Investment Return of Egyptian Insurance Firms Under Political Risks

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Abstract

This research paper aims to estimate the effect of political risks on Egyptian insurance companies' investment returns over the period 2009 – 2021 which consist of a variety of events having influences on different areas of businesses and accordingly on insurance companies' investment returns. We found that insurance companies' investment returns are affected negatively, significantly by control of corruption which reflect events happened in Egypt from unjustifiable election, revolution, and terrorism but positively affected by the regulatory quality and deficit/surplus in insurance operations showing robust evidence on the cohesiveness of Egyptian laws and its significant role in reducing insurance companies' exposure towards political risks. We recommend, on the macro-level, that the government should stress on supporting the rule of law which might mitigate the negative influence of political risks and on the micro-level, we recommend companies to justify their operations especially risk rating and reinsurance to cope with different economic and political changes.

Keywords: Insurance companies; Investment returns; Political risks; Egypt.

1- Introduction

Egyptian insurance market consists of forty companies; eleven of them are commercial life insurance companies, nineteen are commercial general insurance companies and nine insurance companies working according to Islamic Sharia legal system. Referring to the growth rate of Egyptian insurance companies' activities surplus/deficit that vary during the period from 2011 to 2021 (Statistical Yearbook of Insurance Companies, 2021/2022) which addresses the importance of the insurance companies' investment returns to cover the deficit or maximize the surplus.

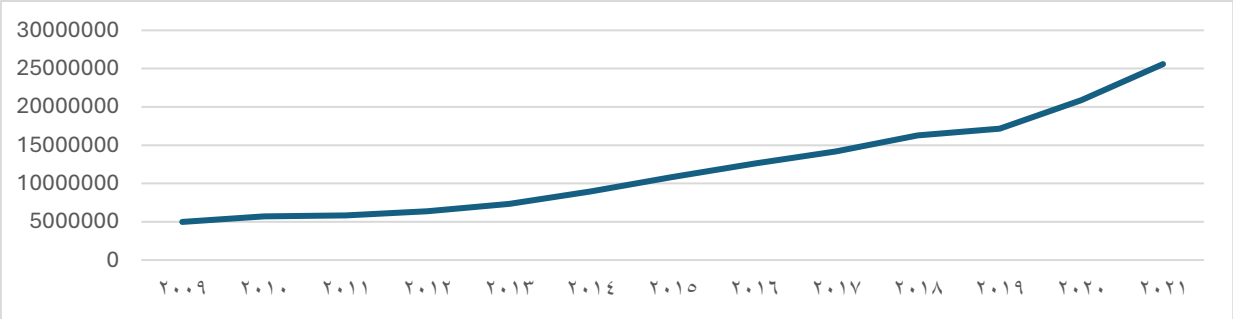

Figure 1: Egyptian insurance companies' surplus/deficit development during the period from 2009 to 20021

Figure 1 showed the slowdown of Egyptian insurance companies' surplus/deficit growth from 2009 to 2014 which address the political changes happened in Egypt during the period from 2009 to 2014 and then start to grow with higher rate for the rest of the period where political changes have been declined. Furthermore, the increasing environmental dynamics which may have negative influence on insurance companies' roles in supporting the sustainability of different economic activities against risks and its profitability. Where investment's returns could suffer because of political changes, accordingly firm investment decisions and political risk are likely to be of particular significance (King, Timothy, et. al, 2021).

Besides this, Insurance companies' investment returns play an important role in covering the insurance companies realized deficits or in increasing the surplus. During this period, there are different political changes, either on the national and international levels, have been raised. Some political changes negatively affect the investment returns (King, Timothy, et. al, 2021). Thus, this paper seeks to examine the impact of political risks on the investment returns of Egyptian insurance companies. The rest of the paper will be organized as follows. Section 2 explains the literature review, section 3 the methodology, section 4 the results of the analysis, and section 5 provides the conclusion.

