IDENTIFYING ZOMBIE FIRMS IN NIGERIAN INSURANCE SECTOR

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Abstract

This paper adopted the definition of a zombie firm as an old firm (aged 10 and above) that make losses in three consecutive years to identify zombie firms in the Nigerian Insurance sector for the period 2005 – 2015. In this study the twenty-four (24) listed insurance firms in the Nigerian stock exchange as at 31st, December 2015 was analyzed with a view to ascertaining if there are zombie firms in the insurance sub-sector. The findings show that seven (African Alliance Insurance, Goldlink Insurance, Guinea Insurance, Linkage Assurance, Niger Insurance, SUNU Assurance Nigeria and Wapic Insurance) out of the twenty-four insurance firms listed in the Nigerian stock market are zombie firms. Thus, the study established that 29.2% of the quoted insurance firms in Nigerian stock market were zombie firms during the period 2005–2015. After assuming the Zombie status, Linkage Assurance, Niger Insurance and Wapic Insurance recovered and have returned to profitability while African Alliance Insurance, Goldlink Insurance, Guinea Insurance, SUNU Assurance Nigeria were not consistent in their return to profitability. The study therefore recommends that there should be early restructuring aim at reducing the spending of zombie firms. Also, Zombie firms should embrace modern technology to gain competitive advantage and should be innovative in their product design.

Keywords: Zombie Firms, Insurance Firms, Profit and Loss, Nigerian Exchange Limited

JEL Classification: D22, G3, G23

1. INTRODUCTION

Policymakers are becoming increasingly concerned about the apparent lack of investment dynamism in the business sector. The possible function of 'zombie businesses' has come to light in this setting according to some recent study. Zombie businesses are those that have been functioning for a long time without declaring any earnings (net of interest paid). If advice from financial textbooks were to be taken

literally, such companies would be labelled "distressed" and likely candidates for liquidation. However, in reality, they are hardly ever liquidated. Additionally, their ongoing presence appears to have some unfavorable effects on the rest of the corporate sector since they inhibit the expansion of other, that is, firms that are non-Zombie. Therefore, it would be predicted that nations and industries with a high proportion of zombie businesses would exhibit far more slow development and investment dynamics than they would have in the absence of sizable proportions of zombie enterprises (Issam, Harasztosi & Schich, 2018).

The word "zombie" was originally used in economics study by Kane (1987) to refer to bankrupt savings and loan institutions during the crisis. Extensive study has been re-started in response to the global economic recession (financial crisis of 2008–2009) with the purpose of identifying zombie companies in various economies and determining the hazards zombie enterprises offer to economic growth. The zombies may limit the development potential of other businesses and discourage the admission of new ones, in addition to slowing the increase of overall productivity due to their own poor productivity (McGowan, Andrews & Millot, 2017b).

The insurance industry contributes significantly to economic growth by reducing company risks brought on by unexpectedly catastrophic events in both developed and emerging economies. The industry assists various economic sectors, including banking, banking, industrial, transportation, agriculture, mining, petroleum, and transportation, with risk management and risk adjustment. By serving as a financial intermediary through capital formation and providing business finance for the economy's deficit sectors, it also promotes economic growth.

Previous studies on zombie firms have focused on different sectors. Researchers such as Fukao & Kwon (2006), Kwon et al. (2015) restrict their analysis to the manufacturing industry while McGowan et al. (2017) consider non-agricultural and non-financial private enterprises. Caballero et al. (2008); Fukuda & Nakamura (2011) and Osório de Barros & Cairese Dora Xarepe Pereira (2017) consider only listed companies in the construction, real estate, retail, wholesale and service sectors while Dai, Qiao & Song (2018) consider coal mining sector. This research, in contrast to other ones, is concerned with the insurance industry.

