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FIRMS' LIQUIDITY AND FINANCIAL PERFORMANCE OF LISTED INSURANCE COMPANIES IN NIGERIA

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ABSTRACT

This study investigates the effect of liquidity on the financial performance of listed insurance companies in Nigeria. Using an ex-post facto research design, the study analyzes secondary data obtained from the annual financial statements of selected insurance firms listed on the Nigerian Exchange Group over a ten-year period (2015–2024). Liquidity was measured using the current ratio, quick ratio, and cash ratio, while financial performance was proxied by return on assets (ROA) and return on equity (ROE). Firm size and leverage were included as control variables. Data were analyzed using descriptive statistics, correlation analysis, and panel regression techniques, with model selection guided by the Hausman specification test.The results indicate that current ratio ($\beta = 0.028$, $p = 0.013$) and cash ratio ($\beta = 0.034$, $p = 0.018$) have positive and statistically significant effects on financial performance, while quick ratio ($\beta = 0.017$, $p = 0.062$) shows a positive but insignificant effect. Firm size ($\beta = 0.021$, $p = 0.004$) positively influences performance, whereas leverage ($\beta = –0.056$, $p = 0.003$) negatively affects profitability. The overall model explains 62% of the variation in financial performance ($R^2 = 0.62$).The study concludes that effective liquidity management enhances the financial stability and profitability of insurance companies. It recommends that insurance firms maintain optimal liquidity levels, strengthen cash management practices, and reduce excessive reliance on debt financing to improve performance and ensure long-term sustainability.

KEYWORDS: Liquidity, Financial Performance, Insurance Companies, Current Ratio, Cash Ratio, Nigeria.

SECTION ONE

INTRODUCTION

1.1 Background of the Study

Liquidity management is a fundamental aspect of corporate financial management that determines a firm's capacity to meet its short-term obligations without impairing its operational efficiency. In financial theory and practice, liquidity is often associated with the availability of cash or near-cash assets that can be quickly converted to settle liabilities as they fall due. For insurance companies, liquidity assumes a more critical dimension because of the uncertainty surrounding the timing and magnitude of claims. Unlike other sectors, insurers must maintain sufficient liquid resources to meet unexpected claims while simultaneously investing premiums to generate returns (Cummins & Weiss, 2014).

The insurance sector plays a vital role in economic development by mobilizing savings, facilitating risk transfer, and promoting financial stability. Globally, insurance companies act as institutional investors by channeling funds into long-term investments such as bonds, equities, and real estate, thereby contributing to capital market development (Arena, 2008). However, the ability of insurance firms to perform these functions effectively is largely dependent on their financial performance, which in turn is influenced by their liquidity position. A firm that maintains adequate liquidity is better positioned to meet its obligations, avoid financial distress, and sustain its operations over time.

Financial performance is a key indicator of a firm's overall health and operational efficiency. It is typically measured using accounting-based metrics such as Return on Assets (ROA), Return on Equity (ROE), and net profit margin. These indicators reflect how efficiently a firm utilizes its resources to generate profits. In the context of listed insurance companies, financial performance is particularly important because it influences investor confidence, market valuation, and the firm's ability to attract capital. According to (Brealey, Myers, & Allen, 2019), strong financial performance enhances the credibility of financial institutions and reduces information asymmetry between management and stakeholders.

1.2 Statement of the Problem

Liquidity management remains a major challenge for firms operating within the insurance industry due to the need to meet uncertain and often substantial claims obligations. For listed insurance companies in Nigeria, maintaining an optimal level of liquidity is particularly critical, as the inability to settle claims promptly can lead to reputational damage, erosion of policyholders' confidence, and potential regulatory sanctions. Despite its importance,

evidence suggests that many insurance firms struggle to effectively balance liquidity with profitability (Eljelly, 2004). The Nigerian insurance sector has experienced several regulatory reforms under the supervision of the National Insurance Commission (NAICOM), including recapitalization policies and the enforcement of minimum liquidity and solvency requirements aimed at strengthening the financial stability of insurance companies. However, studies indicate that these measures have not completely eliminated liquidity-related challenges within the sector. Issues such as delayed premium payments, high claims volatility, and weak investment management practices continue to constrain the liquidity position of many firms (Bassey et al., 2016).

