Unveiling the Profit-Boosting Potential of Reinsurance: Evidence from Sri Lankan Insurance Companies

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Modern businesses face escalating demands to effectively handle their loss exposures, with reinsurance emerging as a widespread risk management strategy among insurance firms. Beyond its role in risk management, many researchers have observed that reinsurance also influences the performance of insurance firms. However, empirical findings on the relationship between reinsurance and financial performance remain inconclusive. Moreover, existing studies primarily focus on developed countries with established insurance markets, limiting their relevance to developing countries like Sri Lanka. Thus, this research aims to address this empirical gap by investigating how reinsurance influences the financial performance of Sri Lankan insurance companies, using Corporate Demand Theory as a theoretical foundation. The study population comprised 28 insurance companies regulated by the Insurance Regulatory Commission of Sri Lanka and due to data constraints, the studied sample was limited to 15 companies. This study followed the deductive approach, and quantitative secondary data was collected from published annual reports of companies from 2012 to 2021. Return on Assets (ROA) serves as a proxy for measuring financial performance while reinsurance price, underwriting risk, financial leverage and reinsurance dependence act as independent variables representing reinsurance mechanism. The study employed multiple ordinary least squares method with the help of EViews software. Results of the study indicate that reinsurance price, financial leverage, and reinsurance dependence significantly impact financial performance, whereas underwriting risk demonstrates no influence on financial performance. The findings further elaborate that high reinsurance premiums and escalated corporate debt deteriorates the firms′ financial performance, while a strong reliance on reinsurance enhances it. The study provides valuable insights for insurance companies and regulatory bodies, deepening their understanding of how reinsurance can influence insurance firms′ financial performance.

Keywords: Financial performance, Reinsurance dependence, Reinsurance price, Underwriting risk, Insurance companies