

Insurance Penetration and Financial Development in Nigeria, 2003-2023

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ABSTRACT

This study investigates the interaction between insurance penetration on the development of the financial system in Nigeria covering the period 2003 to 2023. The main purpose of the paper is to find out the responsiveness of the insurance penetration to the development of the financial system in Nigeria. Financial development broken down into bank development (Credit to the Private Sector divided by Gross Domestic Product) and institutional development (money supply divided by Gross Domestic Product) served as the independent variables while insurance penetration served as the dependent variable. An array of preestimation tests were used to determine the goodness of the used dataset and the adopted methodology is the Autoregressive Distributed Lag Model form of regression analyses. Findings arising from this study indicate that financial development enhances insurance penetration while the regulatory environment controlled for by monetary policy rate also favourably affects insurance penetration. This implies that the interconnectedness of the sectors of the financial system should be explored for the imperatives of overall development of the financial system.

Keywords: Insurance penetration; financial development; bank development and monetization ratio.

INTRODUCTION

Nigeria's insurance sector has faced significant challenges in contributing to the country's financial development, despite its potential to drive economic growth and stability. Low insurance penetration rates, regulatory challenges, and limited access to financial services have hindered the sector's growth. Nigeria, Africa's largest economy, has experienced significant economic growth and transformation over the past few decades. However, the country's insurance sector remains underdeveloped, with low insurance penetration rates hindering financial development and economic growth (Eze and Okoye, 2013). This study examines the relationship between insurance penetration and financial development in Nigeria from 2003 to 2023, with a focus on identifying key factors that influence insurance penetration and developing strategies to enhance financial development. By analyzing the dynamics of insurance penetration and financial development, this research aims to contribute to the existing body of knowledge and inform policy decisions that can stimulate economic growth, reduce poverty, and improve financial inclusion in Nigeria.

Insurance is designed to protect the financial wellbeing of an individual, company, other entity or society at large against unexpected loss (Oke, 2012). It is social in nature because it represents the cooperation of various individuals for mutual benefits by combining together to reduce the consequence of similar risks. As new areas of risk emerge with each passing day, there is need for new insurance packages to take care of more and more

areas of risk, hence, insurance booms. Badejo (1998) in Eze and Okoye (2013) posits that the concept of insurance in its modern form was introduced into Nigeria by the British in the closing years of the 19th Century with the establishments of trading posts by European trading companies (See Kalu, Agwah & Augustina, 2019). These companies effected their insurance with established insurers in the London Insurance market. Later on, some British Insurers appointed Nigerian agents to represent their interest in the country. These agents later metamorphosed into full branch offices of their parent companies in Britain.

Universally, Insurance is a cardinal and essential branch of Finance and its operations play vital role in providing safety environments for economic activities to take place. Though Insurance appears somewhat unpopular to most households and businesses in the Nigerian society for obvious reasons, it has however been an integral part of overall business operations. In developed and some emerging economies of the world where people express trust for insurance services, it plays great roles in boosting the economy. To effectively start this discussion and for the purpose of clarity, it is necessary to give a concise definition and explanation of the term 'Insurance'. In its most simplified form, Insurance is a strategy of protecting individuals, households and business entities from financial loss. It involves risk management; a technique designed to reduce or possibly eliminate financial risk or hedge against unforeseen or accidental loss. According to Chikeleze and Echekoba (2008), Insurance is a contract whereby one party called the insurer, in return for a consideration called the premium, undertakes to pay the other party called the insured a sum of money or its equivalent in kind upon the happening of specified event that is contrary to the interest of the insured. The insurable interest may be as a result of ownership of something precious, a property for instance or pre-existing relationship as in the case of the relationship between spouses or being in possession of an object, et cetera (Chikeleze and Echekoba, 2008).

Nigeria's insurance penetration rate remains low, with only 0.6% of the population having insurance coverage, compared to the global average of 6.2%. This low penetration rate has hindered the sector's contribution to financial development, economic growth, and poverty reduction.

Contributes to the existing body of knowledge on the relationship between insurance penetration and financial development. Provides insights for policymakers and regulators to develop strategies to enhance insurance penetration and financial development. Offers recommendations for insurance companies to improve their services and increase penetration rates. Helps to identify areas for further research in the insurance and financial development sectors.