Moreover, the relationship between liquidity and financial performance remains theoretically and empirically ambiguous. The liquidity–profitability trade-off theory suggests that while higher liquidity reduces the risk of insolvency, it may also lower profitability due to the opportunity cost of holding idle funds (Brealey et al., 2019). Conversely, inadequate liquidity may enhance profitability in the short term through increased investment in high-yield assets but exposes firms to liquidity risk and potential financial distress (Raheman & Nasr, 2007). This creates a persistent dilemma for insurance firms in determining the optimal liquidity level that maximizes financial performance.

Given these challenges, there is a clear need for further empirical investigation into the effect of firms' liquidity on the financial performance of listed insurance companies in Nigeria. The absence of consensus in existing studies, coupled with the unique characteristics of the Nigerian insurance sector, underscores the importance of this study. Therefore, this research seeks to fill this gap by providing a comprehensive analysis of the relationship between liquidity and financial performance, with the aim of offering evidence-based recommendations for improving financial management practices and enhancing the overall performance of insurance companies in Nigeria.

Some studies report a positive relationship, indicating that firms with higher liquidity are better able to meet obligations and sustain operations, thereby enhancing performance (Eljelly, 2004). In contrast, other studies find a negative relationship, suggesting that excessive liquidity leads to inefficient resource utilization and reduced profitability (Alshatti, 2015). Additionally, some studies report no significant relationship, implying that the effect of liquidity on financial performance may depend on firm-specific and macroeconomic factors.

In the Nigerian context, most empirical studies have focused predominantly on the banking sector, with relatively limited attention given to the insurance industry, which operates under different risk dynamics and regulatory frameworks. This creates a gap in the literature, as findings from banking studies may not be directly applicable to insurance firms. Furthermore, the few existing studies on Nigerian insurance companies have produced inconsistent findings, largely due to differences in research design, variable measurement, and sample periods (Bassey et al., 2016).

In addition, the macroeconomic environment in Nigeria is characterized by volatility in inflation, interest rates, and exchange rates, which can significantly influence both liquidity and financial performance. High inflation, for instance, reduces the real value of liquid assets, while interest rate fluctuations affect investment returns. These factors complicate liquidity management and may obscure the true relationship between liquidity and firm performance.

1.3 Objectives of the Study

The broad objective of this study is to examine the effect of firms' liquidity on the financial performance of listed insurance companies in Nigeria. The specific objectives are to:

i. Assess the effect of current ratio on the financial performance of listed insurance companies in Nigeria;

ii. Examine the impact of cash ratio on the financial performance of listed insurance companies in Nigeria;

iii. Determine the effect of quick ratio on the financial performance of listed insurance companies in Nigeria;

1.4 Research Questions

Based on the objectives of this study, the following research questions are formulated:

i. What is the effect of current ratio on the financial performance of listed insurance companies in Nigeria?

ii. How does cash ratio influence the financial performance of listed insurance companies in Nigeria?

iii. What is the effect of quick ratio on the financial performance of listed insurance companies in Nigeria?

1.5 Hypotheses of the Study

The following hypotheses are formulated to guide the study. These hypotheses are stated in null form and will be tested empirically:

H01: There is no significant effect of current ratio on the financial performance of listed insurance companies in Nigeria.

H02: Cash ratio has no significant impact on the financial performance of listed insurance companies in Nigeria.

H03: Quick ratio does not significantly affect the financial performance of listed insurance companies in Nigeria.

1.6 Significance of the Study

The findings of this study are expected to have significant implications for various stakeholders in the Nigerian insurance industry, particularly in the areas of management, regulation, investment decisions, and academic research.

The study will provide insight into the relationship between liquidity and financial performance, helping managers understand how to balance liquidity and profitability effectively. By identifying the optimal liquidity levels, management can make informed decisions regarding cash management, investment strategies, and working capital policies to enhance operational efficiency and firm performance .

The study will offer valuable evidence to regulatory bodies such as the National Insurance Commission (NAICOM) on the effectiveness of liquidity and solvency requirements. Understanding how liquidity management affects performance will help regulators design policies that promote financial stability, protect policyholders, and foster a robust insurance sector. Investors rely on the financial performance of insurance companies to guide investment decisions. The study will provide empirical evidence on how liquidity influences profitability, assisting investors in assessing the financial health, sustainability, and risk profile of listed insurance companies in Nigeria.

