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The Relationship between Premium Collection and Investment of Insurance Companies: A Case Study of Prabhu Insurance Company

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Abstracts

Insurance represents a contractual arrangement between the policyholder and the insurer, wherein the policyholder pays a premium, typically in periodic installments, in exchange for financial protection against specified risks. The primary aim of this study was to evaluate the relationship between premium collection and the investment strategies employed by Prabhu Insurance Company Limited. A descriptive research design was utilized, with data sourced from the company's annual progress reports spanning the financial years 2018/19 to 2022/23, accessible through online resources. The collected data was systematically organized and analyzed using statistical techniques, specifically correlation and time series analysis. The findings indicated variability in both premium collection and investment trends throughout the study period. A strong positive correlation was identified between the two variables, suggesting that an increase in premium collection corresponded with a rise in investment. Furthermore, the study concluded that there exists a one to one relationship between premium collection and investment patterns at the company, highlighting the mutual dependence of these two financial indicators.

Keywords: Premium Collection, Investment, Prabhu Insurance, Life Insurance Company

Introduction

Insurance can be defined as a collective mechanism designed to share the financial burden of a particular risk among individuals who are exposed to it and seek to mitigate its potential impact. Risk refers to the uncertainty regarding the possibility of a financial loss. It is important to distinguish risk from the probability of loss, which represents the expected number of losses within a specified set of exposures. This differentiation also applies to peril, which refers to the underlying cause of a loss, and hazard, which signifies a condition that may increase the likelihood of a loss occurring. Additionally, it is critical not to confuse risk with the actual loss, which pertains to the unintended reduction or elimination of value resulting from an unforeseen event. In situations characterized by uncertainty regarding a potential loss, risk is present (Mishra & Mishra, 2016). Every potential risk inherently carries the possibility of some form of loss. The purpose of insurance is to distribute this potential loss across a large group of individuals who are collectively committed to supporting each other in times of loss. While the risk itself cannot be entirely eliminated, the resulting loss associated with a specific risk can be shared among the participants (Schwarcz & Schwarcz, 2014). A premium is the regular payment made by the insured to the insurer in exchange for the transfer of risk, as specified in the insurance policy (Rejda & McNamara, 2017). Investment refers to the allocation of funds into various financial instruments or assets with the aim of generating returns, increasing capital value, or achieving specific financial goals. This process involves committing resources to secure potential returns that offset the inherent risks. Investment decisions are influenced by factors such as risk tolerance, investment horizon, and prevailing market conditions (Bodie, Kane, & Marcus, 2020).

Sharma (2013) highlighted that micro insurance is a relatively novel concept in countries like Nepal, where its primary objective is to alleviate poverty by helping low-income households mitigate risks. Traditionally, Nepal's insurance industry has focused on middle- and high-income individuals and businesses, rather than micro insurance. However, a few non-life insurance companies have started to offer micro insurance products. It is essential to establish regulations that encourage insurance companies in Nepal to engage in micro insurance. Furthermore, these companies should be mandated to allocate a portion of their funds towards micro-lending initiatives. Recently, the Nepali government has also been providing subsidies to support micro insurance programs. Gururg (2010) observed that both life and non-life insurance policies in Nepal have been steadily increasing over the study period. Similarly, the collection of premiums and their contribution to GDP have shown consistent annual growth. Additionally, the investment by life and non-life insurance companies has also been increasing, with a significant relationship between the two sectors during the study period. The overall growth in premium collection and investment demonstrates a positive trend, with a strong interrelationship between the two. These findings suggest that the performance of Nepalese insurance companies is satisfactory, particularly in terms of premium collection and investment.

Khanal (2020) highlighted that challenges for the insurance sector in Nepal stem from limited education and awareness about insurance, along with a middle-class demographic and political instability. Despite these challenges, recent reports show a steady increase in the number of policyholders each year. Khanal's review outlines the insurance landscape in Nepal, noting growth in premium collection and policyholders, but also emphasizing difficulties in product innovation, customer service, and policy retention. With more refined market research, the potential for both insurance companies and the concept of insurance in Nepal remains promising. Chakraborty (2022) concluded that recognizing health insurance as a distinct category could significantly improve access to healthcare. This shift would reduce the personal financial burden of medical costs and encourage more people to acquire health insurance. The introduction of more competition could lead to more affordable health insurance options. Additionally, allowing greater foreign investment would make the sector more attractive for investment, potentially improving the availability and quality of health insurance in India, thereby ensuring a more secure healthcare future for its population.