REVIEW OF RELATED LITERATURE

Insurance is the business of providing risk against uncertainties and managing such risk for the insured and third parties. It is a means of indemnity against a future occurrence of an uncertain event. It can also be seen as and organizations from potential financial losses due to unforeseen events or risks. Nigeria, insurance plays a crucial role in:

- **Risk Management:** Insurance helps individuals and businesses manage risks, reducing financial losses and promoting economic stability.
- **Financial Inclusion:** Insurance increases access to financial services, promoting financial inclusion and economic growth.
- **Investment:** Insurance companies invest premiums, contributing to Nigeria's economic development.
- **Savings:** Insurance encourages savings, providing a safety net for individuals and businesses.
- **Economic Growth:** Insurance supports economic growth by enabling investment, innovation, and entrepreneurship.
- **Poverty Reduction:** Insurance helps reduce poverty by providing financial protection to vulnerable populations.
- **Financial Deepening:** Insurance contributes to financial deepening, increasing the size and complexity of Nigeria's financial sector.

To increase insurance penetration in Nigeria, the following strategies can be employed

- Awareness Campaigns: Educate the public about insurance benefits.
- Product Innovation: Develop affordable, tailored insurance products.
- Distribution Channels: Expand distribution channels, including digital platforms.
- Regulatory Framework: Strengthen regulatory oversight and enforcement.
- Incentives: Offer incentives for insurance companies to invest in Nigeria.

By increasing insurance penetration, Nigeria can promote financial development, economic growth, and poverty reduction.

Over the years, the insurance sub-sector has witnessed some significant growth worldwide. According to Beck and Webb (2003), the share of this sector in the financial sector has been increasing as reflected in the volume of business of the insurers. Theoretically, the various channels through which insurance can positively impact economic growth include mobilization of domestic savings, efficient management of different risks, mitigation of losses, more efficient allocation of domestic capital and promotion of financial stability (Acha and Ukpong, 2012; Skipper, 2001; Beck and Webb, 2003; Akinolo, 2013). Ward and Zurbrugg (2000) and Kugler and Ofoghui (2005) assert that in offering risk transfer, indemnification for unexpected large losses, financial intermediary services and real services, insurance markets have had a significant productive impact within economies. For instance, insurance can help to promote strategic investments in productive assets by providing surety to investors and other contractual claimants (such as banks) to protect the value of their investments against unanticipated severe losses (Adams, Andersson, Anderson, and Lindmark, 2000).

The study is anchored on Keynesian Liquidity Preference Theory by Keynes (1936) and Shiftability Theory of Liquidity Management by H.G. Moulton (1913) as the theory underpinning the study. Keynesian Liquidity Preference Theory Keynes (1936) identified three key reasons for holding cash. For speculative, precautionary, and transactional reasons. The speculative purpose is to store cash in order to benefit from changes in agreed-upon buying and appropriate interest rates. To achieve these goals, most firms have decided to keep their tradable securities. When an institution wants to have funds on hand in case of unforeseen disasters, calamities, or mishaps. Institutions require money for transaction motivation in order to carry out their economic everyday activities. Individual businesses are thus expected to hoard cash, resulting in a loss of earnings if the capital was profitably spent. Kenyan banks, for example, must hold a minimum of 20% of all deposits, matured obligations, and short-term obligations in liquid assets.

The theory suggests that a firm's liquidity is preserved if it keeps assets that can be sold to other lenders or investors for cash even during a crisis. Liabilities are the topic of the shiftability theory. According to the theory, a firm's liabilities can provide additional liquidity, therefore its assets' shiftability, marketability, or transferability ensures liquidity. Based on the theory, a firm's highly marketable security provides liquidity. This theory held that some liquid assets might boost a firm's liquidity. Nwankwo (1991) claims that firms are not required to store liquidity on the asset side (liquidity asset) of the statement of financial position because they may receive all the cash they need. Scholars have critiqued liquidity management theories. However, firms with poor financial conditions and reduced standing may have trouble accessing liquidity during a crisis since investors' confidence in them has decreased. The study relies on shiftability theory.