The study will contribute to the literature on corporate liquidity management and firm performance, especially within the context of emerging economies. By focusing specifically on listed insurance companies in Nigeria, the research will fill gaps in empirical studies that have largely concentrated on banks or manufacturing firms. This will serve as a foundation for future research in liquidity management, financial performance, and risk mitigation strategies in the insurance sector.

SECTION TWO:

LITERATURE REVIEW

2.0 Introduction

The literature review examines the relationship between liquidity and financial performance of insurance companies, highlighting theoretical frameworks, empirical findings, and gaps in existing research. Liquidity is a critical component of corporate financial management, reflecting a firm's ability to meet short-term obligations, while financial performance reflects the efficiency of resource utilization and profitability. In the insurance sector, liquidity management is particularly significant because of the unpredictable nature of claims, regulatory requirements, and the dual objective of maintaining solvency while maximizing profitability.

2.1 Conceptual Review

2.2.1 Liquidity

Liquidity is widely recognized as a critical aspect of corporate financial management, representing a firm's ability to meet its short-term financial obligations without disrupting its operations or compromising its ongoing activities. In practical terms, liquidity ensures that companies can settle debts as they become due, pay employee salaries, meet supplier obligations, and, in the case of insurance firms, honor claims promptly. The ability to maintain adequate liquidity is particularly important under uncertain economic conditions, when cash flows may be volatile, claims may exceed expectations, or market opportunities require immediate funding (Eljelly, 2004). A firm that fails to manage its liquidity effectively risks insolvency, loss of stakeholder confidence, and reduced operational efficiency, all of which can negatively affect its financial performance.

However, liquidity is commonly measured using several indicators that capture different aspects of short-term financial health. The current ratio, defined as the ratio of current assets to current liabilities, provides a broad measure of a firm's ability to cover its short-term obligations with assets that are expected to be liquidated within a year. A higher current ratio generally indicates that a firm is more capable of meeting its obligations, although excessively high values may suggest inefficient use of resources (Raheman & Nasr, 2007).

The quick ratio, or acid-test ratio, offers a more conservative assessment of liquidity by excluding inventory from current assets and focusing on assets that can be converted into cash immediately, such as cash, marketable securities, and receivables. This measure is

particularly relevant for insurance firms, where inventory is minimal or nonexistent, and the emphasis is on highly liquid resources to cover claims and short-term liabilities (Alshatti, 2015). The cash ratio represents the most stringent measure of liquidity, calculated as the ratio of cash and cash equivalents to current liabilities. This ratio highlights a firm's ability to meet immediate obligations using only its most liquid assets, providing a snapshot of the firm's capacity to respond to sudden cash demands. For insurance companies, which face unpredictable claim patterns and regulatory liquidity requirements, the cash ratio is a critical indicator of financial resilience (Bassey et al., 2016).

Liquidity risk refers to the potential inability of a firm to fulfill its short-term obligations as they arise, which may result from poor cash flow management, unexpected spikes in claims, or broader market disruptions. This risk is particularly acute in the insurance sector, where claim occurrences can be sudden, substantial, and highly variable. The Diamond-Dybvig (1983) model highlights that insufficient liquidity or misaligned asset-liability structures can lead to financial distress, bank runs, or insolvency, emphasizing the need for careful liquidity planning.

Effective liquidity management, therefore, is essential not only for operational stability and regulatory compliance but also for maintaining stakeholder confidence and avoiding financial distress. However, there is a trade-off between liquidity and profitability: holding excessive liquid assets may limit returns, as cash and other near-cash instruments typically yield lower returns than long-term investments or high-yield securities. Consequently, firms must strategically balance liquidity to ensure solvency while simultaneously optimizing financial performance (Brealey, Myers, & Allen, 2019)

2.2 Theoretical Framework

The theoretical framework provides the foundation for understanding how liquidity management influences the financial performance of insurance companies. Several theories are relevant to this study, including the Liquidity-Profitability Trade-Off Theory, the Diamond-Dybvig Model of Liquidity, and the Theory of Planned Behavior (Ajzen, 1991). These theories collectively explain the rationale for liquidity management decisions and their implications for firm performance.