Subedi (2018) found that corporate governance plays a crucial role in the performance of Nepalese insurance companies. The study emphasized the positive effects of increased board meeting frequency on timely issue resolution and overall industry efficiency. A well-structured governance system contributes to the proper functioning of insurance companies. Further research could explore other governance variables, such as independent directorship, board composition, audit meeting frequency, leverage, and ownership structure. The study did not, however, address factors such as board and CEO qualifications, experience, and the frequency of audit meetings. A comparative analysis of corporate governance practices between life and non-life insurance companies could also offer deeper insights. Prescott (2002) argued that relying solely on risk-based deposit insurance premiums is insufficient to address moral hazard in deposit insurance systems. He suggested that more complex pricing structures and examination methods, rather than simple premiums, could better manage moral hazard. This argument is based on the presence of private information, which is common in markets without government insurance. Similar to how insurance contracts use deductibles and copayments, audits can be used to mitigate moral hazard. Banks also employ restrictions and conditions on borrowers' actions to manage the impact of private information, highlighting that deposit insurance pricing involves more than just premium levels. Hissiyah & Meylianingrum (2023) introduced the idea that premium income has a partially significant impact on profit in the context of Sharia life insurance. Premium income, representing funds paid by participants and investment results positively influence net profit, potentially contributing to the company's future growth. Notably, claim expenses do not negatively affect profit, as they are covered by the tabarru' fund derived from participant contributions. Similarly, operating expenses do not diminish profit, as they are offset by company earnings. Together, these factors indicate that premium income, investment returns, claim expenses, and operating expenses collectively influence net profit in Sharia life insurance. Neupane (2010) aimed to analyze and provide independent views on the premium collection and investment patterns of insurance companies in Nepal. The researcher concluded that one of the main challenges facing Nepal's insurance sector is intense competition, resulting from liberalization and privatization. Underpricing, price-cutting, and unhealthy competition are significant issues within Nepal's insurance industry. Shakya (2021) examined the trends in premium collection and investment patterns of Nepalese insurance companies, noting an upward trajectory. Despite the increase in premium collection, the growth rate in percentage terms was deemed unsatisfactory. Similarly, the returns from investments were also underwhelming. Shakya concluded that while insurance companies in Nepal have made commendable progress, they could achieve greater success with improvements based on comprehensive market research, which could elevate the sector and the concept of insurance to a level of excellence. Nischal & Campus (2020) concluded that the profitability of non-life insurance companies in Nepal is positively influenced by the size of the company. Larger non-life insurance companies demonstrate better financial performance, supporting the concept of economies of scale. The study found that non-life insurance companies in Nepal with greater total assets experience better financial outcomes. This suggests that company size plays a crucial role in the financial success of Nepalese non-life insurance businesses.

History of Insurance in the Nepalese Context

Nepal's domestic general insurance industry began with the founding of Nepal Mal Chalani tatha Beema Adda (now Nepal Insurance Company) in 1947. This initiative was a joint effort between Nepal Bank Limited and private investors. Prior to this, Indian insurance companies operated in Nepal, offering general insurance policies without formal registration from the 1930s until 1967, and expanded to life insurance policies by 1974. Regulatory oversight began with the enactment of the Insurance Act in 1968. A significant milestone was the establishment of Rastriya Beema Sansthan in the same year, which became the first life and non-life insurer in the country as a state-owned enterprise governed by specific legislation. The policy shift towards financial liberalization in the 1990s allowed for the entry of private domestic and foreign companies into Nepal's insurance sector (Ghimire, 2014). Today, Nepal has 37 insurance companies, comprising 14 life insurance companies, 14 non-life insurance companies, 2 reinsurance companies, and 7 micro insurance companies (Tiwari et al., 2024).

