A survey of the corporate governance structures and practices in the insurance underwriting sector in Kenya

By
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A management research project submitted in partial fulfilment of the requirements for the Master of Business Administration (MBA) Degree, School of Business, University of Nairobi

October 2006
DECLARATION

This research project is my original work and has not been submitted for a degree in any other university.

Signed: ____________________________ Date 17 November 2006

D/61/P/7691/03

This project has been submitted for examination with my approval as university supervisor

Signed: ____________________________ Date 17/11/2006

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DEDICATION

To my family and especially my daughter, Tessie and son – Peter

for

Their silent understanding and inspiration.
ACKNOWLEDGEMENT

The finalisation of this project would not have been possible without the valuable from the following:

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TABLE OF CONTENTS

CHAPTER 1: INTRODUCTION................................................................................................................1
  1.1 Background .................................................................................................................................1
  1.2 Statement of the problem.............................................................................................................7
  1.3 Objectives of the study............................................................................................................... 9
  1.4 Significance of the study............................................................................................................ 9

CHAPTER 2: LITERATURE REVIEW................................................................................................1 1
  2.1 Background ............................................................................................................................... 11
  2.2 Concept of corporate governance ............................................................................................. 11
  2.3 Benchmarks of corporate governance structures and practices ............................................. 18
  2.4 Factors that promote effective corporate governance environment ....................................... 27
  2.5 Corporate governance research in Kenya ............................................................................... 28
  2.6 Drivers of corporate governance in the insurance underwriting sector ................................ 29

CHAPTER 3: RESEARCH METHODOLOGY....................................................................................3 1
  3.1 Introduction ............................................................................................................................... 31
  3.2 Research design ....................................................................................................................... 31
  3.3 Population ................................................................................................................................ 31
  3.4 Data collection method ............................................................................................................. 31
  3.5 Data analysis ............................................................................................................................. 32
  3.6 Operationalizing corporate governance best practice structures ........................................... 32

CHAPTER 4: DATA ANALYSIS AND FINDINGS..............................................................................35
  4.1 Introduction ............................................................................................................................... 35
  4.2 Profile of the respondent companies ......................................................................................... 35
  4.3 Benchmarking existing corporate governance structures against best practice ................... 40
  4.4 Factors influencing the operation of effective corporate governance structures and practices ............................................................................................................................................ 46

CHAPTER 5: SUMMARY AND CONCLUSION..................................................................................51
  5.1 Introduction ............................................................................................................................... 51
  5.2 Summary ................................................................................................................................ 51
  5.3 Conclusion ................................................................................................................................ 55
  5.4 Limitations and further research ............................................................................................. 56

REFERENCES ............................................................................................................................................................................57

APPENDIX 1 – QUESTIONNAIRE .................................................................................................................63
ABSTRACT

Corporate governance is a subject that has come to the fore because of the recognition that it helps to protects the companies’ reputation and enhances their effectiveness and efficiency thereby increasing value to the shareholders and other stakeholders. Another issue that has made corporate governance a very important issue in business today is the need to avoid significant losses that are incurred by the shareholders and other stakeholders after the company has failed. Corporate failures have caused significant losses across world with examples like Enron, Worldcom in the US and United Insurance Company, Strategis Health, Uchumi to mention a few local companies which failed in 2005 and 2006. This is therefore an area that requires research to create a body of knowledge that will be used to protect stakeholders’ rights and benefit of the country’s continued economic prosperity.

Corporate governance dilemma arises from the fact that it involves power sharing among the various stakeholders and requires companies to take the broader outside view of the firm. However, most organisations, especially those in the insurance underwriting sector, take an inside view of the firm. Most of the corporate governance issues are complex and with apparent conflict between shareholders, directors, management and professionals.

The broad objectives of the study were to investigate corporate governance structures and practices in the insurance underwriting sector in Kenya. The study firstly, sought to identify the existing corporate governance structures in the sector. Secondly, to benchmark the existing corporate governance structures against the best practice as recommended by the Centre for Corporate Governance and identify existing gaps. The last objective was to establish the factors that influence effective operation of the corporate governance structures.
To facilitate the study, 42 companies in the insurance underwriting sector were surveyed. A self administered questionnaire was delivered to senior management of the companies and 30 of them responded to the survey. The information was analysed using percentages, frequency tables, bar charts and pie charts to develop data sets and for analysis.

The results show that 83.3% of the respondent companies have taken steps to develop the required structures and adopted best practice corporate governance practices. However, there is need to reform and enforce the regulatory framework in the sector to enhance effective operation of the corporate governance practices in the sector. This is because shareholding in the sector is very concentrated and therefore the need to introduce rule based corporate governance which requires establishment and enforcement of effective regulations to protect the stakeholders. It is important to encourage the players in the sector to consolidate and list in the Nairobi Stock Exchange as this will introduce and promote reputational agents and capital markets regulations which enhance market control and discipline over poor performing managers. There is also need to introduce rules relating to maximum direct and indirect shareholding by any one individual shareholder, in order to dismantle the pyramid ownership structures that allow insiders to control and, who at times, siphon off assets to the detriment of other stakeholders.
# TABLE OF CONTENTS

## CHAPTER 1: INTRODUCTION

1.1 Background ........................................................................................................... 1
1.2 Statement of the problem ....................................................................................... 7
1.3 Objectives of the study ......................................................................................... 9
1.4 Significance of the study ....................................................................................... 9

## CHAPTER 2: LITERATURE REVIEW

2.1 Background ........................................................................................................... 11
2.2 Concept of corporate governance ........................................................................ 11
2.3 Benchmarks of corporate governance structures and practices ....................... 18
2.4 Factors that promote effective corporate governance environment .................. 27
2.5 Corporate governance research in Kenya .......................................................... 28
2.6 Drivers of corporate governance in the insurance underwriting sector ............. 29

## CHAPTER 3: RESEARCH METHODOLOGY

3.1 Introduction .......................................................................................................... 31
3.2 Research design .................................................................................................... 31
3.3 Population ............................................................................................................. 31
3.4 Data collection method ......................................................................................... 31
3.5 Data analysis ......................................................................................................... 32
3.6 Operationalizing corporate governance best practice structures ...................... 32

## CHAPTER 4: DATA ANALYSIS AND FINDINGS

4.1 Introduction .......................................................................................................... 35
Board Audit committee ............................................................................................... 44

## CHAPTER 5: SUMMARY AND CONCLUSION

5.1 Introduction .......................................................................................................... 51
5.2 Summary ............................................................................................................... 51
5.3 Conclusion ............................................................................................................ 55
5.4 Limitations and further research ......................................................................... 56

REFERENCES ........................................................................................................... 57

APPENDIX 1 - QUESTIONNAIRE .............................................................................. 63
CHAPTER 1: INTRODUCTION

Background

Although corporate governance is considered to be a relatively new topic in strategic management control, its practices are well established. Governance issues arise whenever an enterprise acquires a life of its own i.e., whenever ownership of an entity is separated from its management. Adam Smith (1776) demonstrated that the concept of corporate governance was understood in the eighteenth century, even though the phrase was not in use as indicated in the following quotation:

"The directors of companies, being managers of other people's money than their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private co-partners frequently watch over their own" (KPMG, 2002)

The 'Principal / Agency' problem concerns potential conflicts arising between the owners of companies (as 'Principals') and boards of directors who have effective control over companies (as 'Agents') and who may allow self-interest to influence their decision making. The basis of market economy has its roots on the agency theory where providers of resources leave managers to exploit and control of the resources in pursuit of the owners' objectives which include enhancing owner's value, protecting and promoting rights and interests of the various stakeholders, fostering social responsibility and risk management. Corporate governance has been termed as the process by which the behaviour of the managers is aligned to the stakeholders' interests and objectives (Jensen and Meckling, 1976).

Corporate governance is the mechanism through which individuals are motivated to align their actual behaviors with the overall corporate good i.e. maximum aggregate value generated by the organization and shared fairly amongst all participants (Wikipedia, the free encyclopedia, 2005). Corporate governance is a topic that has been dominating business headlines around the world since the 1980's. Corporate scandals, precipitated by accounting practices that padded and/or...
manipulated earnings, masked expenditures, off the books personal loans and questionable off balance sheet partnerships, are at the core of the crisis of faith in corporate governance. Investor confidence has been shaken, and in the US, class action law suits against corporations and their officers and directors have ensured (Davis, 2002).

The concept of corporate governance has been transcending boundaries of large publicly listed companies to encompass government enterprises, regulatory bodies and other types of organised sectors including the cooperative movement. The term is becoming so pervasive as to cover not merely corporations, to its shareholders, management and the board but also the macro-economic environment comprising policies, legal structures, markets, information flows, financial transfers and the like (Reddy and Raju, 2000).

There is a strong link between corporate governance and the clamor for governance across the world. The concept of "governance" is not new. It is as old as human civilization. Simply put "governance" means: the process of decision-making and the process by which decisions are implemented (or not implemented). Governance can also be used in several contexts such as political and/or economic governance, international governance, national governance, local governance and corporate governance (ADB, 2001).

Being a new area of study, there is no one accepted definition of corporate governance. The concept is commonly referred to as a system by which organizations are directed and controlled. It is the process by which company objectives are established, achieved and monitored. Corporate governance structures specify the distribution of relationships, rights and responsibilities among different participants in corporation, such as shareholders, board of directors, managers and other stakeholders and the rules and procedures for making decisions on corporate affairs (OECD1999, Cadbury report 1992). The Centre for Corporate Governance (2005), observes that corporate governance refers to the manner in which power of a corporation is exercised in the stewardship of
the corporation’s total portfolio of assets and resources with the objective of maintaining and increasing shareholder value in the context of its corporate mission.

Overview of the underwriting insurance sector

Insurance market is very crucial sector in the economy principally because it enables policyholders to transfer and manage their risks. The insurance industry plays an important role in the financial system by indemnifying financial risk in the economy. The sector players also serve as institutional investors for both capital and money market instruments. An insurance policy is an undertaking between the insurer and the insured and serves as a legal document that defines circumstances in which the claim amount must be paid to the insured given that proper care has been taken by the insured to avoid the losses that have been incurred. The market contributed to US$ 3.2 trillion in insurance premiums in 2004 as indicated in the table below.

