

# The Effect of Good Corporate Governance and Premium Growth on the Performance of Insurance Companies

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## ABSTRACT

**Objective** – Insurance companies in Indonesia are considered an important part of society by the Indonesian government. Corporate governance was a major problem during the post-financial crisis period, particularly in emerging markets in Indonesia. Financial Institutions considered the possibility of increasing insurance premiums to cover their operating costs and increase their profits. The purpose of this study is to measure the effect of corporate governance and premium growth on the performance of the insurance sector, to determine the characteristics of good corporate governance.

**Technique/Methodology** – The samples used in this study include insurance companies listed on the Indonesia Stock Exchange between 2011 and 2015. The data used in the study is derived from the Indonesian Stock Exchange Corner. The method of analysis used is descriptive statistics and linear regression. The research objectives are to analyze the influence of the independent variables on the dependent variable. A purposive sampling method is used to determine the sample size of the study. This method generated a sample of 9 commercial insurance companies.

**Findings** – The findings show that corporate governance is significantly and positively related to ROA whereas Insurance Premiums are not significantly related to ROA.

**Novelty** – Study suggests that the insurance companies must aim to improve corporate governance structures by finding solutions to existing problems and improving the management structures of the company, in order to attract future investment which will ultimately lead to an increase in ROA and ROE.

**Type of Paper:** Empirical

**Keywords:** Corporate Governance; Insurance Premium; Corporate Performance; Growth.

**JEL Classification:** G22, L25, M41

## 1. Introduction

Economic and industrial development are increasingly progressive and involve complex implications for the growth of insurance businesses in Indonesia. It should be recognized that it is very difficult to convince people of the importance of insurance for the protection of personal items and their family. Article 1(1) of Law No. 2 of 1992 on Insurance Business (Law on Insurance Business), defines insurance as follows:

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“Insurance or coverage is an agreement between two parties by which is binding on the parties, by receiving insurance premiums, to reimburse the insured for loss, damage, or loss of expected benefits or coverage arising from an uncertain event or for payment based on the life of an insured person”.

Referring to the definition above, it can be concluded that insurance is an agreement where the insurer agrees to bind himself with the insured, in order to receive a payment of a premium, which ensures that the insurer will provide a replacement for any loss, damage, or loss of profits expected arising out of unavoidable events. As according to Khair (2014), insurance involves a transfer of risk from an individual or an organization to the insurance provider.

Thus, insurance is considered a service that provides protection to a family or company from future loss, providing security for life and property that is owned by the policyholder. The appropriate services to be offered by the insurance company will differ with every individual, particularly for families. Family is the most important aspect in the life of every parent. Placing a value on a person's life through an insurance policy may go against moral considerations, but this does not prevent it being given a monetary value in terms of insurance protection (Almajali et al., 2012). An insurance policy is the document that contains the information regarding the terms of the agreement between the insured and the insurer, as well as the rules that have been established between them. The regulations contained within the insurance policy are referred to when a claim is made by the insured person (Malik, 2011; Mwangi & Murigu, 2015).

GCG emerged in 1998 when Indonesia experienced prolonged financial crisis. There were two triggers the development of GCG, namely: the rapid environmental changes which had an impact on global market competition and the increasing number of interested parties, including complex ownership structures, that affect the management of stakeholders (Michelberger, 2014). Many say that the lengthy period of restoration in Indonesia was due to weak corporate governance of Indonesian companies. Since then, both the government and investors have paid significant attention to the practice of GCG. The implementation of GCG allows Indonesian companies to compete at an international level.

GCG involves an effort to improve a company's performance. Several studies have shown that GCG directly affects a company's performance. Michelberger (2014) states that companies with poor performance usually have poor governance structures. This statement is also supported by research conducted by Rachman (2015), which shows that there is a positive relationship between corporate governance and corporate performance as measured by ROA. Kombo et al. (2014) also shows that the variables associated with GCG have a strong influence on company performance. On the other hand, research by Darmawati (2005) shows that GCG has no effect on company performance. The performance of each company not only serves to enhance the company's market value, but also leads to the growth of the entire sector which ultimately leads to overall economic prosperity (Mehari & Aemiro, 2013).

According to Akotey et al. (2013), gross written premium has a positive impact on sale profitability and underwriting profits. It is clear that the growth of premiums increase the profitability of insurance operations and overall profitability. Mehari and Aemiro (2013) also state that there is no relationship between premium growth and financial performance.