Non-Life Insurance in Nepal

Non-life insurance, also known as general insurance, covers various forms of insurance, measuring risk in financial terms. In Nepal, non-life insurance policies encompass a wide range of coverage types, including fire, motor, marine, engineering, micro, aviation, and agriculture, among others.

Profile of Prabhu Insurance Company

Prabhu Life Insurance Company Limited, founded in December 2017, is a public limited company based in Nepal. Initially focused on life insurance, the company expanded its portfolio to include endowment, whole life, and term insurance policies. Prabhu Life experienced rapid growth, with significant increases in both premium collection and profits. In June 2023, Prabhu Life merged with Mahalaxmi Life Insurance, forming Prabhu Mahalaxmi Life Insurance Limited. This merger, which was approved by the Insurance Authority of Nepal, was driven by the need to meet new regulatory capital requirements, including a minimum capital base of Rs. 500 cores. The merger was executed with a 1:1 share swap ratio, helping the combined entity strengthen its market position and streamline its operations.

Research Question

1. What is the relationship between premium collection and investment of Prabhu Insurance Company?

Research Methods

The study employed a descriptive case study research design. There are 37 insurance companies operating in Nepal, consisting of 14 life insurance companies, 14 non-life insurance companies, 2 reinsurance companies, and 7 micro-insurance companies. For the purposes of this study, only non-life insurance company was selected as the sample, specifically focusing on Prabhu Insurance Company. The research utilized secondary data, which was gathered from various sources, including the official websites of insurance companies and the Insurance Board of Nepal. Additional data were obtained from library resources such as books, periodicals, newspapers, company magazines, as well as relevant published journals and academic books. These diverse data sources contributed to a comprehensive analysis, combining industry insights with academic perspectives. Correlation and time series analyses were applied to examine the collected data. Prior to conducting the study, consent was obtained from the relevant authority, and the collected information was analyzed and presented in a systematic manner.

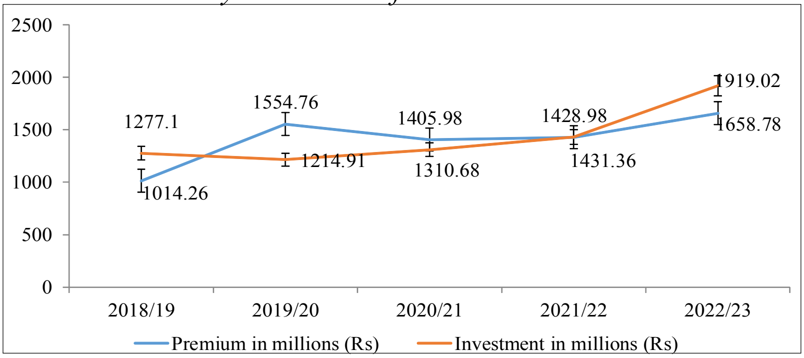
Data Analysis

Conclusions regarding Prabhu Insurance Company can be drawn through a trend analysis of its investment and premium patterns from the fiscal years 2018/19 to 2022/23. This analysis reveals fluctuations and key characteristics of the company's financial activities, offering valuable insights into both past performance and current trends.

The data obtained aids in understanding the relationship between premium collection and investment strategies, reflecting the company's capacity to reinvest policyholders' contributions. These trends also provide a clearer picture of the company's financial health and operational strategies, enabling more informed forecasts regarding its future growth and investment potential. The table below presents the premium collection and investment patterns of Prabhu Insurance Company.

Figure 1:

Time Series Analysis Pattern of Premium Collection and Investment



The analysis of premium collection and investment patterns for Prabhu Insurance Company from 2018/19 to 2022/23 shows notable fluctuations and growth trends. In 2018/19, the company collected Rs.1, 014. 26 million in premiums and invested Rs. 1,277.10 million. Premium collection increased significantly in 2019/20 to Rs.1, 554.76 million, though investment slightly declined to Rs. 1,214.91 million.

In 2020/21, premium collection decreased to Rs.1, 405.98 million, but investment rebounded to Rs.1, 310.68 million. The following year (2021/22) saw a slight rise in premiums to Rs. 1,428.98 million and a matching investment of Rs.1, 431. 36 million, suggesting a more stable financial strategy. Finally, 2022/23 marked the highest figures, with premiums reaching Rs.1, 658.78 million and investments soaring to Rs.1, 919.02 million.