2- Literature review

Several studies have investigated the impact of political risks on corporate decisions. However, many studies examine the firm-level exposure to political risks. For example, Sonenshine, Ralph and Kumari, Sapna (2022) analyze how changes in political risk overall and political risk components impact emerging markets' bond spreads and credit ratings. They find that

improving political risk factors lowers sovereign bond spreads and improves credit rating outlooks. Gad, Mahmoud, et. al, (2023) examine the effects of firm-level political risk on private debt markets and they provided textual evidence of the transmission of political risk from lenders to borrowers. Gyimah, Daniel, et. al, (2022) examine the effects of firm-level political risk on firm leverage decisions and speed of adjustment and found that firm-level political risk has a negative impact on a firm's total and long-term leverage while positive for short term finance, otherwise firms with high political risk are associated with a faster speed of adjustment to target than those with low political risk. Huang, Guan-Ying, et. al, (2023) examine the effect of firm-level political risk on debt choices and found that firms with higher political risk display a preference for private debt over public debt, the magnitude of this preference varies with the aggregate policy uncertainty, and politically risky firms indeed receive less favorable terms in the bond market. Rahman, Dewan, et. al, (2024) examine whether firm-level political risk influences the issuance of equity (debt) to finance corporate investment and found that firm-level political risk is significantly and positively associated with subsequent equity issuance as opposed to debt issuance.

A group of studies have examined the impact of political risks on corporate investment decisions. Goswami. Gour Gobinda and Panthamit, Nisit (2020) measured the impact of disaggregated political risk in lowering the bilateral trade flow of Thailand and found that one unit increase in the ranking of indicators of military in politics at home and abroad, trade flow decreases by 5–9% of the total trade flow of Thailand per year. King, Timothy, et. al, (2021) explored the question, does capital structure influence firms' FDI capital expenditure decisions in countries with varying degrees of political risk? They showed that leverage and political risk interact with one another in determining the financial commitment of the FDI, with leverage exerting a significantly stronger negative effect on capital expenditures in countries where political risk is elevated. Choi, Wonseok, et. al, (2022) investigated the relationship between firm-level political risk and future investment and found that firms with higher political exposure and political risk spend less on capital investment. Banerjee, Pradip and Dutta, Shantanu, (2022) examined the impact of firm-level political risk on capital expenditure and operating investment decisions and found that that when firms face higher political risk, they reduce the irreversible capital investment and deploy the surplus funds in more reversible operating activities. Jeon, Chunmi, et. al,

(2022) examined how firm-level political risk relates to excess cash holding and found that firm-level political risk has a positive relationship to excess cash, consequently less available funds for investments. DeGhetto, Kaitlyn (2023) tried to offer a comprehensive overview of how host country political risk has been conceptualized, measured, and studied in relation to multinational enterprises' (MNEs') investment decisions and they found that the government was the main source of obstacles against MNES investments which negatively affect the available investments.

Some studies focus on the relationship between political risks and financial performance. Tidong, and Cao, Jingsheng, (2020) studied the impact of regulation on the operating burden of insurance companies and found that regulation has a significant positive impact on both the absolute costs and cost efficiency of insurers. Al-Shboul, Mohammad, et. al, (2020) examined the relationship between political risk and bank stability in the Middle East and North Africa (MENA) region and they that political risk is adversely associated with bank stability, however Islamic banks in the Gulf Cooperative Council (GCC) sub-region were less exposed to political risk compared with those operating in the non-GCC countries (other countries in the MENA region outside of the GCC sub-region). MVK. Jagannath and Maitra, Debasish, (2023) investigated whether parliamentary elections, political stability, and government effectiveness affect banks' risk and found that a stable political environment reduces net non-performing loan, while an effective government increases NPL and lending to the priority sector. Hoang, Huy Viet, et. al, (2023) examined the impact of firm-level political risk on corporate earnings opacity among listed U.S. and found that higher firm-level political risk engenders greater corporate earnings, also are more prudent in earnings management when they are highly dependent on government spending. Ahmad, Muhammad Farooq, et. al, (2023) analyzed the effect of firm-level political risk on dividend payouts in publicly listed U.S. firms and found a positive and significant effect of firm-level political risk on dividend payouts, particularly in uncertainties related to economics, institutions, technology, trade, and security.

Many studies have investigated the impact of political risks on firm or aggregate stock performance. Chatjuthamard, Pattanaporn, et. al, (2020) investigated the effect of political risk on shareholder value and found that the market reactions are significantly more negative for firms with more political exposure.Cao, Cathy Xuying, and Chen, Chongyang (2021)