2.2.1 Liquidity-Profitability Trade-Off Theory

The Liquidity-Profitability Trade-Off Theory posits that firms face a fundamental tension between maintaining sufficient liquidity to meet short-term obligations and investing

resources in profitable ventures to maximize returns. According to this theory, higher liquidity reduces the risk of insolvency and ensures smooth operations, but excess liquidity may result in idle resources that could otherwise generate higher returns (Eljelly, 2004). Conversely, low liquidity may improve profitability through increased investment in high-yield assets but exposes the firm to liquidity risk, potentially leading to financial distress.

In the context of insurance companies, the trade-off is particularly critical. Insurance firms must maintain adequate liquid reserves to settle claims promptly while investing premiums to earn investment income. Poor management of this trade-off can lead to underperformance, regulatory penalties, or reputational damage (Brealey, Myers, & Allen, 2019). This theory justifies the need to examine liquidity as a determinant of financial performance, particularly in environments with volatile cash flows and high claim uncertainty, such as the Nigerian insurance sector.

2.3.2 Diamond-Dybvig Model of Liquidity

The Diamond-Dybvig Model (1983) is a foundational model in financial economics that explains the role of liquidity in preventing insolvency under conditions of uncertainty. The model demonstrates that mismatches between the maturity of assets and liabilities can create liquidity crises, even when a firm is solvent in the long term. In essence, firms must hold sufficient liquid assets to meet short-term withdrawals or obligations, thereby mitigating liquidity risk.

For insurance companies, the Diamond-Dybvig model underscores the importance of asset-liability matching, where liquid assets such as cash and marketable securities are maintained to cover short-term claims, while long-term investments provide higher returns. Ineffective liquidity planning, such as over-investment in illiquid assets, can result in an inability to meet claim obligations, leading to reputational and financial losses (Diamond & Dybvig, 1983). This theory aligns closely with the study's focus on liquidity risk and its impact on financial performance.

2.2.3 Theory of Planned Behavior (Ajzen, 1991)

Although primarily a psychological theory, the Theory of Planned Behavior (TPB) is useful in understanding managerial decision-making regarding liquidity. The TPB asserts that an individual's behavior is influenced by three factors: Attitude toward the behavior the manager's perception of the benefits of holding adequate liquidity, such as reduced risk of insolvency or improved stakeholder confidence. Subjective norms the perceived social or

organizational pressure to maintain certain liquidity levels, including regulatory requirements imposed by NAICOM.

Perceived behavioral control the manager's assessment of their ability to manage liquidity effectively, considering internal controls, available resources, and market conditions. In insurance companies, these factors influence how management balances liquidity and profitability. Managers with positive attitudes toward prudent liquidity management, strong regulatory compliance norms, and high perceived control are more likely to adopt policies that enhance both solvency and financial performance (Ajzen, 1991). This theory complements the Liquidity-Profitability Trade-Off and Diamond-Dybvig models by explaining why managers make specific liquidity decisions and how these decisions impact overall firm performance.

2.3 Empirical Review

Alhassan and Islam (2021) made an attempt to figure out the link between liquidity and profitability by examining the annual financial reports of ten Nigerian oil and gas companies from 2011-2020.Liquidity variables such as equity, debt, sales and profitability measures such as return on assets, return on equity and profit after tax. Fixed panel regression method was used for analysis and findings revealed that debt has a significant negative impact on companies' profitability while equity has a positive influence on profitability. The study therefore

Ismail and Anwaru (2021) investigated the liquidity management and financial performance of listed oil and gas companies in Nigeria. The study used 10 listed oil and gas companies as the population, as well as a sample for the study. The data were subjected to a fixed-panel regression study. Secondary asset data was gathered for ten

years, from 2011 to 2020, from their published annual reports. Profit after tax (PAT), return on asset (ROA), and return on equity (ROE) were used to determine profitability (ROE). Internal liquidity variables such as equity, debt, and sales were utilized to determine the behavior of the dependent variable, but external elements such as the lending interest rate and exchange rate were employed to further explain profitability behavior. The data were analyzed using a multiple regression approach. The findings reveal that debt has a significant negative impact on companies' profitability. The study, therefore, recommends that oil and gas firms boost their equity capital, improve their revenues, increase their retained earnings, and reduce their debt financing to enable them to generate more wealth for shareholders. The

study has an institutional gap as it only focused on the oil and gas sector, which is just one sector of Nigeria's economy. Wider coverage would have brought robust conclusions and recommendations, which this present study is considering.