Table 1: World life and nonlife insurance premiums, 2004

(Direct premiums written, U.S. $ millions)

<table>
<thead>
<tr>
<th>Year</th>
<th>Nonlife (1)</th>
<th>Life</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>1,395,218</td>
<td>1,848,688</td>
<td>3,243,906</td>
</tr>
</tbody>
</table>

(1) Includes accident and health insurance.


As indicated in table 2, the most important markets are in developed countries. Africa contributes less than 2% of the total premium as shown in table 3.
Table 2 - The world's leading insurance countries, 2004

(Total direct premiums written, U.S. $ billions)

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country</th>
<th>Nonlife premiums (1)</th>
<th>Life premiums</th>
<th>Amount</th>
<th>Percent change from prior year</th>
<th>Percent of total world premiums</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>USA (2)</td>
<td>603,018</td>
<td>494,818</td>
<td>1,097,836</td>
<td>3.8%</td>
<td>33.84%</td>
</tr>
<tr>
<td>2</td>
<td>Japan (3)</td>
<td>105,587</td>
<td>386,839</td>
<td>492,425</td>
<td>4.1</td>
<td>15.18</td>
</tr>
<tr>
<td>3</td>
<td>UK</td>
<td>105,241</td>
<td>189,591</td>
<td>294,831</td>
<td>15.9</td>
<td>9.09</td>
</tr>
<tr>
<td>4</td>
<td>France</td>
<td>65,811</td>
<td>128,813</td>
<td>194,624</td>
<td>20.5</td>
<td>6.00</td>
</tr>
<tr>
<td>5</td>
<td>Germany</td>
<td>106,261</td>
<td>84,535</td>
<td>190,797</td>
<td>12.1</td>
<td>5.88</td>
</tr>
<tr>
<td>6</td>
<td>Italy</td>
<td>46,728</td>
<td>82,083</td>
<td>128,811</td>
<td>14.6</td>
<td>3.97</td>
</tr>
</tbody>
</table>

(1) Includes accident and health insurance.

(2) Nonlife premiums include state funds; life premiums include an estimate of group pension business.


Source: Swiss Re, sigma, No. 2/2005.
Table 3 - Life and nonlife insurance premiums, 2004 in Africa

(Total direct premiums written, U.S. $ millions)

<table>
<thead>
<tr>
<th>Country</th>
<th>Non life Premiums</th>
<th>Life premiums</th>
<th>Amount</th>
<th>Percentage of total premiums</th>
</tr>
</thead>
<tbody>
<tr>
<td>Algeria</td>
<td>$454</td>
<td>$26</td>
<td>$480</td>
<td>0.01%</td>
</tr>
<tr>
<td>Angola</td>
<td>297</td>
<td>9</td>
<td>305</td>
<td>0.01%</td>
</tr>
<tr>
<td>Egypt (4)</td>
<td>400</td>
<td>211</td>
<td>612</td>
<td>0.02%</td>
</tr>
<tr>
<td>Kenya</td>
<td>289</td>
<td>119</td>
<td>408</td>
<td>0.01%</td>
</tr>
<tr>
<td>Morocco</td>
<td>1,049</td>
<td>323</td>
<td>1,372</td>
<td>0.04%</td>
</tr>
<tr>
<td>Namibia</td>
<td>143</td>
<td>313</td>
<td>456</td>
<td>0.01%</td>
</tr>
<tr>
<td>Nigeria</td>
<td>455</td>
<td>104</td>
<td>559</td>
<td>0.02%</td>
</tr>
<tr>
<td>South Africa (3)</td>
<td>6,301</td>
<td>24,381</td>
<td>30,682</td>
<td>0.95%</td>
</tr>
<tr>
<td>Tunisia</td>
<td>511</td>
<td>43</td>
<td>554</td>
<td>0.02%</td>
</tr>
</tbody>
</table>

(1) Includes accident and health insurance.

(3) Life business expressed in net premiums.


According to the Association of Kenya Insurers (AKI), Insurance Industry Statistics Report for the year 2005 there were 42 licensed insurance companies in 2005 with 21 underwriting general insurance, 6 underwriting life while 15 were composite (i.e. those offering general insurance as well as long term life assurance). Supporting institutions include 212 insurance brokers; 2004 insurance agents; 8 risk adjusters; 208 loss adjusters; and 1 claim settling agent (Government
The sector’s gross premiums amounted to KShs.36.42 billion with short term business underwriting KShs.25.39 billion while business amounted to KShs.11.03 billion (AKI, 2005).

Insurance underwriters are the main player in the insurance industry. The industry is categorized into short term, long term business and those who carry out composite business. Short term business mainly relates to annual policies covers taken by an insured to manage their risks (Ouko, 2004). Long term business, on the other hand, mainly includes life assurance and pension benefits. A company undertaking composite business underwrites both short term and long term life assurance business.

According to Lord Levene, chairman of Lloyds in April 2005, insurance industry sells a promise to pay when things go wrong, and that requires faith and trust. An insurance contract follows the principle of *Ubarinae fidei* (utmost good faith), that the insured has to disclose all the relevant information and in exchange for payment of premiums, the insurer will compensate the insured in case of loss.

Principal products or lines of businesses offered to customers who comprise government, public and private corporations, partnership, sole proprietorship businesses and individuals by insurance underwriting companies include fire and burglary, machinery, workmen compensation, private and commercial motor policies public liability, personal accident, group and personal life, medical insurance policies and retirement benefits. The sector has been slow in developing new innovations and/or methods of distributing products and adapting to new technology (Ouko, 2004).

Growth in short term insurance underwriting sub-sector has been limited, with cumulative average growth rate in real gross direct premiums income of 1.2% over the past 5 years. This is roughly equal to the average growth rate in the economy in the same period. This low growth rate
suggests that the industry is in a mature stage. On the other hand, industry analysts estimate Kenya’s insurance penetration rate at 3.09% of the overall GDP comparing unfavorably to a country like South Africa whose penetration rate is 18.78% according to Swiss Re survey of 2003. The insurance market in Kenya, like other developing countries, is characterized by very low penetration rate due to low disposable income and other economic factors such as over capacity. The low penetration rate, which indicate vast untapped potential, when contrasted with low growth indicate a need for a paradigm shift in order to stem the sector’s slow growth and creation of value for the sector’s stakeholders (Ogutu, 2004).

Statement of the problem

A study carried out by the Centre for Corporate Governance (2004) found that, from the 12 (out of the 38 companies that then comprised the industry) annual reports of insurance companies for the year ending 31st December 2002 that were examined, it was found that there was insignificant financial reporting and disclosures by the industry as a whole. Only two of the ten non-listed companies, whose reports were examined, had issued compliance statements of a limited nature. It was concluded that there was only minimal disclosures and financial reporting in the insurance industry.

Aholi (2004) identified many shortcomings in disclosures, consistency and accuracy in the reporting of financial information of the insurance companies in his compliance review of the 2003 financial statements of the underwriting insurance companies. These findings together with the collapse, in 2005, of United Insurance Company Limited and Strategis, a health management organization, indicate that there is need to establish effective corporate governance structures.

Some of the issues that led to the failure of some underwriters, including United Insurance Company Limited in 2005, relate to the family ownership of many of the insurance companies and block holding factor which hinder effective corporate governance practices in the sector.
Directors/owners in entities where there is concentrated shareholding are more likely to use their positions to influence managers to disadvantage policyholders and other stakeholders for their personal gain (Anderson, 2005). This was also explained by Bianco and Casavola (1999), when describing ownership and concentration structures in Italy. In Kenya, as in most of continental Europe where his research was based, ownership is characterized by a high degree of concentration, both for listed and unlisted firms. There is also a limited separation of ownership and control of firms, with governance structures built around familial relationships, and a widespread use of pyramidal groups. Pyramidal groups are organizations where legally independent firms are controlled by the same entrepreneur (the head of the group) through a chain of ownership relations.

One of the reasons why the Institute of Insurance developed the theme ‘paradigm shift’ as its 2004 theme was to try address issues which were seen as stifling growth in the industry. Some of issues cited include, shallow competitive framework characterized by price undercutting - with destructive consequences. Another issue was the adventure of the Health Management Organizations which lacked identity and proper operating framework which led to failure of many, more recently Strategis Health, in 2005. The collapse of the once largest insurance company in Kenya, Kenya National Assurance, was associated with political patronage, mismanagement and claims of corruption. These issues mainly hinge on lack of effective corporate governance structures and practices (Wandera, 2004)

Effective corporate governance structures can only exist under the right external control environment in terms of statutory and self regulatory frameworks. There have been concerns regarding the capacity of the Commissioner of Insurance (CoI) to supervise the sector. The Minister for Finance, in his budget speech in 2006, promised to create a National Insurance Authority to give the required authority and resources to COI. Currently, the office reports to Treasury and does not have adequate supervisory capacity (Wandera, 2004). Also AKI, the
sector's self regulating organization, has not been successful in creating a competitive environment based on ethical standards. The sectors competitive environment is based on price undercutting. Industry players have been complaining, through the media, about corruption and favoritism in the award for provision of insurance services to Government and public sector institutions. Ogutu (2004) also suggests that 34 underwriters are not viable in the long term since their earnings were below the cost of capital of 18% and therefore destroying shareholder value. Despite the over capacity in the sector and destruction of shareholder value, the Commissioner of Insurance licensed 4 more players in the sector in 2005.

1.3 Objectives of the study

The objectives of the research study are to:

i. Identify the existing corporate governance structures in the insurance underwriting companies

ii. Benchmark the existing corporate governance structures by comparing them with best practice structures as recommended by the Centre for Corporate Governance. The study will identify gaps in the corporate governance structures and practices.

iii. Establish the factors that influence effective operation of the corporate governance structures and practices.

1.4 Significance of the study

The study is very significant to the stakeholders who include shareholders, directors and management industry regulators and policy holders. Shareholders, being the main constituency of the stakeholders, will be aware of the corporate governance structures and practices required to enhance performance and create higher value. They will accrue higher dividends and value of shares.
Board of directors will be able to manage the agency conflict more effectively and ensure that they discharge their duties more effectively.

Management and employees in the sector will also benefit through better compensation and benefits. They will also be guaranteed promising careers as companies adopt best practice corporate governance and improve their performance.