The Nigerian insurance industry was chosen because it has been plagued by a rigid legal system, a lack of funding, limited human and technical resources, a lack of knowledge of insurance and poor levels of public trust. Due to these issues, Nigeria's insurance industry is still having trouble establishing itself as a significant provider of financial services. As a result, it is assumed that zombie firms are prevalent in Nigerian insurance sector. Therefore, the current study focuses on the insurance sector. Also, studies on zombie firms have been conducted for several OECD countries as well as other developed countries. However, published studies about zombie firms in Nigeria are scanty apart from the study by Idehen and Osamwonyi (2020). This paper seeks to ascertain if there are zombie firms in Nigerian insurance sector.

Therefore, the objective of this paper is to ascertain if there are zombie firms in the Nigerian insurance sector by adopting the definition of a zombie firm as an old firm (aged 10 and above) that make losses in three consecutive years.

The remaining part of the paper is structure as follows. Section 2 reviews the literature relating to the study. Section 3 describes the methodology used in the empirical study. Section 4 presents the data analysis and interpretation of result. Finally, section 5 provides conclusion and recommendations.

2. LITERATURE REVIEW

2.1. CONCEPTUAL CLARIFICATION

Zombie Firm

There exists no official or legal definition of zombie firms, since such corporate status is, strictly speaking, ambiguous if not impossible, not to mention derogatory as well. Researchers have utilized several criteria in an effort to quantify what a zombie business is. Others have utilized subsidized credit, while some have used profitability criteria. The definitions of zombie firms discussed below have been used to identify zombie firms in different studies.

Zombie enterprises, as defined by Hoshi (2006), are insolvent businesses with a little chance of revival that manage to escape bankruptcy thanks to the backing of their banks. A zombie firm is defined by Caballeros, Hoshi, and Kashyap (2008) as a company that has low profitability and gets financial assistance. Zombie companies are those, according to Fukuda & Nakamura (2011) that experience ongoing losses while receiving credit subsidies (actual interest cost less than market prime interest rate). Bank of Korea (2013) classifies companies as zombies if their interest coverage ratios have been less than one for three years in a row. This categorization is based on operating characteristics. Bank of England (2013) defined zombie businesses as businesses having negative earnings.

According to the Chinese State Council, zombie enterprises are those that have lost money for three years, are unable to fulfil modern technical and environmental requirements, do not support national industrial policy, and rely significantly on the government or banks in order to exist. They added that regional authorities spot zombies using both financial and production standards. Three years of losses, liabilities to asset ratios above 85%, negative operational cash flow, and debt that has been past due for more than a year are some examples of these financial benchmarks. On the other side, the production benchmarks consist of less than 50% capacity utilization, a six-month production pause, and unpaid taxes or power bills (Lam, Schipke, Tan and Tan, 2017).

According to McGowan et al. (2017), a zombie firm is an old company (aged 10 years or older) with interest coverage of less than one for three years in a row. The age restriction was put in place to address the issue that it could be challenging to discern between young, inventive start-ups and actual zombie enterprises solely based on profitability indicators. Zombie firms, according to Wilbur (2018), are ineffective companies that continue to operate in the market rather than filing for bankruptcy or reorganization. According to Gouveia and Osterhold (2018), a zombie business is one that is not viable and should be forced to leave the market or, where possible, reorganize when competitive forces are in play.

The various definitions above can be categorized as ranging from the too restrictive to the less restrictive. An example of a restrictive definition is those that classify firms making negative profits as zombie firms while the less restrictive definitions are those that classify firms receiving subsidized bank credit as zombie firms.

What causes businesses to turn into zombie companies?