examined the relation between political sentiment and future stock price crash risk and study identified a negative association between both the level and the change of political sentiment and stock crash risk. Ghozzi, Bechir Ben (2021) provided a comparative analysis between emerging and developed financial markets in terms of the effects of political risks on stock market returns and found that the political risk leads to more volatility in developed markets. Zhang, Kassamany, Talie, (2021) investigated the impact of risk disclosure practices (voluntary, mandatory and risk disclosure index) on stock return volatility, market liquidity and financial performance for insurance companies in the UK and Canada and found that that mandatory risk disclosure practices positively influence stock return volatility for UK insurers but not Canadian ones. Moreover, both mandatory and voluntary risk disclosures increase market liquidity for UK insurers. The outcomes also show a negative influence of risk disclosure practices on financial performance for both the UK and Canadian insurers. Gong, Xu, et. al., (2022) investigated how political uncertainty interacts with an international firm's climate risk in affecting the stock market and they found that the global stock markets respond significantly to political uncertainty induced by the U.S. presidential elections but not to elections in their home countries, also firms with high climate risk experience high return volatility and return correlation amid uncertainty associated with U.S. presidential elections. Rungmaitree, Pattamon, et. al, (2022) examined the effects of political risk across a group of seven industrialized countries (G7) on hedge fund returns and found that political risk has a negative and significant impact on hedge fund returns. Tommaso, Caterina and Mazzuca, Maria, (2023) Investigated the effect of environmental, social, and governance (ESG) ratings on the stock price of European insurance companies and found that environmental, social, and governance (ESG) ratings has a positive effect on stock price, also suggested that that ESG ratings can have a significant impact on the equilibrium and efficiency of the stock market. Clancey-Shang, Danjue and Fu, Chengbo (2024) investigated the divergence in market quality between high-ESG (Environmental, Social, and Governance) and low-ESG firms in response to the Russia-Ukraine conflict. With an event-study approach and found that better CSR (Corporate Social Responsibility) performance alleviates the market quality deterioration following the outbreak of the war for US-listed foreign firms.

The literature review showed the following aspects:

- Political risks and leverage exerting a significantly stronger negative effect on capital expenditures.
- Firm-level political risk has a positive relationship to excess cash, consequently less available funds for investments.
- Host countries' governments were the main source of obstacles against multinational enterprises investments which negatively affect the available investments.
- Negative association between both the level and the change of political sentiment and stock crash risk.
- Political risk leads to more volatility in stock returns.
- Market reactions are significantly more negative for firms with more political exposure.
- Political risks affect banks and insurance companies' risks positively and financial performance negatively.

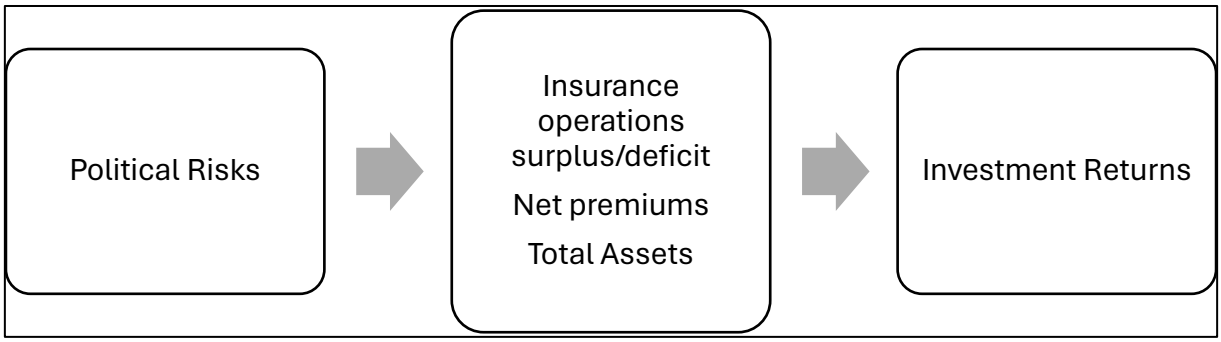

Figure 2: Conceptual Framework of the Relationship between Political Risks and Investment Returns

The literature review presents that most studies have concentrated on the response of corporate financing decision (leverage), stock price, investment decisions (capital expenditures) to political issues. To our best knowledge, very few studies attempted to investigate the response of investment returns to political risks. In this context, the current study contributes to cover this gap in the political risks – firm level literature. Figure 2 describes the conceptual framework through which the political risks could affect the ROI, especially in insurance market through their effects on Insurance operations surplus/deficit and Net premiums.

3- Data and Methodology

The research utilized data created by the World Bank Worldwide Governance Indicators (WGI), (Kaufmann et. al, 2010) of political risks and Statistical Yearbook for Egyptian Insurance Companies over the period from 2009 to 2021. Variable definitions are presented in table 1.