The study provides information which Government policymakers and regulators can use to understand the structures and practices that will propel the industry towards higher growth and compliance with policies and regulations. This will help them identify early warning parameters and intervene when companies are faced with difficulties. Poor corporate governance acts as an early warning for companies which are headed into difficulties.

Arising from the establishment and disclosures of the corporate governance structures and practices a market discipline will arise. Policyholders will be able to choose their insurer and insurance products based on accurate and understandable information and therefore create a market discipline in the sector. There will also be fewer incidences of delayed claims settlement. This will help customers effectively manage their risks through insurance products.
CHAPTER 2: LITERATURE REVIEW

2.1 Background

Corporate governance issues are receiving greater attention in both developed and developing countries as a result of the increasing recognition that a firm's corporate governance affects both its economic performance and its ability to access long-term, lower-cost investment capital. In response to calls by OECD ministers, a revised version of its "Principles of Corporate Governance" was produced in 2004 (Wikipedia, the free encyclopedia, 2005). Corporate Governance concerns have been widely studied. In the United States, an analysis of these concerns has been published by the New York Society of Securities Analysts in their 2003 Corporate Governance Handbook. What constitutes good and bad corporate governance is an on-going debate in politics, civil society, and academia. Becht, Bolton and Roell, 2002 has carried out an international survey of the scientific literature on this area.

2.2 Concept of corporate governance

Concept of governance

According to UNESCAP (2005), the terms "governance" and "good governance" are being increasingly used in development literature. Bad governance is being increasingly regarded as one of the root causes of all evils within our societies. Major donors and international financial institutions are increasingly basing their aid and loans on reforms that ensure "good governance" are undertaken.

According to UNESCAP (2005), the concept of "governance" is not new. It is as old as human civilization. Simply put "governance" means: the process of decision-making and the process by which decisions are implemented (or not implemented). Governance can be used in several
contexts such as political and/or economic governance, international governance, national governance, local governance and corporate governance. An analysis of governance focuses on the formal and informal actors involved in decision-making and implementing the decisions made and the formal and informal structures that have been set in place to arrive at and implement the decision.

Good governance has 8 major characteristics. It is participatory, consensus oriented, accountable, transparent, responsive, effective and efficient, equitable and inclusive and follows the rule of law. It assures that corruption is minimized, the views of minorities are taken into account and that the voices of the most vulnerable in society are heard in decision-making. It is also responsive to the present and future needs of society. The characteristics of governance are the pillars on which corporate governance concepts are built.

![Characteristics of good governance](image)

**Figure 1 - Characteristics of good governance**

**Source UNESACP (2005)**

The term governance has become almost synonymous with civil or political governance. But in recent years, the importance of both economic and corporate governance has come to the fore. The relationships between political governance, economic governance and corporate governance is analogous to a series of concentric circles in which the political governance forms the outside
circle, followed by economic governance circle, with corporate governance at the center. Political governance sets the orientation of the economy and it supplies the institutional infrastructure for economic governance. In turn, economic governance provides the context in which corporate governance is practiced. In particular, it provides the laws under which corporations are established and the regulatory framework for the conduct of corporate affairs, and sets the macroeconomic framework. Corporate governance, thus, stands at the intersection of law, public policy, and business practice. The key challenge facing many countries will be to devise the corporate governance institutions that can help nurture and regulate the private sector in order for it to fulfill its developmental role. Corporations must be able to tap both domestic and international capital markets in today's world. Increasingly, individual investors, funds managers, banks, and other financial institutions base their decisions not only on a company's outlook, but also on its reputation and its governance. It is this growing need to access financial resources, domestic and foreign, and to harness the power of the private sector for economic and social progress that has brought corporate governance into prominence (ADB, 2001).

The concept of corporation and the theory of agency

Some of the critics of the concept of incorporation have defined a corporation as "an artificial person of legal entity..."or as an "ingenious device for obtaining individual profit without individual responsibility." (Bierce, 1958). Another critic described these entities as "Corporations that determine far more than any other institution, the air we breathe, the quality of the water we drink, even where we live. Yet they are not accountable to anyone."(Minnows and Monks, 1991). It is from here that the need for corporate governance arises to ensure that the interests of the shareholders and other stakeholders are protected and the concept of corporate philanthropy becomes a reality.
As a result of the separation of stakeholder influence from control in modern organizations, a system of corporate governance controls is implemented on behalf of stakeholders to reduce agency costs and information asymmetry. Corporate governance is used to monitor whether outcomes are in accordance with plans; and to motivate the organization to be more fully informed in order to maintain or alter organizational activity. Corporate governance is the mechanism through which individuals are motivated to align their actual behaviors with the overall corporate good (i.e. maximum aggregate value generated by the organization and shared fairly amongst all participants) (Wikipedia, the free encyclopedia, 2005).

Both the US and UK capital markets have widely dispersed share ownership. This is in contrast to concentrated shareholdings which is predominant in Europe and many developing countries. Ownership patterns fundamentally influence the way in which policymakers approach corporate governance and the management of potential conflicts of interests between ownership and control – the 'Principal / Agency' problem. In countries with widely dispersed shareholding the ‘Principal / Agency’ problem concerns potential conflicts arising between the owners of companies (as ‘Principals’) and the boards of directors who have the effective control over companies (as ‘Agents’) and who may allow self-interest to influence their decision making. Countries with more concentrated ownership structures like Kenya often have majority shareholders who are the directors themselves or have significant influence over the board. Consequently, an ‘agency’ conflict arises between controlling 'majority' shareholders who may extract private benefits, and oppress minority shareholders and other stakeholders. According to Jensen and Meckling (1976) corporate governance systems ensure that managers do not pursue their self interest but maximizes shareholder value.
Corporate governance as a concept

Due to the fact that the study of corporate governance is a new area of study which started gaining prominence in the 1980's, there is no one accepted definition of corporate governance. Various writers have defined the term from a contextual perspective while others have defined the term from the structures perspective.

Corporate governance is commonly referred to as a system by which organizations are directed and controlled (Cadbury, 1992). It is the process by which company objectives are established, achieved and monitored. Corporate governance is concerned with the relationships and responsibilities between the shareholders, board of directors, management, and other relevant stakeholders within a legal and regulatory framework. Corporate governance aims to protect shareholder rights, enhance disclosure and transparency, facilitate effective functioning of the board and provide an efficient legal and regulatory enforcement framework. It addresses the 'Principal / Agency' problem through a mix of company law, stock exchange listing rules and self-regulatory codes.

There is no 'one size fits all' approach to corporate governance. A number of countries in continental Europe tend to adopt an inclusive 'stakeholder' approach where companies are considered 'social institutions' with responsibilities and accountability – not just to shareholders – but to employees and the wider community in general. This contrasts to UK and US approaches where there is an emphasis on creating wealth for shareholders. That said, while approaches may differ, there is global appreciation of the OECD's generic corporate governance principles of responsibility, accountability, transparency and fairness.

Looking at the strategic importance of corporate governance, in its 'Global Investor Opinion Survey' of over 200 institutional investors first undertaken in 2000 and updated in 2002, McKinsey found that 80% of the respondents would pay a premium for well-governed companies.
They defined a well-governed company as one that had mostly outside directors, who had no management ties, undertook formal evaluation of its directors, and was responsive to investors' requests for information on governance issues. The size of the premium varied by market, from 11% for Canadian companies to around 40% for companies where the regulatory backdrop was least certain for example in Morocco, Egypt and Russia.

In their explanatory notes, ICEAW (2002) notes that corporate governance is also a key element in enhancing investor confidence, promoting competitiveness, and ultimately improving economic growth. It is at the top of the international development agenda as emphasized by James Wolfensohn, President of the World Bank: when he stated that: 'The governance of companies is more important for world economic growth than the government of countries.'

ICEAW (2000) further notes that much of the recent emphasis on corporate governance has arisen from high-profile corporate scandals, globalization and increased investor activism.

Corporate scandals – High profile corporate collapses due to a number of circumstances including financial reporting irregularities leading to a lack of investor confidence and public trust.

Shareholder activism – Institutional investors pursue good corporate governance when managing long-term investments and often take an active role in bringing under-performing companies to task. Institutional investors such as Hermes in the UK use ‘Focus lists’ which identify companies with the potential to improve corporate performance through investor pressure and oversight. It is also common for rating agencies such as Standard and Poor's (S&P) to rank companies in terms of corporate governance compliance. This is achieved at S&P by measuring the degree to which companies practice corporate governance through indicators such as: (1) concentration, influence and transparency of ownership, (2) shareholder rights and stakeholder relations, (3) transparency, disclosure and audit, and (4) board structure and effectiveness.

Globalization - has resulted in, increased competition; convergence of consumer markets, convergence of financial markets, change in attitude, changes in technology, and the whole
The concept of business is changing (Gupta, 2005). To attract global capital as well as domestic capital, Kenyan businesses will have to resort to international standards of corporate governance. Price movements in markets are influenced by reputation, as shown in an East African survey carried out by PwC which shows that the most respected companies are those that have adopted the highest level of corporate governance. In developed markets, corporate breakup, mergers and takeovers, are often driven by the sentiments in the financial market. Corporate governance often influences good ratings. Investors' confidence and trust will reap dividends for Kenyan organizations.

Good ethical practice towards consumers becomes a necessity as slogans such as 'customer is king'; "value for money" are today a common refrain. A company following unethical practices often risks losing market due to public opposition, for e.g. Nike sales significantly reduced due to public opposition to low cost labor market (Gupta, 2005). The same things can happen in Kenya. Corporate governance therefore becomes a necessity.

Gupta (2005) further concludes that a good vision and core values become necessary in the new global market, where each employee derives his charisma from the company's values. E.g. GE - It has also been found that that companies that have values in their mission and vision fared better than those having none. To become leaders within the region, Kenyan companies have to nurture leaders with strong values. Thus corporate governance becomes indispensable.