Insurance companies play very important roles as financial markets round the world. Their roles somewhat complement those of Banking institutions and the Capital markets. Jointly, the roles of these three specialized institutions and markets boost economic activities of nations. Specifically, Insurance provides protection for risks inherent in everyday life activities and in particular risks in financial operations. The insured has an obligation to pay specified amount as premium with a promise from the insurers to pay compensation should the events insured against occurs. According to Ozuomba (2013), Insurance is designed to protect the financial well-being of an individual, company or other entity in the case of unexpected loss. In a more elaborate form, we reiterate that Insurance contract is referred to as 'insurance policy' and the holder thereof is known as the

policyholder or an insured. These contracts or policies vary in kind and structure depending on the type of contract. It could be informal or formal contract. The first type of insurance was the informal insurance being practiced by most communities and it is also known as 'self-insure'. This mechanism of micro-insurance has been popular in communities that cannot afford formal insurance policy for some reasons; in particular, as a result of transaction cost. These communities take to informal mechanism through pooling resources and contributions to cover future and probable, unforeseen expenses. This mechanism is referred to locally in Nigeria as 'Osusu'. It may also be carried out through building assets and also diversifying income. This informal insurance practice is growing fast because it helps participants to alleviate their welfare challenges. It also has the merit of avoiding transaction costs but the main disadvantage is lack of legal enforceable obligations amongst participants. Overall, this mundane insurance practices has helped and is helping communities to enhance economic activities and contributing immensely to GDP increase. Though the informal insurance practices have been useful to communities and households, other formal types of Insurance contract existing in Nigeria and are contributing greatly to GDP Increase assume the following broad headings.

Umoh, *et al.* (2023) investigated talent retention and insurance performance in the South South Zone of Nigeria. The population of this study was 157 and its sample 113. The study made use of the survey research design while 86% response rate was recorded. The analysis of data was done with multiple regression method. It was found that economic security has a significant influence on insurance performance (Beta =2.981, $t=4.785$, $p<0.05$); psychological security has a significant influence on insurance performances (Beta =1.003, $t=2.143$, $p<0.05$); affiliation has a significant influence on insurance performance (Beta =3.138, $t=3.381$, $p<0.05$); and that self-actualization has a significant influence on insurance performance (Beta =1.064, $t=2.011$, $p<0.05$). The research recoded an adjusted R² of 67.1%. It was concluded that talent retention can influence insurance performance in Nigeria.

According to Alagah (2022) examine the stimulating influence of management development on workers' efficiency of the insurance industry in Rivers State. Correctional research design was applied. The Krejcie and Morgan sample size determination table was employed in a bid to determine the sample size. Hence, the sample size is fifty-six; 27 managers and 28 supervisors drawn from the population size of 62 from the 10 insurance companies under review. The outcome of the analysis led to the finding that experiential learning, management training, and technology has significant effects on workers' efficiency. The Spearman' Rank Order Correlation Coefficient was used via the aid of the Statistical Package for Social Sciences. It was recommended that: Experiential learning should be encouraged as it gives room for critical thinking, enhances problem-solving and increases decision making skills which will translate into workers' efficiency for the insurance companies. Management should be consistent with having management trainings as this will help boost employees' confidence, while creating the ability of the trainee to implement company strategies and mitigate avoidable damages that could result in workers' inefficiency.

Dahiyat, Weshah, and Aldahiyat (2021) examined how liquidity and solvency management affected the financial performance of Jordanian manufacturing companies listed on the Amman Stock Exchange from 2010 to 2019. Financial performance is measured by ROA and EPS. Current ratio (CR) and total debts to total assets were utilised as liquidity and solvency management proxies, whereas logarithm of total assets measured size. Correlation and multiple regression were used to analyse the data. Liquidity has a negligible negative impact on Amman Stock Exchange manufacturing enterprises' financial performance.

Hacini, Boulenfad, and Dahou (2021) examined how liquidity risk management affected selected Saudi conventional banks' financial performance from 2002 to 2019. Liquidity risk is measured by the loan to deposit ratio (LTD) and cash to deposit ratio (CTD). Financial performance is measured by Return on Equity (ROE). The control variable is equity to total asset ratio (ETA). Panel data (Pool, Fixed-effects, Random-effects) is used to test the study hypothesis. Saudi Arabian banks' financial performance suffers from liquidity risk.