This study hypothesizes that the political risks have negative effect on investments returns of Egyptian insurance companies by employing stepwise regression models. The empirical model takes the following mathematical form:

$$ROI_{it} = \beta_0 + \beta_1 VO_t + \beta_2 PS_t + \beta_3 GE_t + \beta_4 RQ_t + \beta_5 RL_t + \beta_6 COC_t + \beta_7 Ast_{it} + \beta_8 Def_{it} + \beta_9 Pre_{it} + \varepsilon \quad (1)$$

Where ROI is return on investment for firm i at year t. The components of political risks include VO denoting Voice and Accountability; PS for Political Stability and no Violence; GE for Government Effectiveness; RQ for Regulatory Quality; RL for Rule of Law; COC for Control of Corruption. The control variables include Ast for assets; Pre for net premium; Def for Insurance operating surplus/deficit.

4- Results

4.1 Descriptive Statistics

The dependent variable investment returns, and most of independent variable showed nonnormal distribution where Jarque-Bera test were significant for most of the model variables except insurance operating profits (LnDef) and rule of law (RL) which create the need for stationary test to clarify the ability of applying the model under panel data.

Table 1: Descriptive Statistics

	ROI	LnAs	LnDe	LnIns	PS	RL	RQ	VO	GE	CO
Mean	0.11	14.02	10.80	12.37	-	-	-	-	-	-
Median	0.10	13.70	10.65	12.27	-	-	-	-	-	-
	0.90	17.64	15.07	15.96	-	-	-	-	-	-
	-0.01	10.83	6.20	7.25	-	-	-	-	-	-
Std.	0.09	1.44	1.53	1.65	0.26	0.18	0.23	0.19	0.17	0.09
	5.30	0.75	0.25	-0.62	0.80	-	0.65	0.63	0.08	-
Kurtosis	40.14	3.04	3.42	4.50	3.18	2.20	2.18	3.55	2.10	3.43
Jarque-	12621	18.83	3.54	31.83	21.8	5.52	20.0	15.9	7.12	19.3
	0.000	0.000	0.170	0.000	0.00	0.06	0.00	0.00	0.02	0.00
Sum	21	2846	2193	2511	-264	-88	-122	-250	-104	-123
Sum Sq.	1.81	420.3	474.8	551.9	14.1	6.44	10.8	7.30	5.59	1.53
Observat	203	203	203	203	203	203	203	203	203	203

Source: Prepared by Authors

Table 2: Variable Definitions

	Variable Name	Definition	Symbol	Used by
	A. Dependent Variable			
	Return on insurance companies' investments	Calculated as the net income from investments/Volume of investments	ROI	Researchers
	B. Explanatory variables			
1	Voice and Accountability	reflects perceptions of the extent to which a country's citizens are able to participate in selecting their government	VO	(Al-Shboul , Mohammad, et. al, 2020), (Sonenshine, Ralph and Kumari, Sapna, 2022). (MVK. Jagannath and Maitra, Debasish, 2023) and others
2	Political Stability and no Violence	measures perceptions of the likelihood of political instability and/or politically-motivated violence, including terrorism	PS	(Al-Shboul, Mohammad, et. al, 2020), (Sonenshine, Ralph and Kumari, Sapna, 2022). (MVK. Jagannath and Maitra, Debasish, 2023) and others
3	Government Effectiveness	measures the quality of public services, civil service, policy formulation and implementation, and the credibility of a government's commitment to improving or	GE	(Al-Shboul, Mohammad, et. al, 2020), (Sonenshine, Ralph and Kumari, Sapna, 2022). (MVK. Jagannath and Maitra, Debasish, 2023) and others

		maintaining these aspects.		
4	Regulatory Quality	measures the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development.	RQ	(Al-Shboul, Mohammad, et. al, 2020), (Sonenshine, Ralph and Kumari, Sapna, 2022). (MVK. Jagannath and Maitra, Debasish, 2023) and others
5	Rule of Law	captures perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence	RL	(Al-Shboul, Mohammad, et. al, 2020), (Sonenshine, Ralph and Kumari, Sapna, 2022). (MVK. Jagannath and Maitra, Debasish, 2023) and others
6	Control of Corruption	is the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests.	COC	(Al-Shboul, Mohammad, et. al, 2020), (Sonenshine, Ralph and Kumari, Sapna, 2022). (MVK. Jagannath and Maitra, Debasish, 2023) and others
C. Control Variables				
1	Total Assets	Represent the aggregate current	LnAssets	Researchers

		and fixed assets and calculated as logarithm of total assts		
2	Net premiums	Represents the difference between gross premiums and outgoing reinsurance premiums and calculated as logarithm of net premium	Lndef	Researchers
3	Insurance operating surplus/deficit	Represents the difference between insurance operations revenues and expenses and calculated as logarithm of net premium	LnPre	Researchers