This trend analysis indicates a generally positive correlation between premium collection and investments, especially in the later years, demonstrating the company's growing capacity to reinvest higher premiums into strategic investments.

Correlation Analysis between Premium Collection and Investment

To discover the two variables microscopically a statistical technique known as a correlation can be utilized. It helps to find out the degree of their relationship .Two or more variables are said to be correlated if a change in the value of one variable appears to be related to a change in the other variables. How closely variables are related to one another is discussed in correlation analysis. It is calculated as below

Coefficient of correlation (r) = $\frac{\sum XY}{\sqrt{\sum X^2 * \sum Y^2}}$

Table 2:

Correlation Analysis between Premium Collection and Investment

FY	Premium in millions(X)	Investment in millions (Y)	X2	Y2	XY
2018/19	1014.26	1277.1	1028723.348	1630984.41	1295311.446
2019/20	1554.76	1214.91	2417278.658	1476006.308	1888893.472
2020/21	1405.98	1310.68	1976779.76	1717882.062	1842789.866
2021/22	1428.98	1431.36	2041983.84	2048791.45	2045384.813
2022/23	1658.78	1919.02	2751551.088	3682637.76	3183231.996
$\sum X^2$ =10216316.69				$\sum Y^2$ =10556301.99	$\sum X.Y$ =10255611.59

Coefficient of correlation (r) = $\frac{\sum XY}{\sqrt{\sum X^2 * \sum Y^2}} = \frac{10255611\ .59}{\sqrt{10216316\ .69\ X\ 10556301\ .99}}$

$= \frac{10255611\ .59}{\sqrt{107846524256673\ \ .00}} = \frac{10255611\ .59}{10384918\ .12} = 0.9875$

Coefficient of correlation between premium collection and investment

Coefficient of correlation	Relationship
0.98	Higher degree of positive relationship

According to the study's findings, there is a stronger correlation between insurance company in overall premium collection and their investment. That has shown that a greater premium collection result to greater investment. The change in the independent variable (premium collection) explained 98.75 percent of the variance in the dependent variable (investment) for the company.

Discussion

This study employed secondary data analysis to provide a thorough overview of the premium collection and investment practices of Prabhu Life Insurance Company. It focused on examining the patterns in premium collection, their composition, and the investment strategies adopted by the company, aligning with the study's objectives. By utilizing trend analysis and correlation models, the research highlighted the relationships and trends between premium collection and investment strategies. This analysis provided valuable insights into how these two elements interact, enhancing the understanding of Prabhu Insurance's financial operations and strategic decision-making processes.

The company's investment trends show flexibility, suggesting that future investments will likely increase. However, the investments have primarily been concentrated in a limited number of sectors. As premium collections are expected to grow, it is anticipated that investments will also rise correspondingly. The study found a strong positive correlation between the premiums collected by non-life insurance companies collectively and their investment activities, indicating a robust relationship between premium collection and investment patterns. Overall, a strong positive correlation was observed between the premiums collected by non-life insurance companies and their investment practices, reflecting a significant link between these two aspects of the industry.

Conclusion and Implications

The pattern of premium collection and investment during the first three years exhibits significant flexibility, primarily due to the economic impact of COVID-19, which affected a large portion of the Nepalese population. This disruption highlights that many individuals, particularly from lower income groups, are hesitant to invest during periods of economic uncertainty. Reports, however, indicate a steady increase in the number of insurance policyholders each year.

There is a one-to-one relationship between premium collection and investment. In the later years, both premium collection and investment trends show an upward trajectory, particularly in the non-life insurance sector (Prabhu Insurance Company). To ensure long-term sustainability, insurance companies must develop robust investment portfolios to enhance earnings. The primary objective of these investments is to safeguard reserves, ensuring that funds are available to meet future policyholder obligations without experiencing resource shortages. While insurance companies have made some progress in this area, there has been limited change overall. Market research-driven improvements have the potential to significantly elevate both insurance businesses and the concept of insurance in Nepal to an exceptional level.

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Conflict of Interest

The author affirms that there are no conflicts of interest associated with this study.

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