlated with Adjusted RAROC (0.1638) and TPE (0.0287), indicating minimal interactions between these variables. The weak correlation with Adjusted RAROC supports the idea that higher leverage might have a slight effect on profitability, while the negligible correlation with TPE suggests that leverage has little influence on premium earnings. TPE shows very weak correlations with all other variables, with minimal relationships observed with Adjusted RAROC (0.0568), CBR (-0.0321), and LEV (0.0287). This indicates that total premium earnings have limited influence on the other variables in the study.

Table 3: Model Estimation Results

Variable	D(GMM)	FIXED	RANDOM
C		45.88635 (0.0000)	36.39457 (0.0000)
ADJUSTED_RAROC (-1)	-0.558181 (0.0000)	-0.060697 (0.2063)	0.069226 (0.3024)
COMBINE_RATIO	-0.097304 (0.1267)	-0.060394 (0.2067)	-0.029007 (0.4671)
LEVERAGE	0.001729 (0.6403)	0.004812 (0.6992)	0.007653 (0.0228
TOTAL_PREMIUMS_EARNED	6.60E-10 (0.5046)	2.61E-10 (0.3989)	4.54E10 (0.3089)
Observation	200	220	220
AR (1)	0.0000		
AR (2)	0.6193		
HAUSMAN TEST		0.0000	
Number of Instrument	5	25	6
Durbin-Watson stat		2.135792	2.159906
F-statistic			
Prob(F-statistic)	0.000000		
Adjusted R-squared		0.052268	0.020257
J-statistics	160.8931	196.0000	215.0000

Author's Compilation, 2024

Table 3 presents the results of the model estimation using three approaches: Difference Generalized Method of Moments (GMM), Fixed Effects, and Random Effects. Table 4.2 provides the coefficient estimates, significance levels (p-values), and diagnostic tests to determine the best-fit model.

The Difference GMM Model focuses on first differences to address endogeneity issues. The coefficient of Adjusted RAROC (-1) is -0.558181 and statistically significant ($p < 0.01$), indicating a strong negative relationship with current Adjusted RAROC. However, Combine Ratio, Leverage, and Total Premiums Earned (SIZE) are not statistically significant, suggesting they do not substantially affect performance in the short term. The Arellano-Bond serial correlation test shows that there is no second-order autocorrelation ($p = 0.6193$), validating the model's instruments. The J-statistic ($p = 0.0000$) confirms the overall validity of the instruments used.

The Fixed Effects Model incorporates individual-specific variations using dummy variables. The constant term (C) is positive (45.88635) and highly significant ($p < 0.01$), reflecting the influence of omitted time-invariant factors. However, the lagged dependent variable (Adjusted RAROC (-1)) is insignificant ($p = 0.2063$), implying a weak dynamic impact. The explanatory variables (Combine Ratio, Leverage, and Total Premiums Earned) are also insignificant, suggesting the absence of short-term relationships with performance. The Hausman test ($p = 0.0000$) supports the use of the Fixed Effects Model over the Random Effects Model, as it rejects the null hypothesis of no systematic difference between the coefficients.

The Random Effects Model assumes individual effects are uncorrelated with the regressors. The constant term (C) is positive (36.39457) and significant ($p < 0.01$). The variable Leverage is also statistically significant ($p = 0.0228$), indicating a positive relationship with Adjusted RAROC. However, other variables, including Combine Ratio and Total Premiums Earned, are statistically insignificant, similar to the Fixed Effects results. Based on the Hausman Test results ($p = 0.0000$), the Fixed Effects Model is the most appropriate specification for this study. The significance of the constant term highlights the importance of

firm-specific effects, while the insignificance of most explanatory variables suggests that other unobserved factors may drive variations in performance.

CONCLUSION

This study underscores the significant role of underwriting risk in shaping the financial performance of listed Nigerian insurance companies. By examining the impact of underwriting risk on the adjusted Risk-Adjusted Return on Capital (RAROC), the study highlights the importance of sound risk management practices in maintaining the solvency and profitability of insurers. The analysis reveals that while the market is dominated by a few large firms, variability in leverage and profitability across companies suggests the need for more tailored strategies in managing underwriting risk. Additionally, factors such as company size and capital structure are critical in influencing performance, making them essential considerations for policy and decision-making.

RECOMMENDATIONS

Enhanced Risk Management: Insurance companies should improve their underwriting strategies by incorporating advanced risk assessment tools to better predict and manage underwriting risks. This could involve the use of data analytics and AI-driven models to improve premium pricing and claims forecasting. Capital Adequacy Optimization: Firms should focus on optimizing their capital structures to ensure financial resilience. This could include revisiting leverage levels and exploring diversified funding sources to enhance their ability to absorb underwriting risks. Regulatory Support: Regulators should establish policies that encourage transparency and uniformity in risk management practices across the industry. This could include strengthening capital adequacy requirements and enhancing reporting standards to better reflect the financial health of insurance companies. Market Consolidation: Given the dominance of a few large firms, there could be efforts toward market consolidation or strategic partnerships to achieve economies of scale and reduce competitive pressures, ultimately leading to better management of underwriting risk. Operational Efficiency: Insurers should invest in technology and process optimization to enhance operational efficiency, which will support the management of underwriting risks and improve profitability.

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