Source: Prepared by Authors

4.2 Stationarity Test

Table 3. presents the results of testing the presence of unit root in variables of research. It shows that the ROI and two independent variables; PS and GE are stationary at level, but the other variables are stationary in the first order, but RQ is stationary in the second order (by taking the difference in the first difference).

Table 3: Results of Panel Unit Root Test

	Panel Unit Root Test							
	Levin, Lin & Chu t*		Im, Pesaran and Shin W-stat		ADF - Fisher Chi-square		PP - Fisher Chi-square	
	Statistic	Prob.**	Statistic	Prob.**	Statistic	Prob.**	Statistic	Prob.**
ROI	-5.308	0.000	-3.066	0.001	72.142	0.001	71.554	0.001
COC	-8.380	0.000	-5.359	0.000	94.091	0.000	58.199	0.019
LnPre	-6.195	0.000	0.427	0.665	53.728	0.047	65.635	0.004
LnDef	-3.507	0.000	-0.183	0.427	40.373	0.283	41.856	0.232
Vos	0.456	0.676	3.320	1.000	7.593	1.000	9.654	1.000
dVos	-14.766	0.000	-8.788	0.000	136.944	0.000	154.273	0.000
Rl	-2.275	0.012	-2.012	0.022	47.948	0.129	44.953	0.204
dRl	-4.766	0.000	-2.188	0.014	50.559	0.084	51.376	0.072
Rq	-3.030	0.001	-0.437	0.331	30.496	0.802	30.496	0.802
d2Rq	-12.884	0.000	-9.727	0.000	147.823	0.000	154.970	0.000
PS	-1.512	0.065	-2.480	0.007	53.861	0.046	75.944	0.000
LnAsset	0.915	0.820	2.628	0.996	24.328	0.958	59.104	0.016
dLnAsset	-2.317	0.010	-4.135	0.000	80.507	0.000	209.071	0.000
GE	-3.062	0.001	-1.914	0.028	46.760	0.156	47.521	0.138

Source: Prepared by Authors

4.3 Correlation Matrix

Table 3. shows the correlation coefficients between research variables. There is a strong correlation (0.83) between PS and GE, which may result in a multicollinearity problem if both are included in the regression.

Table 4: Correlation Matrix

	ROI	COC	d2Rq	dLnAsset	dLnDef	dLnInst	dRL	dVOS	GE	PS
ROI	1	-0.21	0.11	0.01	0.11	0.04	0.06	-0.05	0.10	0.17
COC	-0.21	1	-0.02	0.01	0.11	-0.01	0.19	0.04	-0.31	-0.45
d2Rq	0.11	-0.02	1	0.00	-0.01	-0.02	0.21	-0.14	0.01	-0.16
dLnAsset	0.01	0.01	0.00	1	0.16	-0.21	0.02	0.03	-0.05	0.01
dLnDef	0.11	0.11	-0.01	0.16	1	0.01	0.06	-0.07	-0.03	-0.09
dLnPre	0.04	-0.01	-0.02	-0.21	0.01	1	0.11	0.02	0.04	0.06
dRL	0.06	0.19	0.21	0.02	0.06	0.11	1	0.04	0.09	0.29
dVOS	-0.05	0.04	-0.14	0.03	-0.07	0.02	0.04	1	-0.03	0.08
GE	0.10	-0.31	0.01	-0.05	-0.03	0.04	0.09	-0.03	1	0.83
PS	0.17	-0.45	-0.16	0.01	-0.09	0.06	0.29	0.08	0.83	1

Source: Prepared by Authors

4.4 The Results of regression analysis

We apply the Hausman test to choose the appropriate panel model: random effect model and fixed effect model where the results couldn't reject the null hypothesis that random effect is appropriate. We run the panel regression model in Two models to avoid multicollinearity problems due to the correlation between Two variables. We ran the model and found that it suffered from an autocorrelation problem and thus, we augmented the lagged dependent variable. Durbin-Watson statistic is 2 indicates that there is no autocorrelation problem.