Ukpong and Acha (2017) examined the cointegration and causal relationship between insurance and economic development in Nigeria using time series data from 1990 – 2013. Gross domestic product (GDP) is adopted as a proxy for the level of economic development, while total life insurance premiums (TPL), total non-life insurance premiums (TPNL) and total insurance investment (TII) are used in measuring growth in the insurance sector. Data is operationalized through the stationarity test, cointegration test, regression analysis

and granger causality tests. The stationarity test reveals that all-time series data are stationary at the 1%, 5% and 10% levels of significance. The test for cointegration shows that all cointegrate when GDP is the endogenous variable. The granger causality test reveals that there is a bidirectional relationship existing between GDP and total non-life insurance premiums while a unidirectional relationship exists between GDP and total life insurance premiums with no causal relationship existing between GDP and total insurance investments. An R-squared value of 0.9776 indicates that the independent variables account for 97.8% of the variations in GDP while the remaining 2.2% is attributable to influence of other variables or factors not in the scope of this study.

Yusuf, *et al.* (2017) investigation of insurance claims management among selected insurance companies in Nigeria. For this purpose, the researchers have been able to review critically the significant contribution of the claims processing in the management of insurance firms' claims. This study conducted in Lagos metropolis, employed a descriptive survey design using random sampling technique and thus gathered data through the use of structured questionnaire. The sample population consisted of 127 respondents made up of claims managers and other members of staff within the surveyed companies. One sample T-test was adopted in the analysis of collected data. Empirical assessment reveal that the various claims handling processing have significant effects in the claims management processes of insurance companies. The findings from study confirm the significance of the various claims handling processing in claims management of insurance companies in Nigeria. It therefore recommends that claims manager should put forward strategic plans to ensuring that insurance claims complaint files are properly kept, monitored and handled for needs that may warrant its usefulness in the future.

DATA AND METHODS

The data for this study came from the Central Bank of Nigeria statistical bulletin sand are time series in nature. In addition, they are secondary as they were drawn from preexisting sources. The datasets covers the period 2003 to 2023. To evaluate the impact of the explanatory variables (financial development) on insurance penetration in Nigeria, the Autoregressive Distributed Lag Model (ARDL) estimation techniques specified thus:

$$IP_t = \beta_0 + \sum_{n=1}^k \beta_1 \Delta IP_{t-n} + \sum_{n=1}^k \beta_2 \Delta CPSGDP_{t-n} + \sum_{n=1}^k \beta_3 \Delta M2GDP_{t-n} + \sum_{n=1}^k \beta_4 \Delta MPR_{t-n} + \rho_1 IP_t + \rho_2 CPSGDP_t + \rho_3 M2GDP_t + \rho_4 MPR_t + \varepsilon_t$$

Where:

IP_t is Insurance penetration and the measures for financial development include CPSGDP, that is credit to the private sector scaled by economic growth and monetization ratio which is money supply scaled by economic growth, money policy rate (MPR) is used as control variable.

β_0 = the constant or the intercept,

$\beta_1 - \beta_4$ = the coefficient of the short run parameters

$\rho_1 - \rho_4$ = the coefficient of the long run parameters,

$t - n$ = indicative of the lagged time series,

Δ = difference operators,

k, n = the minimum and maximum lag

ε_t = the residual, noise or error term.

In addition, the main estimation technique, an array of standard tests and tests for validity were used to show the adequacy of the data as well as the reliability of the results. Decisions followed the 0.05 level of significance.

RESULTS

First, the basic descriptive statistics of the investigated variables are presented in table 1.