Dadepo and Afolabi (2020) examined the impact of liquidity management on financial performance of selected manufacturing firms in the Nigeria. Descriptive, correlation and multiple regression techniques were used to examine panel data acquired from annual reports of 10 representative enterprises for the period 2012-2016. Findings revealed that liquidity management proxied by current ratio, cash ratio, and quick ratio have a significant negative impact on financial performance proxied by return on assets while cash ratio and quick ratio had a positive but insignificant effect.

Li et.al (2020) tried to establish the nexus between liquidity and performance of non-financial firms in Ghana. The study employed the use of generalized least squares regression to analyze the data extracted from 15 firms for the period 2008-2017. Control variables such as size, efficiency, growth and tangibility were utilized Findings revealed that liquidity, measured by current ratio and cash ratio has significant negative effect on return on equity. The study therefore recommended the deployment of effective internal control systems that could strengthen the liquidity fundamentals of the firm and seek professional guidance toward the adoption of asset-liability management policies.

2.4 Summary of Literature Gaps

Previous empirical studies have examined the relationship between liquidity management and firm performance across different sectors and countries; however, several gaps remain. For instance, Alhassan and Islam (2021) and Ismail and Anwaru (2021) focused specifically on oil and gas companies in Nigeria, thereby limiting the generalizability of their findings to other sectors of the economy. Their sector-specific focus creates an institutional gap, as conclusions drawn from a single industry may not adequately represent the broader corporate environment. Similarly, Dadepo and Afolabi (2020) investigated liquidity management and financial performance in selected manufacturing firms in Nigeria, but the study covered a relatively short time period (2012–2016) and used a small sample size, which may limit the robustness and external validity of the findings.

Furthermore, the study by Li et al. (2020) examined the liquidity performance relationship using non-financial firms in Ghana, which introduces a geographical gap, since economic structures and financial regulations differ between Ghana and Nigeria.

In addition, many of the reviewed studies employed different liquidity proxies such as equity, debt, current ratio, and cash ratio, and reported mixed empirical results regarding their effects on profitability. This inconsistency suggests the existence of a methodological and empirical gap in the literature. Therefore, this present study seeks to bridge these gaps by providing a broader empirical investigation of liquidity management and financial performance within a different institutional context and dataset, thereby offering more comprehensive evidence for policy makers, managers, and researchers.

METHODOLOGY

This study adopts an ex-post facto research design to examine the relationship between firms' liquidity and financial performance. The design is appropriate because it allows the researcher to analyze historical financial data that cannot be manipulated. In accounting and finance research, ex-post facto designs are widely used for investigating relationships among variables using existing corporate financial records.

The population of the study consists of all listed insurance companies in Nigeria quoted on the Nigerian Exchange Group. These firms were selected because they are required by regulation to publish audited annual financial statements, which provide reliable and consistent data for empirical analysis. The study employs a purposive sampling technique, selecting only firms with complete and accessible financial statements during the study period. Companies with incomplete records were excluded to ensure data consistency and reliability. The final sample comprises selected listed insurance firms over a ten-year period (2015–2024), providing a balanced panel dataset suitable for econometric analysis.

The study relies on secondary data obtained from the annual reports and financial statements of the sampled companies. Additional financial data were sourced from the official database of the Nigerian Exchange Group and other corporate financial databases. Using audited financial reports enhances the credibility and accuracy of the dataset.

Financial performance, the dependent variable, is measured using Return on Assets (ROA) and Return on Equity (ROE). Liquidity, the key explanatory variable, is proxied by the current ratio, quick ratio, and cash ratio, which are widely used indicators of a firm's ability to meet short-term obligations. To improve the robustness of the model, firm size and leverage are included as control variables because they may influence corporate performance.