A review of ownership disclosures in listed companies reveal that small shareholders and families, hold less than 10% of the stake in listed companies in Kenya, as in other developing countries. Minority shareholders of the countries are widely scattered and are mute and fervently obliged to management for petty gifts offered at the AGMs. They obediently consent to all resolutions enabling the management to fulfill their vested interest. Corporate governance is not only necessary for protecting the right of the shareholders and other stakeholders but also to gain a competitive edge in the fast moving business environment (Gupta, 2005).
2.3 **Benchmarks of corporate governance structures and practices**

Corporate governance is part of strategic control in a broader perspective. It focuses on the need for both shareholders, who are the owners of the organization, and their elected representatives, the board of directors, to actively ensure that management fulfils its overriding purpose of enhancing the long term shareholder value, (Dess and Lumpkin, 2003)

According to Monks and Minow (2004), corporate governance is the relationship among various participants in determining the direction and performance of the corporation. The primary participants being shareholders, board of directors, and management - led by the chief executive officer (CEO). Stiles and Taylor (1993) defines the relationship or channels of corporate governance as various agents such as shareholders, legislative codes, regulatory mechanisms and the board of directors, which the society has developed over the years in order to ensure that corporations are run according to the expectation of the shareholders.

The Centre for Corporate Governance in 2000 published code of Principles for Corporate Governance in Kenya which was an endorsement of the international benchmark structures for good corporate governance. The Code calls the boards of directors to account to their shareholders and other stakeholders on their stewardship of the resources of the enterprise. The Code recommends that all enterprises, regardless of how they are organized adopt the code to the extent applicable to their circumstances. The code recommends the following corporate governance structures;

2.3.1 **Government and regulators as a structure of corporate governance**

An effective corporate governance framework thrives where there are clearly defined rules and regulations, including voluntary codes. Governments and regulators have to put in place and maintain an enabling environment in which efficient and well-managed underwriters can thrive.
Recently new legislative and self-regulatory corporate governance requirements have helped to instill global market confidence in other sectors like in the banking industry both locally and abroad. This includes improved integrity and oversight of management, scrutiny over board composition and its independence, effective use of internal and external audit functions, higher levels of disclosure and transparency and greater engagement with investors.

Insurance underwriters in Kenya are regulated by the Commissioner for Insurance under the Insurance Act. The sector has self-regulating organization, Association of Kenya Insurers. There have been concerns over the effectiveness of the COI and AKI to police the underwriters. According Berglof and Claessens (2003), weak enforcement environment affects the effectiveness of corporate governance structures and systems. They contend that enforcement more than regulations, laws-on-the-books or voluntary codes are key to effective corporate governance. Corporate governance and enforcement mechanisms are intimately linked as they affect firms’ ability to commit towards their stakeholders, in particular towards external investors.

2.3.2 Shareholding as a structure of corporate governance

Members or shareholders [as owners] of the corporation jointly and severally protect, preserve and actively exercise the supreme authority of the corporation in general meetings. They have a duty, jointly and severally, to exercise that supreme authority of the institution to ensure that only competent and reliable persons, who can add value, are elected or appointed to the Board of directors. After the appointment, they must ensure that the Board is constantly held accountable and responsible for the efficient and effective governance of the company so as to achieve its corporate objectives, prosperity and sustainability; they should change the composition of a Board that does not perform to expectation or in accordance with the mandate of the company. In Kenya and other developing countries, corporate governance has a different dimension due to the structure of ownership of companies where there is a controlling shareholder combined with many
small shareholders and other stakeholders with vested interest like policyholders. In this case, the controlling shareholder is likely to stop the managers from enriching themselves. This shareholder, however, has an incentive to enrich himself at the expense of the many small shareholders and other stakeholders, in other words, not share the profits of the company fairly among all shareholders or leave individual policyholders to bear insurance claims as in the case of United Insurance Company Ltd. This was also, part of the reason for the recent scandal involving the Parmalat Company in Italy. The controlling shareholder was diverting company revenues to himself resulting in large debts. Thus in the absence of effective regulation protecting shareholders, small shareholders may be cheated in many ways (Anderson, 2005).

2.3.3 Board of directors as a structure of corporate governance

The company should be headed by an effective independent board that should exercise leadership, enterprise, integrity and judgment in directing and controlling the organization so as to achieve continued prosperity and to act in the best interest of the firm based on transparency, accountability and responsibility.

Research carried out indicates that the size of the board affects effectiveness of corporate governance. Boards should be no larger than strictly necessary for the conduct of business, even when they include appointees from large shareholders. Salmon (1993) recommends that there should be a balance between large and small boards since a large board could diffuse and cut productive debate. The larger the boards get, the more likely that serious decisions will be decided by an inner committee beforehand. On the other hand, a very small boards more often than not transform into clubs with directors being unable to challenge their colleagues courtesy to the friendly atmosphere that eventually evolves and hence the need for balance (Demb and Neubauer, 1992). CCG (2000) recommended that the Board comprises between seven and eleven members.
Another aspect that has been shown to affect effectiveness of corporate governance is the boards' composition and mix of skills. An ideal board will include members with a wide range of different backgrounds and some with special financial, technical and marketing skills, others with a breadth of specific and general business experience. The objective of having various skills is not to substitute their experience for expert advice, which the board will need in particular situations, but to ensure that matters are appropriately considered.

The board should be composed of mainly independent and non executive members. Gilley, Coombs and Ford (1999) found that strategic input from outside board members has a more positive influence on firm performance. The findings that outsiders, in the board, play a more important role provides further empirical support for Baysinger and Butler’s (1985) conclusion that outsiders on boards will enhance firm performance. The results also provide empirical support for Johnson and colleagues’ (1991) assertion that outsiders may have the best interests of the owners in mind. Baysinger and Butler (1985) and Daily and Dalton (1992, 1993) found that firms with more outsiders on their boards achieved superior returns.

Assessing how well the board works and the contribution, both on and off the board, of its individual members is delicate and difficult, but it needs to be done in order to evaluate effectiveness of the board at the time of making reappointment decisions.

For a board to be effective, duties and responsibilities of the board of directors should be very clearly stated in the board mandate. Insurance companies are different from the other companies in that their collapse affects a far wider circle of people and moreover may undermine the financial system itself, with dire consequences on the country’s economy. This places a special responsibility upon the directors. This responsibility remains with them even though they operate under the supervision of a regulatory authority like the Commissioner of Insurance, whose task is to ensure their business is conducted in a way that is conducive to the industry’s stability. Their
regulators' concern will be with the quality of the institution's management, starting with the shareholders and the board of directors itself.

Directors normally meet as a board as often as the conduct of business require, usually on quarterly basis. A study by Vafeas in 1999, concluded that companies going through prolonged periods of decline respond by increasing the number of board meetings in order to derive benefits to increased board activity that include more time for directors to confer, set strategy and monitor management. It is the chairman's task, supported by the company secretary to ensure that an agenda with the relevant supporting papers be circulated to all members at least seven days beforehand. The chairman must ensure that the order of the agenda and the conduct of meetings in order to do justice to the importance of the issues before the board.

Since directors cannot do everything themselves and must delegate, they must constantly keep in their minds the capacity of those to whom they entrust authority and therefore must establish a framework for checking its sound, sensible, and honest use. Each director, individually and collectively, is responsible for the effective and efficient management of the company.

CCG (2000) recommends that the board must develop a timetable for all its meetings in advance for the coming year including a timetable for reporting from all the relevant committees and the internal and external auditors. In companies with unitary boards, some directors will have two sets of duties, those duties that flow from their position as directors and their executive duties. Whether they are non-executive or executive directors, the main elements of their work are described below:

Enterprise - The main elements of the directors' duties relating the overall enterprise of the company are to support management in its task of driving the company forward and encourage innovation. Also, the board will consider with great care the company's strength and weaknesses in human, physical, and financial resources. Against this background, the directors will agree the company's, aims, long-term strategy, and its medium and short-term business plans, bearing in
mind the external economic environment in which the company will be operating. The board is also required to institute and support a clear framework of policies and objectives in all spheres within which management must operate. These would cover personnel policies, the basic financial regime including budgeting, and financial operations including asset and liability management, capital planning, and investments.

Leadership - Patton and Baker (1987) argue that maintaining superior corporate leadership is the responsibility of the Board. The director's duties are to set the tone for the behavior of all the company's employees by example and prescript. Integrity is indivisible. Statements about the company's corporate values and ethical policy should be short, simple, and available to everyone; but it is the example of the directors themselves that constitutes the most persuasive statement about ethics. The board is also required to disclose any possible conflicts of interest in matters before the board and abstain from participating in the discussions on it and refrain from voting (which should be minuted).

Reporting – Currently, the responsibility for vetting financial statements and discussing them with the auditors is delegated to the audit committees. However, the ultimate duty to ensure that any reports issued by the company, including the financial statements, present a true and fair view of its position rests on the Board. Therefore, performance and full review responsibility still rests with the board as a whole (KPMG, 2005).

Communication - Directors should ensure that there is an agreed communications strategy and procedure including agreement about appropriate channels and spokesmen. This includes a decision on what roles, if any, independent directors should play in the communication process.

Internal Controls - In a typical best practice structure, these duties are delegated to the audit committee and are therefore discussed under the audit committee structure.
Human Resource Management - In relation to human resources, directors' duties are to select competent executive officers and dispense with the services of the inadequate, to promulgate policies designed to maintain the quality of management by sound appointments. Salmon (1993) contends that if the board does not dominate the process of selecting the CEO, then the current CEO will most probably appoint a successor in his own image. It is vital that at all levels of management, directors should know their staff and ascertain that they are fit and proper for the work on which they will be engaged. Their competence and honesty should be above suspicion and that the company has established programmes for training and retraining at all levels including board members themselves. Independent directors on first appointment should have a course of induction, to familiarize them with the company's operations and the functions of the board and its responsibilities.

In practice, boards establish committees to help them ensure that the company is soundly managed. All committees derive their powers from what the board wishes to assign to them; the board may delegate but can never abdicate their responsibility. The board has to establish each committee's terms of reference. It is also for the board to name the chairmen and members, and to arrange how the committees should report and to monitor the committees' effectiveness (CCG, 2000).

Appointing an audit committee is sound practice, and many consider it indispensable. Most regulators in financial and non financial sectors including the CMA corporate governance guidelines require companies to do so. The key features of an effective audit committee are its thoroughness and its independence (Government printer, 2002).

Audit committees play a key role in financial control and reporting, thus strengthening corporate governance and increasing public confidence. In helping to protect the company's assets, they serve the interests of shareholders, investors, policyholders, regulators, and all those who work in and have dealings with the organization. They are allies of the institution's supervisors and
regulators and should work closely with them. It is therefore very important for the members of the audit committee to be independent of the management and supervisors themselves.