## **2. Literature Review**

### **2.1 Premium Growth**

Mehari and Aemiro (2013) state that premium growth is measured using gross written premium (gross premium). Premium growth is used as a proxy for measuring changes in premium increases generated by the company. Companies that grow too quickly may cause the demise of the company, where the company prioritises growth over other important goals. The present research found that there is no relationship between premium growth and financial performance. These results are consistent with Ghofar (2012). It can be

concluded that the growth of premiums of insurance companies is not the only factor leading to growth of the company.

## 2.2 Good Corporate Governance (GCG)

There are two main theories associated with GCG: the Stewardship Theory and Agency Theory. Stewardship Theory is built on philosophical assumptions about human nature, namely that men are essentially trustworthy and are able to act with full responsibility, integrity and honesty towards others. In other words, stewardship theory views management structures as being inherently trusted to act in the best interests of the public and other stakeholders. Meanwhile, agency theory, developed by Michael Johnson, believes that a company's management structures act as "agents" for shareholders, therefore acting with full awareness of its own interests. GCG is defined as structures, systems and processes used by a company in order to provide long term sustainable value.

According to Jensen and Meckling (1976), agency theory is a contract between the manager (agent) with the owner (principal). Klapper and Love (2002) state that GCG involves convincing the owners of a company in order to obtain a return on their investment. Yoo and Jung (2015) define corporate governance as a system that uses the leadership of an organization to direct, control, and supervise the organization's resources management in an efficient, effective, economical and productive way, with the principles of transparency, accountability, responsibility, independence and fairness, to achieve organizational goals. Theoretically, corporate governance practices can improve the performance of a company and reduce the risk involved with board decisions which are only in the interests of the board. Generally, GCG can increase the confidence of investors (Darmawati, 2005).

## 2.3 Financial Performance

According to Gitman and Zutter (2015), financial performance is divided into two categories: Performance Profit and Market Value. Profit Performance can be measured as the difference between revenue and outgoing costs.

## 3. Research Method

### 3.1 Research Framework and Hypothesis

The above description is the basis for the establishment of a conceptual framework, which appears below:

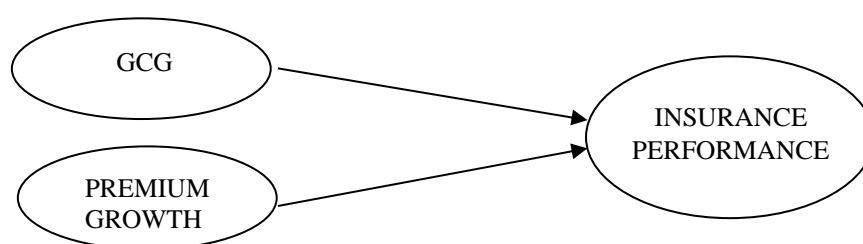


Figure 1. Research Framework

The hypotheses in this study are:

H<sub>1</sub>: Good corporate governance has a positive effect on the performance of insurance companies.

H<sub>2</sub>: Insurance premiums have a positive effect on the performance of insurance companies.

According to Santi et al. (2015) and Ghofar (2012), insurance premiums affect the performance of the insurance company more following their fourth year of operation. This is because the income generated from insurance premiums is mainly used to finance outgoing costs relating largely to administration in earlier years. Hence, larger premiums may increase the performance of the insurance company.

### 3.2 Population and Sample

The research sample consists of insurance companies listed on the Indonesian Stock Exchange (BEI) that implement GCG and premiums, with the observation period starting in 2011 and ending in 2015. The sampling method used was purposive sampling and the sample was determined using specific considerations (Sekaran, 2009; Widarjono, 2015). The considerations used in selecting samples were: the companies must have complete data regarding their implementation of GCG measures and the cost of their premiums between 2011 and 2015 and they must be listed on the Indonesian Stock Exchange.