Table 1: Summary of Basic Descriptive Statistics

Variables	Mean	Median	Std. Dev.	Skewness	Kurtosis	Jarque-Bera	Prob	CV	Obs
IP	7.90	8.21	0.87	-0.91	2.89	2.11	0.34	0.11	20
CPSGDP	5.39	5.74	2.02	-0.24	1.67	1.25	0.53	0.37	20
M2GDP	4.92	4.96	2.69	-0.43	2.15	0.92	0.63	0.54	20
MPR	12.46	12	3.36	-0.24	3.27	0.20	0.90	0.26	20

Source: Computed by the author

In Table 1 above, the metrics of central tendency (test for aggregative tendencies), dispersion, symmetrical features of the series, and degree of peakness of the distribution are all included. From table 1 above, MPR has the highest mean and M2GDP has the lowest median value. That shows that MPR is less closely knitted and M2GDP is more closely knitted. Standard deviation is a measure of dispersion, that is, how far apart is the distribution. In table 1 MPR is farther apart. Skewness measures the degree of symmetry or departure from symmetry of the distribution whereas kurtosis measures the degree of peakness of the distribution. The distribution is normal if skewness is zero (0) and kurtosis is three (3). Also, the distribution is leptokurtic (statistical distribution with kurtosis greater than three) if kurtosis is > 3 , playkurtic (statistical distribution with kurtosis less than three) if kurtosis is < 3 , mesokurtic if it is $= 3$. This leads to the conclusion that MPR is Leptokurtic, while the other variables are Playkurtic. CV stands for coefficient of variation, also known as relative standard deviation (RSD), this is the quotient of the standard deviation over the mean of the respective variables. This measure shows the level of dispersion around the mean in this study shows that the variables are not highly dispersed as all the RSD are less than unity (1).

Next, the table below displays correlation factors between different variables. The correlation matrix also shows whether there is a suspicion of multicollinearity.

Table 2: Summary of correlational matrix

Variables	LIP	LCPSGDP	LM2GDP	LMPR
LIP	1.00			
LCPSGDP	R = -0.40 {-1.59} [0.13]	1.00		
LM2GDP	R = -0.21 {-0.79} [0.44]	R = 0.67 {3.30} [0.00]	1.00	
LMPR	R = -0.23 {-0.86} [0.40]	R = 0.53 {2.30} [0.03]	R = 0.91 {8.16} [0.00]	1.00

R=correlational coefficient; = t-stat; [] = probability of t-statistics.

The t-statistic must be > 2.5 and the probability must be < 0.05 for two variables to have a linear relationship with one another. Based on this criterion, there is no linear correlation between IP and the independent variables. The absence of high correlation amongst the variables is indicative of absence of multicollinearity.

Next, to prevent running a spurious regression, the stationarity test was employed to look at the stationarity characteristics of the variables under examination. The Augmented Dickey-Fuller (ADF), a test that adheres to the conventional unit root test and breakpoint consistent technique, were utilized. The decision was based on a 5% level of significance.

The table 3 below shows the results of the traditional, as well as the innovation, and additive unit root test whose inclusion to the table was necessary as the traditional Unit root test does not recognize the presence of outliers which makes the Break point Unit tests (Innovation and additive tests) superior as they account for the presence of structural break.

Table 3: Unit Root Test Results

VARIABLES	TRADITIONAL UNIT ROOT			INNOVATION OUTLIER				ADDITIVE OUTLIER			
	ADF STAT	TCV @ 5%	ORDER OF INT	ADF STAT	TCV @ 5%	ORDER OF INT	BREAK DATE	ADF STAT	TCV @5%	ORDER OF INT	BREAK DATE
IP	-10.02	-3.87	1	-45.09	-5.17	1	2016	-9.27	-5.17	1	2020
CPSGDP	-5.07	-3.87	1	-22.54	-5.17	1	2020	-10.25	-5.17	0	2020
M2GDP	-9.41	-3.87	1	-10.03	-5.17	1	2016	-6.18	-5.17	1	2015
MPR	-6.54	-3.87	1	-6.77	-5.17	0	2017	-6.87	-5.17	1	2019

Source: Computed by Authors

From Table 3 above, all the variables in the traditional unit root tests were found to be stationary at order 1 of integration. For the Innovation outlier IP, CPSGDP and M2GDP were stationary at order 1 of integration while MPR was found to be stationary at levels. For the Additive outlier, all the variables were found to be stationary at order 1 of integration except for CPSGDP which was stationary at levels.