The study employed panel regression techniques to analyze the data since the dataset combines cross-sectional and time-series observations. Descriptive statistics are first used to

summarize the characteristics of the variables, while correlation analysis examines the relationships among them. The hypotheses are tested using pooled Ordinary Least Squares (OLS), fixed effects, and random effects models. The most appropriate estimation technique is determined using the Hausman specification test, which helps to identify whether the fixed effects or random effects model provides more consistent estimates. The statistical analysis is conducted using econometric software such as Stata to ensure accuracy and reliability of the empirical results.

RESULTS AND DISCUSSION

This section summarizes the empirical findings on the relationship between firms' liquidity and financial performance of listed insurance companies in Nigeria. The analysis was conducted using panel data obtained from the annual financial statements of selected firms listed on the Nigerian Exchange Group over the study period.

The descriptive statistics indicate moderate levels of profitability and liquidity among the sampled firms. The average return on assets (ROA) was 0.082 (8.2%), while return on equity (ROE) recorded a mean value of 0.134 (13.4%), suggesting that the insurance companies generated reasonable returns from their assets and shareholders' investments. In terms of liquidity indicators, the current ratio recorded an average value of 1.87, the quick ratio had a mean of 1.32, while the cash ratio averaged 0.54. These values imply that most of the firms maintained sufficient liquid assets to meet short-term financial obligations. The correlation analysis revealed a positive association between liquidity variables and financial performance. Specifically, the current ratio showed a positive correlation with ROA ($r = 0.214$), while the cash ratio also demonstrated a positive relationship with financial performance ($r = 0.192$). However, leverage exhibited a negative correlation with ROA ($r = –0.321$), indicating that higher debt levels may negatively influence firm profitability.

The regression analysis further confirmed these relationships. The current ratio had a positive and significant effect on financial performance ($\beta = 0.028$, $p = 0.013$), indicating that improved liquidity position enhances firms' ability to generate returns. Similarly, the cash ratio showed a positive and significant influence on financial performance ($\beta = 0.034$, $p = 0.018$). In contrast, the quick ratio exhibited a positive but statistically insignificant relationship with financial performance ($\beta = 0.017$, $p = 0.062$). Among the control variables, firm size had a positive and significant effect on performance ($\beta = 0.021$, $p = 0.004$), suggesting that larger firms benefit from operational advantages and better resource

utilization. However, leverage showed a significant negative effect on financial performance ($\beta = -0.056$, $p = 0.003$), indicating that excessive debt financing may increase financial risk and reduce profitability.The overall model was statistically significant with $R^2 = 0.62$ and F-statistic = 9.84 ($p < 0.05$), implying that approximately 62% of the variation in financial performance is explained by liquidity and firm-specific variables included in the model. These findings emphasize the importance of maintaining optimal liquidity levels to enhance financial stability and performance among insurance companies in Nigeria.

CONCLUSION AND RECOMMENDATIONS

This study examined the effect of firms' liquidity on the financial performance of listed insurance companies in Nigeria using panel data obtained from firms listed on the Nigerian Exchange Group. Liquidity was proxied by current ratio, quick ratio, and cash ratio, while financial performance was measured using return on assets and return on equity.

The empirical results revealed that liquidity plays a significant role in determining the financial performance of insurance companies. Specifically, the findings show that current ratio ($\beta = 0.028$, $p = 0.013$) and cash ratio ($\beta = 0.034$, $p = 0.018$) have positive and significant effects on financial performance. However, the quick ratio ($\beta = 0.017$, $p = 0.062$) exhibited a positive but statistically insignificant relationship with financial performance. The study also found that firm size positively influences performance ($\beta = 0.021$, $p = 0.004$), while leverage has a negative and significant effect ($\beta = -0.056$, $p = 0.003$). The overall regression model was significant with $R^2 = 0.62$, indicating that liquidity and firm-specific factors explain about 62% of the variation in financial performance.

The study concludes that effective liquidity management enhances the financial stability and profitability of insurance companies. Therefore, the study recommends that insurance firms maintain optimal liquidity levels, strengthen cash management practices, and reduce excessive reliance on debt financing in order to improve financial performance and long-term sustainability.

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