- **A significant debt load:** A business that takes on a lot of debt is more susceptible to an increase in interest rates.
- **A time when interest rates were so low that it encouraged borrowing:** Interest rates were extremely low — about zero percent — from 2009 to 2016. This pushed businesses to increase their debt loads. Debt may be taken on affordably at current rates. However, extremely low interest rates might persuade businesses to take on debt that may not be manageable should rates increase.
- **Taking out a loan in a foreign currency:** Businesses that borrow money in a foreign currency are susceptible to that currency's depreciation. A fall in the value of the currency relative to the Euro, for instance, effectively increases the domestic cost of servicing the Euro debts, and the cost of debt interest payments may become greater than their income. As a result, Eastern European businesses borrowing in Euros may assume stable exchange rates.
- **A decline in demand:** A company may be left with unsold merchandise and lost capital expenditure if technology advances or customer preferences shift and cause it to fall behind. For instance, record labels may spend money on new studios and CD players, but as electronic downloads became popular; their old revenue stream was destroyed, leaving them with bad debts.
- **Being exposed to other bad debts:** Many European banks had a successful core business in the years before the credit crisis, but they also bought US home debt packages. They were unaware that these loan bundles were truly made up entirely of sub-prime debts, nevertheless. These loan bundles lost value when the US home market crashed due to an increase in mortgage default. The losses suffered by banks were more than anticipated.
- **Deflation:** A period of deflation combined with high levels of debt for a company may result in a rise in the actual value of debt repayments. Deflation forces them to lower prices for their goods, but at the same time, the value of their debt keeps rising, making it harder and harder to pay off the loan.

Resolving Zombie Firms

Tan, Huang and Woo (2017), identify four key measures that are linked with firms transitioning from zombie firms to non-zombie firms. One of the measures is deleveraging which involves restructuring to reduce the debt burden. This would enhance repayment capability and therefore increase the chances of turning a zombie firm into viable firm. Debt-equity swap where creditors are encouraged to take an ownership stake and have common incentives to improve the performance of the firm for upside gains could also reduce the debt burden of zombie firms.

A second measure is ownership change which involves privatization of government owned enterprises. This is likely to bring in the needed efficiency associated with private ownership compared to government ownership. A third measure is reduction in labor cost which can be brought about by downsizing or right sizing of the labor force in zombie firms. This can be a serious concern as the fear of job losses has been given as one of the reasons for government continued support of zombie firms. Therefore, policies that promote job turnover and labor mobility from less productive firms to more productive firms are likely to lead to the transitioning of zombie firms to non-zombie firms. Asset injection and sale that facilitates the extensive unloading of noncore assets or asset injection from parent companies can help zombie firms to transit into viable firms.

2.2. EMPIRICAL LITERATURE

Hoshi (2006) used a sample of 63 companies listed in Japan between 1997 and 2001 to identify Zombie firms. The researcher found that Zombie companies tend to have low profit, a high debt-to-total-assets ratio, and a high dependence on banks. When the size of the business (capital size, labor size) is small, the business is more likely to become a zombie, but when the size of the business is large enough, the business is less likely to become a zombie.

Imai (2016) studied the prevalence of zombies among Japanese Small and Medium-sized enterprises (SMEs) for the period 1999 – 2008. The researcher found that 4 – 13% of SMEs was zombie firms during the studied period. McGowan, Andrews, and Millot (2017) also look at how zombie enterprises affect productivity performance in certain OECD nations. According to their proposed definition, a zombie company is one that has been in business for ten years or longer and has three years in a row of coverage ratios below one, where coverage ratio is the ratio of earnings before interest and tax payments but before depreciation (EBIT) to interest payments. Credit analysts frequently utilize the coverage ratio, a common metric for evaluating borrower repayment potential. If the coverage ratio consistently drops below one, it is assumed that there are significant financial concerns. The study's findings demonstrate how the proportion of zombie enterprises differs greatly among the 13 nations included as samples. They calculate what they refer to as "sunk capital," or the portion of total capital (fixed assets) retained by zombie enterprises. According to their sample, sunk capital in 2013 varied from 4% in Slovenia to 15% in Spain and over 20% in Italy. According to this estimation, the empirical relevance of the zombie business phenomena may be significant for nations other than Japan in the 1990s.