### 3.3 Variables and Variables Measurement

The dependent variable is Return on Assets (ROA), and the two independent variables are Good Corporate Governance (GCG) and Premium Growth (PG). The measurement of each variable is as follows:

Table 1. Variables Measurement

No	Variable	Notation	Measurement
1	Good Corporate Governance	GCG	Board of Directors, Board of Commissioners And frequency of meetings for both
2	Premium	PG	Gross Premium
3	Return on Assets	ROA	Total Assets

### 3.4 Data Analysis

To answer the hypothesis proposed in this study requires accurate analysis tools. This study uses a linear regression model to measure company performance from corporate governance variables and premium growth using SPSS 21.0 as a proponent. The multiple regression model is as follows:

$$\text{Insurance Performance} = \alpha + \beta_1 \text{GCG} + \beta_2 \text{IP}$$

## 4. Research Result

To test the hypothesis of linear regression model, SPSS 21.0 calculation is used where ROA is a measurement of financial performance, which happens to be the dependent variable. The independent variables are Good Corporate Governance (GCG) and Premium Growth (PG) as shown in the table below (Table 2).

Table 2. ANOVA<sup>a</sup>

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	9.864	2	4.932	9.751	.000 <sup>b</sup>
Residual	21.242	42	0.506		
Total	31.105	44			

Dependent Variable: Y

Predictors: X<sub>1</sub>, X<sub>2</sub>

From the ANOVA table above, it can be concluded that the model framework described above is feasible. The multiple linear regression model test can be seen in Table 3.

Table 3. t-TEST. Coefficients<sup>a</sup>

Model	Unstandardized Coefficient		Unstandardized Coefficient	t	Sig.
	B	Std. Error	Beta		
(Constant)	19.7	20.074		0.981	0.332
X <sub>1</sub>	1.132	0.287	0.666	3.942	0
X <sub>2</sub>	-6.808	6.29	-0.183	-1.082	0.285

Dependent Variable: Y

The multiple Linear regression model is:

$$\text{Insurance Performance} = \alpha + \beta_1 \text{GCG} + \beta_2 \text{IP}$$

$$\text{Insurance Performance} = 19.700 + 1.132 \text{ GCG} - 6.808 \text{ IP}$$

The model shows that if GCG is increased by 1 unit, performance will be increased by 1.132 units. In addition, if insurance premiums are increased by 1 unit, performance will decline by 6.808 units.

The results of the T-test in Table 3 show that the significance level of GCG to ROA is at 0.000 which is smaller than the required for a significance level ( $<0.05$ ). Therefore, GCG has a positive and significant impact on ROA. The T-test results show that the significance level of premium growth on ROA is 0.285 which is higher than the required significance level ( $>0.05$ ). Therefore, premium growth does not have a significant impact on ROA.

## 5. Discussion

### 5.1 GCG influence on ROA

Darmawati et al. (2005) found that statistically, GCG significantly affects the company's operating performance that is proxied by ROA. This may be due to delayed market responses towards the implementation of corporate governance. Indifference towards corporate governance can reduce a company's competitiveness, which can have a negative effect on performance. Nurainy et al. (2013) and Yoo and Jung (2015) examined the effect of corporate governance on ROA and found that corporate governance has a significant negative effect on ROA.

### 5.2 Premium influence on ROA

As described above, the results of the t-test found that the significance level of the effect of insurance premiums on ROA is 0.285 which is higher than the required significance level ( $>0.05$ ). Premium growth therefore does not have a significant impact on ROA. In addition, it also has a standard error of 6,290. This is

in accordance with the findings of Mehari and Aermiro (2013) which states that there is no relationship between premium growth and performance.

## 6. Conclusion

Based on the analysis of the 9 insurance companies, it can be concluded that GCG has a positive and significant impact on the financial performance of an insurance company. This is shown by the results of the regression calculation by linear regression analysis test, which has a value of 3.942 with a significance level of 0.000 ( $<0.05$ ). However, the remaining hypothesis is not accepted so it can be concluded that "premium growth does not have a significant impact on the financial performance of insurance companies". This is shown by the results of the regression calculation from linear regression analysis test, which has a value of 1,082 with a significance level of 0.285 ( $>0.05$ ).

Companies with higher levels of corporate governance, usually demonstrate higher competitive strength in terms of market competition. Therefore, insurance companies must aim to improve corporate governance structures by finding solutions to existing problems and improving the management structures of the company, in order to attract future investment which will ultimately lead to an increase in ROA and ROE. For investors, return on equity and return on assets are critical considerations when determining whether or not to invest. This research can be continued by investigating the influence of Debt Equity Ratio on both ROE and ROA with a longer time span, to increase the validity of any conclusions made.

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