The audit committee will constitute three to five members, mainly independent directors, who will be appointed by the board. The board will appoint the chairman of the audit committee who sets the committee's style, tone, and agenda. To ensure the committee's effectiveness it is very crucial that he be independent as defined above.

The committee should meet as often as the dispatch of business requires. Three or four meetings in a year would be usual (plus any additional meetings with the external auditors if felt to be necessary). Management including the CEO and Finance Director (and any other employee) may be invited to attend. The internal and external auditors will normally be invited to attend. Minutes of the proceedings of the audit committee will be circulated to all members of the board and the chairman of the board as soon as possible and placed on the agenda of the next meeting of the board. The four major functions of the audit committee are described below.

The first duty of the committee is the review of financial statements before the board considers them in order to improve the quality of financial reporting, focusing particularly on changes in accounting policies, significant adjustments resulting from the audit, and compliance with accounting standards. The committee must satisfy itself that what is being presented shows 'a true and fair view' of the company's position and performance. The committee should be well appraised with the latest developments internationally in accounting and auditing and report major developments to the board. Hampel (1998) in the Combined Code of UK recommended that at least one committee member should have recent experience in accounting or financial management.

The other duty is in relation to internal controls, the audit committee has to appraise, improve, and reinforce the control environment. As part of this task, the committee will review the statement on corporate governance and internal controls in the ensuing annual report. This includes the design,
operation, manning, and testing of the system of controls, thus enhancing a climate of discipline and control and reducing the opportunity for fraud. In the course of this function, it will have reviewed the relevant management reports and the information required by the regulatory agencies. The committee will also need to review the company's system of risk analysis and controls and ensure they work and are cost effective.

The third duty of the committee is the responsibility of improving communication with internal and external auditors so as to enhance their independence. This is achieved by meeting the auditors regularly to check on their relationship with management, to discuss any emerging issues, to assure themselves of the auditors' continued objectivity and independence and to review and agree their audit plans for the ensuing year and the execution of these plans. The committee has to review periodically the remuneration and performance of the external auditor and ensuring that they maintain their objectivity by agreeing a change of senior audit partner every five to seven years. The audit committee should propose to the board when they deem it wise that a replacement firm should be sought. David Aldous, chair of the Institute of Chartered Accountants of England and Wales (ICAEW, 2000) working party that produced the guidance 'The Power of Three: understanding the roles and relationships of internal and external auditors and audit committees. Commented: "The Smith report recommended that audit committees play an active part in relationships with internal and external auditors.

The fourth duty of the committee is the review of compliance with the rules and the regulatory requirements, monitor the company's response, and report material deficiencies to the board.

Another important committee is nomination and remuneration committee. This committee will normally be delegated the task of helping to ensure a thorough and objective process of selection of potential members of the board and senior management. Names proposed by the committee and approved by the board will be cleared with the regulator where applicable.
The other committee that is very important deals with risk management committee. The board may appoint one or more committees to deal with risk management other than the management of strategic risk for which it has direct responsibility. The terms of reference of this committee will establish the structures and procedures for identifying risks that may prevent the company from achieving its objectives, analyzing those risks, avoiding those risks and managing remaining risks.

2.3.4 Management as a structure of corporate governance

The board is not involved in the day to day running of the company and would ordinarily delegate the responsibility to one of their own by appointing a managing director or chief executive (CEO). It is common practice for the chief executive officer (CEO) to report to the board on any major issues that arise (CCG, 2000).

It is also common practice, for organizations to appoint an executive committee comprising senior line and staff managers with the CEO (or managing director) as chairman. This is a convenient way to separate the task of running the institution on a day-to-day basis from the consideration of longer-term strategic matters. The terms of reference (TOR) for the management committee and other major committees should be approved by the Board. The TOR lays out matters that should be reported to the board for information or decision.

2.4 Factors that promote effective corporate governance environment

According to the Center for International Private Enterprise (2002), an effective corporate governance system relies on a combination of internal and external controls. Internal controls are arrangements within a corporation that aim at minimizing risk by defining the relationships between managers, boards of directors, shareholders and other stakeholders. In order for these measures to have a meaningful effect, they must be buttressed by a variety of extra-firm institutions tailored to a country’s environment (referred to as external controls).
External controls require the private and the public sectors to work together to establish the necessary statutory and self regulation regulatory frameworks and a climate of trust through ethical behaviour and oversight. There is need to build capacity within the regulators and supervisors through provision of training and resources for them to be able to police compliance of the set rules. Effective corporate governance also depends on the independent judicial structures, reform of government agencies to reduce bureaucracy. Another challenge is establishing a rule-based (as opposed to a relationship-based) system of governance. It is vital to promote reputational agents and capital markets which enhance market control over poor performing managers. Rules should be made for dismantling pyramid ownership structures that allow insiders to control and, who at times, siphon off assets to the detriment of other stakeholders and get away few consequences.

2.5 Corporate governance research in Kenya

The area of corporate governance has been studied extensively since corporate governance came into the spotlight in the 80’s and 90’s. In Kenya, studies on corporate governance have been spearheaded by the Centre for Corporate Governance whose mission is, among others, to provide research to develop corporate governance and introduce best practices in Kenya.

MBA students in the University of Nairobi have not been left behind, between 2001 and 2003 there has been 6 research studies and surveys which include Mucuvi EM (2002) – A survey of Corporate governance practices in the motor vehicle industry; Mwangi AKG (2002) – A survey of corporate governance practices among insurance companies in Kenya. The most relevant study was the study by Mwangi in 2002 since it was on the same sector. The study was carried at a time when the corporate governance structures and practices were still in their nescient stage. The study mainly focused on the role of the board of directors in promoting effective corporate governance.
Growth in the insurance industry has been slow compared to other sectors of the financial services industry. In the short term underwriting insurance sub-sector the cumulative average growth rate in real gross direct premiums income of 1.2% over the past 5 years. This is roughly equal to the average growth rate in the economy in the same period. This low growth rate suggests that the industry is in a mature stage. On the other hand, industry analysts estimate Kenya’s insurance penetration rate at 3.09% of the overall GDP comparing unfavorably to a country like South Africa whose penetration rate is 18.78% according to Swiss Re survey of 2003. The low penetration rate indicates that there is vast untapped potential. The contrast of low growth and low penetration rate indicate a need for a paradigm shift in order to stem the sector’s stagnant growth and create value for the sectors stakeholders. Various options such as lobbying government for regulatory and policy interventions to improve prospects of the industry have been proposed. However, this will create market distortion and may not be to the benefit of firms that are already creating shareholder value. The other option is to create sustainable competitive advantage by adopting best practice corporate governance structures and practices that will enhance leadership in the firms. Involvement in proactive leadership by the boards will help develop bold strategies such as restructuring, consolidation and advanced of technology in pursuit of opportunities to create value for the shareholders (Ogutu, 2004).
CHAPTER 3: RESEARCH METHODOLOGY

3.1 Introduction

This section deals with the research design which was used to conduct the study. It consists of research design, the population of the study, the survey method, and research instruments and data analysis.

3.2 Research design

The study was a descriptive survey which provided insight into the corporate governance structures in the underwriting companies and to enable benchmarking the structures to national and international benchmark guidelines. Cooper and Schindler (2003), concludes that descriptive study aims at determining answers to the questions, who, what, when and sometimes how and which were the focus of this study. Mucuvi, 2003 and Mwangi, 2002 used the same study design in related studies.

3.3 Population

According to the Association of Kenya Insurers report for 2005, there are 42 underwriters as at 31 December 2005. The population consisted of the 42 underwriting companies in Kenya. A census survey method was chosen since the study units were few and therefore it was deemed more effective and efficient to conduct a survey rather than carrying out a study on a sample.

3.4 Data collection method

The research data used consist of primary and secondary sources. Primary data was collected through a structured, self administered and open and close ended ‘drop and pick later’ questionnaire technique. This type of data collection method was used by Mucuvi, 2003 and
Mwangi, 2002 in related studies. The target respondents were the principal officers of the underwriters or the chief financial officers. This is because these persons play a crucial role in the development of the corporate governance structures in the companies and determine the relationships with the various stakeholders.

Secondary data sources used was the 2005 published annual reports of the underwriters. The companies’ websites were also visited, to gather any information on the corporate governance structures.

5 Data analysis

Data collected was analyzed using percentages, tables, frequency distributions. Data collected was analyzed using content analysis. This is a systematic, detailed qualitative description of the objectives of the study. It involves observation and detailed description of the objects, items or things that comprise the study (Mugenda and Mugenda, 1999). This method facilitated in the analysis and logically group data and compiles the results of the study.

6 Operationalizing corporate governance best practice structures

<table>
<thead>
<tr>
<th>Factors that indicate existence of best practice corporate governance structures and measurement criteria of the effectiveness of those structures</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Government and regulatory framework</strong></td>
</tr>
<tr>
<td><strong>Measurement criteria</strong></td>
</tr>
<tr>
<td>Effective legal frameworks promote effective corporate governance. The Insurance Act (which is the primary law governing insurance should have the right check and balances).</td>
</tr>
<tr>
<td>The office of the Commissioner of Insurance should have autonomy and have supervisory regulatory capacity to be able to carry out risk based reviews.</td>
</tr>
<tr>
<td>Factors that indicate existence of best practice corporate governance structures and measurement criteria of the effectiveness of those structures</td>
</tr>
<tr>
<td>---------------------------------------------------------------</td>
</tr>
<tr>
<td><strong>Shareholders control</strong></td>
</tr>
<tr>
<td><em>Measurement criteria</em></td>
</tr>
<tr>
<td>Members should convene annually in an annual general meeting for the purpose of approving the annual report and financial statements, vote for election of directors and auditors.</td>
</tr>
<tr>
<td><strong>Disclosures</strong></td>
</tr>
<tr>
<td><em>Measurement criteria</em></td>
</tr>
<tr>
<td>Annual report and accounts should include - Financial statements (which a true and fair view), corporate governance report (which discloses the corporate governance structures and practices within the company) and corporate social responsibility report.</td>
</tr>
<tr>
<td><strong>Board of directors control</strong></td>
</tr>
<tr>
<td><em>Measurement criteria</em></td>
</tr>
<tr>
<td>Chairman and chief executive officer - The roles should be independent and played by separate persons. Board balance – It recommended that two-thirds of the board members should be non executive. Independence – majority of the non executive directors should be independent – not connected to the company by relations with management nor have business ties. Experience – there should be a mix between business and professionals skills and experience among the board members. Board size – The board should be neither too large nor too small. A board must be of Sufficient size to benefit from a diversity of viewpoints, skills and backgrounds. Recommended size is between 7 and 11 members.</td>
</tr>
</tbody>
</table>
Factors that indicate existence of best practice corporate governance structures and measurement criteria of the effectiveness of those structures

Frequency of board meetings – meeting should as frequent as the business requires usually quarterly. The Board should have an agenda for all its meeting.