In the non-tradable industries of construction and services, Osório de Barros and Cairese Dora Xarepe Pereira (2017) look at the prevalence of zombie companies in Portugal. The study's findings show that between 2008 and 2015, there were 5.2 percent (2008) and 12.5 percent (2013) of zombie enterprises in the non-tradable sectors of construction and services. Their findings also show that the large percentage of zombies in the construction and services industry has a negative impact on the sector's healthy businesses.

Using firm-level microdata from the Deutsche Bundesbank Financial Statement Data Pool for German firms, Deutsche Bundesbank (2017) studied the emergence of zombie firms in Germany. The results show that zombie firms make up a relatively small portion of all firms in Germany and that this share has not increased as of late compared to the situation eight years earlier. The outcome was based on the commonly accepted definition of a zombie company, which is a business with interest rate coverage that is less than one for three years. A rise in zombie firm occurrence may be seen when using an alternate definition of zombie businesses, which categorizes a zombie firm as one whose cash flow has been negative for three years in a row, but at considerably lower levels than when using the more popular definition.

Issam et al. (2018) use firm-level data for more than one million enterprises to analyses the prevalence of zombie firms across 19 European nations between 2010 and 2013, taking three possible definitions into consideration to assure the accuracy of estimations. According to estimations for 2013 compared to those for 2010, the researchers discover that zombie enterprises are growing throughout Europe. It also discovers that significant variances between nations are concealed by the overall statistics. In terms of total corporate capital, zombie company shares are especially high in Greece and Spain and relatively low in the Czech Republic and Slovakia. The estimations differentiate between company size and age, and they indicate that larger, more established businesses are more likely to be zombie businesses than are comparatively smaller, younger businesses (although very young firms of less than three years of age are not included in the sample). The outcome further demonstrates that, in terms of employment, the rise of zombie businesses stifles the expansion of other, non-zombie firms, and particularly young ones.

Banerjee and Hofmann (2018) examine the incidence of zombies in 14 advanced economies using firm-level data on listed enterprises. They discovered that the rise in zombie businesses is associated with lessened financial strain, which in turn appears to partially reflect the benefits of decreased borrowing rates. The outcome further demonstrates that zombies negatively impact economic performance due to their lower productivity and the fact that their existence discourages investment in and employment at more productive enterprises.

Using a data collection of all Norwegian companies, Matre and Solli (2019) investigated the prevalence of zombie enterprises in Norway. In 2016, there were 2.12 percent more zombie enterprises than there were in 1997 (0.97 percent), according to the study. Köhler (2019) uses data from SME and German listed companies to analyze the zombie share in Germany using descriptive statistics and in-depth knowledge of the growth and dispersion of zombie firms since 2005. The resulting benchmark for the German economy reveals a steadily rising proportion of publicly traded zombie companies, with a drop during the Great Financial Crisis. Unlisted enterprises, in contrast, exhibit a higher proportion of zombie firms and a stagnant development, reaching a peak during the GFC. Further research reveals that major non-manufacturing enterprises in fundamentally sound regions have the highest zombie share for unlisted firms.

Idehen and Osamwonyi (2020) examine the prevalence of zombie firms in the Nigerian economy. A survey of firms listed in the Nigerian stock exchange between 2005 and 2015 was carried out with a view to finding out if there are zombie firms in the economy. The findings show that zombie firms are prevalent in virtually all the sectors of the Nigerian economy with the highest number found in the industrial goods sector while the lowest number was found in the agricultural sector. The findings also show evidence that support the likelihood of a firm becoming a zombie at age 40 and above.

3. METHODOLOGY

The population of this study comprised of all the insurance firms in Nigeria and the period of study is from 2005 to 2015. However, the twenty-four (24) quoted insurance firms in the Nigerian Stock Exchange constitute the sample. The profit or loss data was collected from the audited financial statements of the sample insurance firms as well from the fact books of the Nigerian Stock Exchange.