Table 4 Summary of ARDL Results

PANEL A MODEL (1, 1, 0, 1, 1, 1)						
Variables	Short run estimates			Long run estimates		
	Coefficient	T-stat	P-value	Coefficient	T-stat	P-value
LCPSGDP	15.87	9.86	0.01	18.21	5.57	0.03
LM2GDP	10.75	4.71	0.04	10.39	7.43	0.01
LMPR	0.28	1.46	0.28	1.88	3.81	0.04
PANEL B : JOINT STATISTICS						
R ²	0.99					
F-STAT	43.03 (0.02)					
D-W STAT	2.39					
PANEL C: DIAGNOSTICS						
BG-LM	0.08 (0.82)					
BPG	0.30 (0.92)					
RESET	0.07 (0.91)					

Source: Computed by the authors

The joint statistics are displayed in table 4 panel B. The R² of the model indicates test of goodness of fit. In the model, there is 99% (0.99) variation in insurance penetration which can be jointly explained by the explanatory variables. The 1% (0.01) unexplained variation is caused by factors not captured in the Model. In the Model, the F-stat is greater than 2.5 (43.03) and the probability value is less than 0.05 (0.02) which mean that the model is statistically significant. The Durbin-Watson (D-W Stat) which is a test for first order autocorrelation is approximately 2, which implies that there is no first order autocorrelation.

For the diagnostics in panel C of table 4, the BG-LM is the test for higher auto correlation. The insignificant p-value of the BG-LM test shows that there's no higher auto correlation for the three models. BPG is a test for

heteroscedastic residuals. The insignificant p-value of the BPG test suggests that the three models are without heteroscedastic residuals. The Regression Error Specification Test (RESET) being insignificant suggests that the model is without misspecification.

In Summary, the model is best, linear and unbiased. This is due to the R^2 good test of fit. The F-statistic's conclusion demonstrates the statistical significance of the whole regression. There is no higher auto correlation, according to the diagnostic test, specifically the BG-LM test. The lack of heteroscedastic residuals in the outcome is demonstrated by the BPG's insignificance. The RESET test, which is supported by the CUSUM graph, demonstrates that the model is stable and without any specification error. Having confirmed that the model is best, linear, and unbiased, suffice it say that the results can be used to judge the relationship between insurance penetration and financial development.

In looking the elasticity of insurance penetration to financial development indicators, it is found that insurance penetration is a positive and significant function of financial development. A unit increase in bank development and monetization ratio respectively increases insurance penetration by 18.21 and 10.39 points. Monetary policy rate, which is the control variable caused a 0.28point increase in insurance penetration for every unit increase.

This implies that the development of the insurance sector shown by insurance penetration goes side by side with the level of development of the financial system. A developed financial system will undoubtedly have a significant depth in the insurance sector.

In sum, it can be said that financial development deepens the activities of the insurance sector in the Nigerian financial system over the investigated period.

CONCLUSION

This study investigated the impact of financial development on the financial performance of banks in Nigeria. This is a macro study that focused on the Nigerian economy using financial development broken into bank development and monetization ratio as explanatory variables. Insurance penetration (insurance premium over economic growth) in Nigeria served as the response variable.

Relevant estimation techniques were adopted and it was found that financial development deepens the insurance sector and make it more responsive to the demands of the financial system. The regulatory environment which was controlled for by the use of Monetary Policy Rate showed that it also enhances the insurance penetration.

This shows the interconnectedness of the sectors of the financial system given that as bank and institution develops, the insurance sector also benefits through greater insurance penetration.

Following the outcome of this study, we recommend as follows:

- That insurance should be driven through enhance awareness and creation of attractive product to the advantage of the users of financial services.
- Adequate regulatory frameworks need to be created for the imperative of enhanced deepening of the insurance sector.

This study supports the shiftability theory with the likely shift that a developed financial system with reasonable insurance depth and penetration will have investor shift their investment across liquid and profitable investment opportunities. This will not only aid the further development of the system but will also aid the transmission mechanism from investment to cash.

This study is believed to be a significant addition to the conversation on the interconnectedness of the sectors of the financial system in enhancing the overall development of not just the Nigerian economy but also other economies in the shape of Nigeria.

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