Table 5: Results of Panel Regression Analysis

	1		2	
	Coefficient	Prob.	Coefficient	Prob.
C	-0.1136	0.0466	-0.1145	0.2213
ROI(-1)	0.8922	0.0000	0.8924	0.0000
COC	-0.2035	0.0058	-0.2034	0.0155
d2RQ	0.1664	0.0102	0.1646	0.0153
dLnAsset	-0.0041	0.7611	-0.0039	0.7706
dLnDef	0.0182	0.0497	0.0181	0.0513
dLnIns	0.0072	0.5889	0.0072	0.5893
dRL	-0.0391	0.4492	-0.0379	0.5114
dVOS	0.0319	0.4459	0.0324	0.4397
GE	-0.0085	0.8352		
PS			-0.0041	0.9171
Adjusted R-squared	0.4330		0.4329	
Prob(F-statistic)	0.0000		0.0000	
Durbin-Watson stat	2.0137		2.0171	

Source: Prepared by Authors

Table (5) reports the results of the panel regression model where the ROI of insurance companies is affected negatively, significantly by control of corruption but positively affected by the regulatory quality and deficit/surplus in insurance. The selected variables could explain 43% of variations in firms' ROI in the Egyptian insurance market.

5. Conclusion:

In this paper we seek to measure the effect of political risks on insurance companies' investment returns. We used descriptive statistics to identify normal distribution of data, but due to the nonnormality of most variables, a stationary test has been applied to clarify the ability of the model. Then correlation matrix to identify the extent of correlation between different variables to avoid multicollinearity problems this lead to have a valid estimating model where Durbin Watson value is very near to two.

The model showed moderate influences of political risks especially regulatory quality which affect positively the insurance companies' investment returns, and this refer to undermining of Egyptian insurance law number 10 for 1981 and updated by law number 91 for 1995 against the autonomy of volume of investment towards different fields of investments available to insurance companies which are securities, deposits, real-estate, loans and others with a deterministic percentage for each. However, control of corruption has a negative effect which addresses the need for effective rule of law in general hoping to have positive effect on investment returns. Besides this, (LnDef) insurance operation surplus/deficit as a firm characteristic has a positive effect on investment returns where it represents as one of the main contributors in available investment funds. Finally, the results confirm the main source of positive effect on insurance investment returns which address the protection of Egyptian law against risks and that insurance operations are one of the main sources of available funds for investments.

The authors recommended researchers doing more research about the impact of political risks on different items that affect directly insurance company financial performance, stability and growth by utilizing more macro variables especially economic ones as control variables besides firm characteristics.

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العائد الاستثماري لشركات التأمين المصرية تحت المخاطر السياسية

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ملخص البحث:

تهدف هذه الورقة البحثية إلى تقدير تأثير المخاطر السياسية على عوائد استثمار شركات التأمين المصرية خلال الفترة ٢٠٠٩ – ٢٠٢١ والتي تتكون من مجموعة متنوعة من الأحداث التي لها تأثير على إدارة أعمال الشركات في مختلف القطاعات وكذا على عوائد استثمار شركات التأمين.

وقد خلص الباحثون إلى أن عوائد الاستثمار لشركات التأمين تتأثر سلباً، بشكل كبير بمؤشر السيطرة على الفساد الذي يعكس الأحداث التي وقعت في مصر من نتائج انتخابات غير شفافة، والثورة، والإرهاب وفي الوقت نفسه تتأثر بشكل إيجابي بجودة القوانين على مستوى مؤشرات المخاطر السياسية والعجز / الفائض في عمليات التأمين على مستوى خصائص الشركة، وقد توصل الباحثون إلى التأثير الإيجابي للقوانين المصرية خاصة قانون شركات التأمين رقم ١٠ لسنة ٩١ وتعديلاته ودوره الكبير في تقليل تعرض شركات التأمين للمخاطر السياسية.

وقد أوصى الباحثون على المستوى الكلي، أن تقوم الحكومة على دعم سيادة القانون مما قد يخفف من التأثير السلبي للمخاطر السياسية، وعلى المستوى الجزئي أي الشركات بتطوير عملياتها وخاصة تصنيف المخاطر المؤمن عليها وتسعيرها ونشاط إعادة التأمين للتخفيف من الأثار السلبية للمخاطر السياسية مختلفة.

الكلمات المفتاحية: شركات التأمين؛ عوائد الاستثمار، المخاطر السياسية؛ مصر.