Analysis of Results and Discussion of Findings

Table 1 show the twenty-four (24) listed insurance firms whose financial statements were sourced from their audit financial statements and the fact books of the Nigerian Stock Exchange (NSE) for the period of 2005 - 2015. The profit or loss for the year of each of the insurance firm was extracted and used for the analysis. For some years we could not get the profit or loss, so those years were captured with N/A meaning not available. A firm (that is aged above 10 years above) that makes consecutive losses for three years is identified as a zombie. Using these criteria to identify zombie firm, our analysis in Table 1 reveals that seven (7) insurance firms (African Alliance Insurance, Goldlink Insurance, Guinea Insurance, Linkage Assurance, Niger Insurance, SUNU Assurance Nigeria and Wapic Insurance) out of the twenty-four (24) listed insurance firms were found to be Zombie firms.

Table 1 also shows that the seven insurance firms that are zombie firms have spent more than 10 years in the market. Therefore, the study established that 29.2% of the quoted insurance firms in Nigerian stock Exchange were zombie firms during the period 2005–2015. After assuming the Zombie status, Linkage Assurance, Niger Insurance and Wapic Insurance recovered and have returned to profitability while African Alliance Insurance, Goldlink Insurance, Guinea Insurance, SUNU Assurance Nigeria were not consistent in their return to profitability.

5. CONCLUSION AND RECOMMENDATIONS

5.1. CONCLUSION

This paper adopted the definition of a zombie firm as an old firm (aged 10 years and above) that make losses in three consecutive years to identify zombie firms in the Nigerian Insurance sector for the period 2005 – 2015. In this study the twenty-four (24) listed insurance firms in the Nigerian stock exchange was analyzed with a view to ascertaining if there are zombie firms in the Nigerian insurance sector. The

findings show that seven (African Alliance Insurance, Goldlink Insurance, Guinea Insurance, Linkage Assurance, Niger Insurance, SUNU Assurance Nigeria and Wapic Insurance) out of the twenty-four listed insurance firms are zombie. Therefore, the study established that 29.2% of the listed insurance firms in Nigeria were zombie firms during the period 2005–2015. After assuming the Zombie status, Linkage Assurance, Niger Insurance and Wapic Insurance recovered and have returned to profitability while African Alliance Insurance, Goldlink Insurance, Guinea Insurance, SUNU Assurance Nigeria were not consistent in their return to profitability.

5.2. RECOMMENDATIONS

Based on the findings of the study, the following is offered as recommendations:

- There should be early restructuring aim at reducing the spending of zombie firms.
- Zombie firms should embrace modern technology to gain competitive advantage and should be innovative in their product design.