Evaluating boards, audit committees and chairmen – Evaluation should be done annually

The board should appoint specialised committees as follows:

Audit committees – The board should appoint an audit committee which should be headed by an independent non executive director (who should be a qualified accountant) to review internal controls, financial statements, appointment of external auditor and compliance with laws and regulations,

Internal control and risk management – The board should appoint this committee to deal with the board’s responsibility for the system of internal control, risk awareness

Management control

Measurement criteria

Existence of executive committee – Due to specialised nature of the insurance business, team management which bring to bear different skills in top management is required,

Succession plan for the CEO and senior management – There should be a succession plan for the CEO and senior management.
CHAPTER 4: DATA ANALYSIS AND FINDINGS

4.1 Introduction

This chapter presents data analysis and presentation on the research study of the corporate governance structures and practices in the insurance underwriting sector in Kenya.

This part provides an analysis of the respondents’ details with regard to the organization. There were 42 companies surveyed. The respondents were 30 representing over 73% of the underwriters.

4.2 Profile of the respondent companies

Nature of its business

In the developed markets life and general businesses operate as separate entity players in the insurance market. This is mainly because the two businesses adopt very different models and approaches to marketing, products and distribution. Respondents were asked to the nature of their business as shown below.

Table 4: Nature of its business

<table>
<thead>
<tr>
<th>Nature of business</th>
<th>Frequency</th>
<th>Percentage</th>
<th>Cumulative %</th>
</tr>
</thead>
<tbody>
<tr>
<td>General</td>
<td>14</td>
<td>46.7</td>
<td>46.7</td>
</tr>
<tr>
<td>Composite</td>
<td>12</td>
<td>40.0</td>
<td>86.7</td>
</tr>
<tr>
<td>Life</td>
<td>4</td>
<td>13.3</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>30</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Out of 30 respondents, 40% were composite businesses, combining life and general insurance, 46.7% carryout general business and 13.3% carry out life business only. The results show that majority of companies are either in the general short term or composite insurance business.
Type of company

The type of company affects effectiveness of corporate governance. Public companies are governed by the Capital Market Authority guidelines and there is more market discipline due to disclosure requirements. Respondents were asked to state the type of company. The table below gives the distribution by type of respondent companies.

Table 5: Type of company

<table>
<thead>
<tr>
<th>Type of company</th>
<th>Frequency</th>
<th>Percentage</th>
<th>Cumulative %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public listed</td>
<td>2</td>
<td>6.6</td>
<td>6.6</td>
</tr>
<tr>
<td>Public non listed</td>
<td>4</td>
<td>13.4</td>
<td>20.0</td>
</tr>
<tr>
<td>Private</td>
<td>24</td>
<td>80.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>30</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

The results indicate that 80% of the respondent companies are private companies. The rest were 13.4% public non-listed and 6.6% publicly listed. The information shows that majority of the companies are private or non-listed therefore are not governed by any mandatory corporate governance standards.

Size of the companies in term of issued shares

The size of the company has a bearing on the resources that the company is able to marshal for the operational, compliance, risk management and corporate governance. Small companies are more likely to ignore corporate governance structures and practices as resources are directed towards day to day operations. The respondents were requested to state the number of issued shares. The results are as shown in the pie chart below.
Number of shares issued

<table>
<thead>
<tr>
<th></th>
<th>0-5 million</th>
<th>6-10 million</th>
<th>Above 10 million</th>
</tr>
</thead>
<tbody>
<tr>
<td>10%</td>
<td>□</td>
<td>■</td>
<td>□</td>
</tr>
<tr>
<td>80%</td>
<td>□</td>
<td>□</td>
<td>□</td>
</tr>
</tbody>
</table>

Figure 2: Number of issued shares

As can be seen in the chart above, 80% of the companies had issued shares of between 2 to 5 million, 10% had issued shares of between 6 million and 10 million while the other 10% over 10 million shares. The results show that the sector is dominated by relatively small companies.

Share ownership structure - holding block of shares of 20% or more of the voting shares

This section provides an analysis of the shareholder control within the insurance underwriting sector and whether the ownership is widely dispersed. Research shows that concentration in share ownership will affect the effectiveness of corporate governance. Respondents were requested to state whether the shares were owned in blocks of 20% or more by an individual shareholder and how many shareholders held share in blocks. The results are as shown in the table below.

Table 6: No. of shareholders holding block shares

<table>
<thead>
<tr>
<th>No. of shareholders</th>
<th>Frequency</th>
<th>Percentage</th>
<th>Cumulative %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-2</td>
<td>26</td>
<td>92.9</td>
<td>92.9</td>
</tr>
<tr>
<td>3 to 4</td>
<td>2</td>
<td>7.1</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>28</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>
92.9% of the respondents indicated that there were between 1-2 shareholders having block shareholding. 7.1% of the respondents indicated that number of shareholders with block shareholders having block shareholders was 3-4. This indicates that ownership is not dispersed but concentrated in few controlling shareholders.

**Block shareholding by directors.**

Shareholder rights will be guaranteed where the directors also control the voting shares of the company. They will be more inclined to protect their own interests when voting for directors and also when determining the direction and control of the company. Respondents were asked to state the number of shares owned by the directors of the company. The results are as shown in the table below.

Table 7: Block shareholding by directors

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Percentage</th>
<th>Cumulative %</th>
</tr>
</thead>
<tbody>
<tr>
<td>0-20%</td>
<td>15</td>
<td>50.0</td>
</tr>
<tr>
<td>21-50%</td>
<td>5</td>
<td>17.2</td>
</tr>
<tr>
<td>51-100%</td>
<td>10</td>
<td>34.5</td>
</tr>
<tr>
<td>Total</td>
<td>30</td>
<td>100.0</td>
</tr>
</tbody>
</table>

50% of the respondents said that directors hold between 0-20 percent of the shares. In 17.2% of the respondent companies, the directors own between 21 -50% of the shares while in 34.5% of the companies, the directors own more than 51% of the shares. The results show that directors’ ownership levels are able to influence the direction and control of the companies and protect shareholders’ rights.
Market positioning

The market positioning of the company will determine the effectiveness of corporate governance in the company. Highly positioned companies will be out to protect their reputation and also enhance effectiveness and efficiency in order to create higher value proposition for their stakeholders. Respondents were requested to indicate the market positioning based on the 2005 gross premium written. The results were as analyzed below.

Table 8: Market shares of respondents based on gross premiums written in 2005

<table>
<thead>
<tr>
<th>Market shares of respondents</th>
<th>Frequency</th>
<th>Percentage</th>
<th>Cumulative %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 3%</td>
<td>16</td>
<td>53.4</td>
<td>53.4</td>
</tr>
<tr>
<td>3% - 5%</td>
<td>10</td>
<td>33.3</td>
<td>86.7</td>
</tr>
<tr>
<td>More than 5%</td>
<td>4</td>
<td>13.3</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>30</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

The result show that 53.4% of the respondents have market shares of less than 3%, while 33.3% have market shares of 3% and 5%, 13.3% have market shares of more than 5%. The results show that the market is dominated by many small players, by international standards, no one company commands 10% market share of KShs.32 billion gross premium industry.

Years in operation

The number of years that the company has been in operation has a significant bearing on the structures and operation of effectiveness corporate governance practices in because long established companies would be seeking to sustain their long standing reputation. Respondents were requested to indicate the date of incorporation of the respondent companies. The results are as shown in the table below.
Table 9: Years in operation since incorporation

<table>
<thead>
<tr>
<th>Years in operation since incorporation</th>
<th>Frequency</th>
<th>Percentage</th>
<th>Cumulative %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 to 10 years</td>
<td>9</td>
<td>30.0</td>
<td>30.0</td>
</tr>
<tr>
<td>11-20 years</td>
<td>11</td>
<td>36.7</td>
<td>66.7</td>
</tr>
<tr>
<td>Over 20 year</td>
<td>10</td>
<td>33.3</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>30</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Majority of the respondent companies, representing 66.7%, were incorporated in the 1980s and 1990s when the issues of governance were at their lowest ebb in the country. Companies which were incorporated more than 20 years ago, representing 33.3%, are mainly owned by multinationals or were at one time owned by multinational. The results show that most companies were incorporated less than 20 years ago at a time when political, economic as well as corporate governance were at their lowest ebb.

4.3 **Identifying existing corporate governance structures in the insurance underwriting companies and benchmarking them against best practice**

**Government and regulatory framework**

Effective legal framework promotes effective corporate governance. The Insurance Act which is the primary law governing insurance sector should have the right check and balances. The respondents were required to indicate the extent to which laws and regulations governing insurance sector contribute to effective corporate governance rating from a low of 1 to a high of 5.
The results are shown in the chart below.

![Chart](image-url)

**Figure 3: Extent to which laws and regulations promote good corporate governance.**

Most of the respondents, representing 70%, indicated that the extent to which laws and regulations governing insurance sector contribute and promote effective corporate governance practices is low. 16.6% felt that the regulatory framework contributes to some extent to effective corporate governance while 13.4% felt that the extent is high. This shows that there is need for regulatory framework reforms and enforcement in the sector shown by the chart, since the highest proportion of respondents said that the extent to laws and regulations governing the insurance sector was low.

**Shareholder control**

Effective shareholder control is exercised when members convene annually in an annual general meeting (AGM) for the purpose of approving the annual report and financial statements, vote for election of directors and auditors. The respondents were requested to indicate how often the AGM were held. The responses were as shown in the table below.
Table 10: Convening of the Annual General Meetings (AGMs)

<table>
<thead>
<tr>
<th>Convening AGMs</th>
<th>Frequency</th>
<th>Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Half yearly</td>
<td>2</td>
<td>6.7</td>
<td>6.7</td>
</tr>
<tr>
<td>Annually</td>
<td>28</td>
<td>93.3</td>
<td>100</td>
</tr>
<tr>
<td>Total</td>
<td>30</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

In 93.3% of the respondents companies, it was found out that they convened annual general meeting annually as per the provisions of the Companies’ Act. 6.7% held the shareholders’ meeting twice a year. This indicates that the shareholders control is exercise effectively.

Disclosures

**Year when the company started including a corporate governance report**

Various disclosure requirements are meant to create market discipline as the stakeholders are able to get relevant information required to make decisions either to invest or have other dealings with the company. Best practice requires that the annual report should include a corporate governance report. Respondents were asked whether they include a corporate governance report and the year they started reporting on corporate governance. The results were as indicate in the table below.

Table 11: Commencement of disclosure of the corporate governance report

<table>
<thead>
<tr>
<th>Date of 1st disclosure</th>
<th>Frequency</th>
<th>Percentage</th>
<th>Cumulative %</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>5</td>
<td>16.7</td>
<td>16.7</td>
</tr>
<tr>
<td>2004</td>
<td>6</td>
<td>20.0</td>
<td>36.7</td>
</tr>
<tr>
<td>2005</td>
<td>14</td>
<td>46.6</td>
<td>83.3</td>
</tr>
<tr>
<td>No disclosures</td>
<td>5</td>
<td>16.7</td>
<td>100</td>
</tr>
<tr>
<td>Total</td>
<td>30</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>
The highest frequency was in 2005 with 46.6%, principally in response to the Commissioner of Insurance directive calling on the disclosures. Prior to 2005, 20% of the respondent companies started including the disclosures in 2004 while 16.7% started including the disclosures in 2003. 16.7% do not include a corporate governance report in their annual report. The results show that there is need to introduce rule based corporate governance structures as the players were quick to respond to the Commissioner of Insurance directives.

The extent of the company's corporate governance report disclosures in 2005.

CCG and CMA guidelines include minimum disclosure requirements to be included in the annual corporate governance report that accompanies the annual report. Respondents were asked to rate, on a scale of 1 to 5, 1 being the lowest, the extent to which their corporate governance report complied with the CCG recommendations. The results are as shown in table 12 below.

Table 12: The extent of the company's corporate governance structures and practices in 2005.

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percentage</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>No disclosures</td>
<td>5</td>
<td>16.7</td>
<td>16.7</td>
</tr>
<tr>
<td>minimal disclosures</td>
<td>6</td>
<td>20.0</td>
<td>36.7</td>
</tr>
<tr>
<td>Average disclosures</td>
<td>12</td>
<td>40.0</td>
<td>76.7</td>
</tr>
<tr>
<td>Above average disclosures</td>
<td>6</td>
<td>20.0</td>
<td>96.7</td>
</tr>
<tr>
<td>Full disclosures</td>
<td>1</td>
<td>3.3</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>30</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

The table shows only 3.3% of the respondents included a corporate governance report that included full disclosures per the CCG guidelines. 20% of the companies’ disclosures were above average, 33.3% were average, and 20% were below average while 16.7% did not have the corporate governance report. The results indicate that there is need for the player to embrace corporate governance market discipline requirements since only 3.3% had full disclosures in their annual report.
Board of directors' control - Board size

Research carried out indicates that the size of the board affects effectiveness of corporate governance (Salmon, 1993). Boards should be no larger than strictly necessary for the conduct of business, even when they include appointees from large shareholders. Best practice recommends a board size of between 7 and 11 members neither being. Respondents were asked to state the number of board members. The results are shown in the table below:

Table 13: No of board members

<table>
<thead>
<tr>
<th>No of board members</th>
<th>Frequency</th>
<th>Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>2-6 directors</td>
<td>6</td>
<td>20.0</td>
<td>20.7</td>
</tr>
<tr>
<td>7-11 directors</td>
<td>24</td>
<td>80</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>30</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Majority of the respondent companies, representing 80% have board members of between seven and eleven directors. The rest which represents 20% of the companies have six directors or less. This indicates that the majority of the companies have the sufficient number of directors to benefit from diversity of views, skills and background.

Board Audit committee

An audit committee is a principal board sub committee which deals with corporate governance issues. CCG recommendations underscore the importance of the audit committee as a principal board sub committee that assists the board in carrying their mandate. Respondents were request to indicate whether their company has set up an audit committee which comprises independent non executive directors and has at least one member who is a member of ICPAK. The results were as shown in figure 4 below.
The respondents companies which have established board audit committee were 73.3% while 26.7% of the respondents had not established an audit committee which comprise independent non executive directors with at least one of them being a member of ICPAK. The results show that the audit committee structure has been established in most of the companies in the sector.

**Management control – existence of an executive management committee**

Due to the specialized nature of insurance business, team management brings to bear different skills in top management. Involvement of senior management in the overall strategic implementation helps in developing the skill base for succession planning in the company. Respondents were requested to indicate whether they have set up an executive committee structures which comprise senior managers in the company. The results are as shown in table 14 below.

**Table 14: Existence of executive management committee (EXCO)**

<table>
<thead>
<tr>
<th>Existence of EXCO</th>
<th>Frequency</th>
<th>Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>10</td>
<td>33.3</td>
<td>33.3</td>
</tr>
<tr>
<td>No</td>
<td>20</td>
<td>66.6</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>30</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>
Majority of respondents, representing 66.7% indicated that they have not set up an executive management committee and therefore major operating decisions are made by the managing director. 33.3% respondents said that the companies have executive management committees which incorporate senior management.

4.4 Factors that influence the establishment and operation of effective corporate governance structures.

Directorship control

Directors play a very crucial role in the direction and control of the company. Effective corporate governance is principally determined by how effective the board is. This part provides an analysis of information relating to effectiveness of directorship structures in promoting corporate governance culture in the insurance underwriting sector.

Board mix

To support management in direction and control, the board of directors should have diverse professional skills and experience. Board mix enhances board effectiveness by bring to bear different skills and experiences. Respondents were asked to indicate the extent to which their boards include various mix of various professionals. The results are as shown in the table below.

Table 15: Board mix

<table>
<thead>
<tr>
<th>Board mix</th>
<th>Frequency</th>
<th>Percentage</th>
<th>Cumulative %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Full extent (more than 3 professionals)</td>
<td>5</td>
<td>16.7</td>
<td>16.7</td>
</tr>
<tr>
<td>Partially (3 professionals)</td>
<td>15</td>
<td>50.0</td>
<td>66.7</td>
</tr>
<tr>
<td>Minimal extent (less than 3 professionals)</td>
<td>10</td>
<td>33.3</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>30</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>
50% of the respondents companies have a mix of directors from 3 different professions. In 16.7% of the companies that indicated that the directors are drawn from more than three different professions, while 33.3% of the respondents had a mix of directors of less than 3 three different professions. From the results the respondents’ boards have the required mix of skills and experience.

**Frequency of board meetings**

Board meetings should be held on a quarterly basis or as frequent as the business usually requires. Respondents were asked to indicate the frequency of board meeting. The results are as shown in the bar chart below.

![Frequency of board meetings](image)

**Figure 5: Frequency of board meetings**

From the chart above, 66.7% of the companies hold their board meetings on a quarterly basis. Other companies representing 6.7% hold their meetings on monthly basis, half yearly meetings are held in 20.0% of the companies and 6.7% hold their board meetings annually. The results indicate that the boards are effective, through frequency of board meetings.
Directors' performance evaluation

Best practice corporate governance requires that directors' performance evaluation should be conducted at least once a year to gauge the effectiveness of the directors in the direction and control of the company. Respondents were requested to indicate whether they conduct directors' evaluation at least once a year. The results are as shown in the table below:

Table 16: Directors' performance evaluation

<table>
<thead>
<tr>
<th>Directors' evaluation</th>
<th>Frequency</th>
<th>Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>8</td>
<td>30</td>
<td>30.0</td>
</tr>
<tr>
<td>No</td>
<td>21</td>
<td>70.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>30</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Majority of the respondent companies do conduct evaluation of directors' performance as shown by 70% of the respondents. It only in 30% of the companies is evaluation done. This means that directors' performance and therefore their effectiveness is not monitored formally.

Succession plan for the directors and senior management

Continuity of boards and senior management is key to effective corporate governance. Best practice requires that companies should have succession plans for the chairman and the chief executive officer. Respondents were requested to indicate whether the respondent companies had succession plan for the chairman, chief executive officer and senior management. The results are analyzed in the table below:
Table 17: Existence of formal succession plans

<table>
<thead>
<tr>
<th>Existence of succession plans</th>
<th>Frequency</th>
<th>Percentage</th>
<th>Cumulative %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>8</td>
<td>26.7</td>
<td>26.7</td>
</tr>
<tr>
<td>No</td>
<td>22</td>
<td>73.3</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>30</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Most of the companies, representing 73.3% of the respondents, do not have a succession plan. Only 26.7% have succession plans for the chairman and chief executive officer. This means that the companies' direction and control may be affected by the resignation of the chairman and/or the CEO and senior management.

**Duties of the audit committee**

CCG guideline recommends that the duties and responsibilities of the audit committee should include financial reporting, appointment and review of the independence of the internal and external auditors, review of internal controls and risk management. Respondents were asked to state the extent to which the duties of their audit committee reflect the CCG recommendations. The results are as shown in the table below:

Table 18: Extent to which audit committee duties reflect CCG recommendations

<table>
<thead>
<tr>
<th>Extent to which audit committee duties reflect CCG recommendations</th>
<th>Frequency</th>
<th>Percentage</th>
<th>Cumulative %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Full extent (all of the duties)</td>
<td>2</td>
<td>9.1</td>
<td>9.1</td>
</tr>
<tr>
<td>Partially (3 of the duties)</td>
<td>14</td>
<td>63.6</td>
<td>72.7</td>
</tr>
<tr>
<td>Minimal extent (less than 3 of the duties)</td>
<td>6</td>
<td>27.3</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>22</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>
Of the respondents who have established audit committees, 63.6% indicated that the committee’s duties include at least three of the CCG recommended duties pertaining to review of the financial reporting, appointment of auditors, review of internal controls and risk management. 27.3% indicated to a partial extent and 9.1% agreed to a full extent. The results show that their need to review the duties of the audit committee to reflect the recommended best practice.