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Appendix 1

Table 1: Identifying Zombie Firms in Nigerian Insurance Sector

S/N	LISTED INSURANCE FIRMS	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	STATUS	YEAR OF STATUS	DATE OF INCORPORATION	AGE AT STATUS
1	AFRICAN ALLIANCE INSURANCE	N/A	-18393	2825	-7933737	-5111418	-3090730	-1094978	-315375	-1462405	-485974	-4941299	**ZOMBIE**	2010	1960	51
2	AIICO INSURANCE	81810	483702	304709	624759	1002729	1117587	-28381	1320663	-739226	2232871	1195606	EXCLUDED	NOT APPLICABLE	1970	NOT APPLICABLE
3	AXAMANSARD INSURANCE	N/A	294432	821242	1865220	516588	643646	931574	2179807	1991266	1537256	1662181	EXCLUDED	NOT APPLICABLE	1989	NOT APPLICABLE
4	CONSOLIDATED HALLMARK INSURANCE	5297	56871	230007	360458	242673169	2.12E+08	153389264	395206516	-197658528	254030384	285170848	EXCLUDED	NOT APPLICABLE	1991	NOT APPLICABLE
5	CORNERSTONE INSURANCE	304920	129489	324960	-419460	-442965	399067	-5111418	510402	860363	946482	1630754	EXCLUDED	NOT APPLICABLE	1991	NOT APPLICABLE
6	GOLDLINK INSURANCE	46710	1283946	593988	547048	-190639	-362806	-2302777	-824273	68508	-529207	-350206	**ZOMBIE**	2011	1993	19
7	GUINEA INSURANCE	30002	86708	92605	75348	-13394	-106602	-655741	50090	39835	-187030	44597	**ZOMBIE**	2011	1958	54
8	INTERNATIONAL ENERGY INSURANCE	197	139	740	473	-13394	-256	52413	-403975	13569	-2164	-767578	EXCLUDED	NOT APPLICABLE	1969	NOT APPLICABLE
9	LASACO ASSURANCE	144388	171532	688171	457601	-13394	249658	589304	457601	688171	445745	283320	EXCLUDED	NOT APPLICABLE	1979	NOT APPLICABLE
10	LAW UNION AND ROCK INSURANCE	152368	164533	311278	-93040	-13394	360922	246620	-1337180	485432	125435	276246	EXCLUDED	NOT APPLICABLE	1969	NOT APPLICABLE
11	LINKAGE ASSURANCE	-775779	71519	273979	-156380	-13394	-150930	220691	176770	414282	324997	512247	**ZOMBIE**	2010	1991	20
12	MUTUAL BENEFITS ASSURANCE	209025	702220	1037682	-1554521	-13394	804979	755722	-3390238	555752	4221938	312048	EXCLUDED	NOT APPLICABLE	1995	NOT APPLICABLE
13	NEM INSURANCE	-2267	8772	399808	461676	-13394	833854	253294	455312	395060	1525321	71370	EXCLUDED	NOT APPLICABLE	1970	NOT APPLICABLE
14	NIGER INSURANCE	287680	589592	670871	-124754	-13394	-123661	1228618	776293	599472	627425	600911	**ZOMBIE**	2010	1962	49
15	PRESTIGE ASSURANCE	284472	407416	638084	711649	-13394	487699	91374	201877	284472	407416	-145295	EXCLUDED	NOT APPLICABLE	1970	NOT APPLICABLE
16	REGENCY ASSURANCE	8898	215229	237570	312656	-13394	246655	-68752	444597	439980	429093	373112	EXCLUDED	NOT APPLICABLE	1993	NOT APPLICABLE
17	ROYAL EXCHANGE	N/A	N/A	N/A	N/A	-13394	-36435	-49467	623935	N/A	139540	-1298960	EXCLUDED	NOT APPLICABLE	1921	NOT APPLICABLE
18	SOVEREIGN TRUST INSURANCE	15765	233800	357789	360796	-13394	308764	704114	1476355	346930	294943	582209	EXCLUDED	NOT APPLICABLE	1980	NOT APPLICABLE
19	STACO INSURANCE	24319	491462	757982	542420	-13394	43054	-1051536	272335	464167	184773	84323	EXCLUDED	NOT APPLICABLE	1991	NOT APPLICABLE
20	STANDARD ALLIANCE INSURANCE	799950	262381	333576	766450	-13394	-8667599	6819	-2024232	-789736	1982613	887481	EXCLUDED	NOT APPLICABLE	1981	NOT APPLICABLE
21	SUNU ASSURANCES NIGERIA	N/A	54131	445041	4186	-13394	-28796	-549552	245855	N/A	N/A	-717000	**ZOMBIE**	2011	1984	28

22	UNIVERSAL INSURANCE COMPANY	1877	330222	209438	206660	-13394	-108275	N/A	22660	265631	436264	-186851	EXCLUDED	NOT APPLICABLE	1961	NOT APPLICABLE
23	VERITAS KAPITAL ASSURANCE	4740	-30753	-125765	98461	-13394	-190234	413914	316864	264021	141477	340503	EXCLUDED	NOT APPLICABLE	1973	NOT APPLICABLE
24	WAPIC INSURANCE	239813	701121	601813	181582	-13394	-587657	-345751	383032	208127	179001	18788	**ZOMBIE**	2011	1958	54

Source: Author's Computation, (2022).