Establishment of internal audit department

CCG corporate governance principles require that an internal audit department to be established to assist the audit committee in carrying out its mandate especially in the review of internal control in the company. Respondents were requested to indicate whether they have an internal audit which reports to the audit committee. The results are shown in the table below:

Table 19: Existence of internal audit department

<table>
<thead>
<tr>
<th>Existence of an internal audit department</th>
<th>Frequency</th>
<th>Percentage</th>
<th>Cumulative%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>22</td>
<td>73.3</td>
<td>73.3</td>
</tr>
<tr>
<td>No</td>
<td>8</td>
<td>26.7</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>30</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

For all the companies involved in the survey, 73.3% of them have an audit department which reports to the audit committee, while 26.7% of them did not have an audit department. The results indicate that in most companies, the effectiveness of the audit committee is enhanced by the establishment of an internal audit department.
CHAPTER 5: SUMMARY AND CONCLUSION

5.1 Introduction

The broad objectives of the study was to investigate corporate governance structures in the insurance underwriting sector in Kenya, firstly by identifying the existing corporate governance structures in the sector. Secondly, benchmark the existing corporate governance structures against the best practice structures as recommended by the Centre for Corporate Governance and identify existing gaps. The last objective was to establish the factors that influence effective operation of the corporate governance structures.

In the search for literature on the subject, it was apparent that most of the published research on corporate governance has carried in the western developed world especially the United States and Britain. Although not much research has been done on the subject in Kenya, corporate governance challenges have been taken up by Kenyan businesses due influences of globalization and also as a response to corporate failures that have occurred and most recently United Insurance in 2005 and Uchumi Supermarkets in 2006.

5.2 Summary

The survey sought to understand where we are as far as the existing corporate governance structures in the insurance underwriting sector. The survey used the measures identified by Standard & Poor which gauge the degree to which companies practice corporate governance through indicators such as: (1) concentration, influence and transparency of ownership, (2) shareholder rights and stakeholder relations, (3) transparency, disclosure and audit, and (4) board structure and effectiveness.
Concentration, influence, transparency of ownership.

Shareholding in the sector is not widely diverse. The sector has only 2 public listed companies, as shown in table 5. In most companies, as shown in table 6, the shareholding is held in blocks with 93% of the respondents indicating that 1 to 2 shareholder hold block shares of over 20% of the companies voting power. Also, directors’ holding is relatively high with 50% of the respondents indicating that directors own more than 20% of the shares and therefore effectively control and influence the day to day running and decision making. With the high concentration of ownership, it follows that influence is exercised by a few shareholders and directors. The sector has lagged behind in the transparency of ownership since only 3.3% of the respondent companies gave full disclosure of the corporate governance structures and practices in their annual reports as table 12 indicates. Adopting best practice corporate governance structures and practices has been very slow and only picked up after the Commissioner of Insurance directed all the players to include the disclosures in their 2005 annual report. Even with the directive 96.7% of the respondents did not comply in full and included partial disclosures which omitted details on shareholding in most instances.

Shareholders’ rights and stakeholder relations

Due to the concentration of shareholding by a few shareholder and directors, shareholders rights are protected through the appointment of directors who direct and control the companies. All respondents indicated that annual general meeting are held at least annually in 100% of the cases as shown in the analysis in table 10. From the survey it is apparent that in Kenya like other developing countries, corporate governance has a different ‘agency conflict’ dimension due to the structure of ownership of companies. Given the ownership that has a few controlling shareholders, many small shareholders and other stakeholders with vested interest like policyholders must be protected by rule based corporate governance structures. In this case, the
controlling shareholder is likely to stop the managers from enriching themselves. These small numbers of shareholders, however, have an incentive to enrich themselves at the expense of the many small shareholders and other stakeholders, in other words, not share the profits of the company fairly among all shareholders or leave individual policyholders to bear insurance claims as in the case of United Insurance Company Ltd. There have been cries that the sector pricing of premiums is not transparent at least for the commercial vehicles and matatus after the Michuki rules drastically reduced the risk of accidents but the premiums charged fail to recognise the risk reduction. Also, policyholders have been complaining about non payment of claims. This corroborates the view that in the absence of effective regulation protecting shareholders and policyholders, small shareholders may be cheated in many ways (Anderson, 2005).

At the moment there 42 players in the industry, it was noted in the 2004 insurance survey that about 34 insurers are destroying shareholder value since their rate of returns were below the market cost of equity. Consistent with the observation 10 of the 22 long term business companies have consistently maintained the market share of about 90% of total premiums written in 2004 and 2005 financial years. 20 of the 36 short term underwriters accounted for over 82% of the total market, in 2005, leaving 16 companies with the remaining dismal market shares of life business – 12 companies remaining market share of 10% while in short term business 16 companies were left with the remaining market share of 18%. There is no one company which commands a market share of 10% and therefore all companies are faced with intense competition characterised by price undercutting. This phenomenon has a negative effect on the shareholder value create by the players in the sector.

**Board structures and their effectiveness.**

The size of the boards according survey is ideal as most boards have between over 7 members in 80% of the respondent companies as table 13 indicates. The mix of skills and experience of the
Directors in the insurance businesses is considered adequate for effective direction and control of the companies as table 15 indicates only 33.3% of the respondents companies had directors from less than 3 different professions. The majority of the directors are independent non executive directors although majority were also shareholders or appointed by the majority shareholders in the annual general meetings. Board effectiveness was also enhanced by the frequency of meeting which are held quarterly in 66.7% of the respondent companies as shown in figure 5.

Directors' performance evaluation is not carried in many cases given that 70% of the respondents do not conduct directors' evaluation as Table 16 indicates. 73.3% of the respondents' companies do not have succession plans for directors and senior management as shown in table 17. Although the board structures of corporate governance are in many instances per the best practices, there is need to develop the practices that enhance board effectiveness.

**Transparency, disclosure and audit**

Majority of respondents companies representing 73.3%, as shown in table 18, have established audit committees which have charters and majority of the members are independent non executive directors and at least one member is a member of the ICPAK. However, the duties of the committee was found not to be in line with the CCG recommendations that the audit committee's duties should be, to review financial reporting, appointment of external auditors, review of internal controls and risk management as indicated by 90.9% of the respondents. The frequency of meeting is less than 4 times a year in 45.5% of cases. Therefore audit committees are not effectively carrying out their corporate governance mandate effectively in line with the CCG recommendations. As many as 73.3% of the respondent companies had established an internal audit department which headed a member of ICPAK.

The sector players have lagged behind in the disclosure of the corporate governance structures and practices since only 3.3% of the respondent provided full disclosure corporate governance
report in the annual reports. There is need to create market discipline through enhanced corporate governance disclosures.

At the moment the Commissioner of Insurance does not have adequate capacity to oversee the industry through issuance of guidelines and supervise their compliance. Positive steps have been taken by the Government to create, by January 2007, a National Insurance Authority, an independent body which will not be part of the Ministry of finance. The success will however depend on resource availability.

**Conclusion**

Given the over concentration of ownership by major shareholders and directors, the sector needs a rule-based corporate governance model. The model emphasises on establishment and enforcement of effective regulatory framework to check on excesses of major shareholders and directors. There is need to introduce regulatory reforms relating to maximum shares that one shareholder can own directly or indirectly. This will help open up the companies to diverse ownership and avoid concentration of shareholding. There is also need for consolidation, through mergers and acquisitions, in the industry in order to create efficiency and effectiveness since as many as 50% of the respondent have a market share of less than 3% as shown in the analysis on table 8. This can be achieved by increasing the minimum capital and solvency requirements to international standards. Companies in the sector need to be encouraged to list in the stock exchange as this will introduce and promote reputational agents and capital markets regulations which enhance market control and discipline over poor performing managers.

The Association of Kenya Insurers should be given enforcement powers so that ethical issues can be enforced with through self regulation. This will help in creating ethical discipline among
report in the annual reports. There is need to create market discipline through enhanced corporate governance disclosures.

At the moment the Commissioner of Insurance does not have adequate capacity to oversee the industry through issuance of guidelines and supervise their compliance. Positive steps have been taken by the Government to create, by January 2007, a National Insurance Authority, an independent body which will not be part of the Ministry of Finance. The success will however depend on resource availability.

5.3 Conclusion

Given the over concentration of ownership by major shareholders and directors, the sector needs a rule based corporate governance model. The model emphasises on establishment and enforcement of effective regulatory framework to check on excesses of major shareholders and directors. There is need to introduce regulatory reforms relating to maximum shares that one shareholder can own directly or indirectly. This will help open up the companies to diverse ownership and avoid concentration of shareholding. There is also need for consolidation, through mergers and acquisitions, in the industry in order to create efficiency and effectiveness since as many as 50% of the respondent have a market share of less than 3% as shown in the analysis on table 8. This can be achieved by increasing the minimum capital and solvency requirements to international standards. Companies in the sector need to be encouraged to list in the stock exchange as this will introduce and promote reputational agents and capital markets regulations which enhance market control and discipline over poor performing managers.

The Association of Kenya Insurers should be given enforcement powers so that ethical issues can be enforced with through self regulation. This will help in creating ethical discipline among
members. Though self regulation, the industry will move from rule based corporate governance to relationship based corporate governance in the long term.

Adoption and disclosure of corporate governance practices and structures can be addressed by the Commissioner of Insurance corroborating with the Centre for Corporate Governance to develop industry specific guidelines. The guidelines need to bring reforms meant to increase directors’ effectiveness like succession plans, annual evaluations and duties of the audit committees. The Commissioner can introduce levies for non compliance with the guidelines once they are issued.

5.4 Limitations and further research

Limitations

Some respondents were hesitant to return the questionnaires for fear of disclosing vital information. Even though the introduction letter accompanied every questionnaire, it was apparent that the managers were observing confidentiality of information asked for in the questionnaire.

Suggestions for Further Research

Since this was a study of corporate governance structures and practices within the insurance underwriting companies in Kenyan context, further comparative studies may be appropriate between Kenya, other developing countries and even developed countries which should act as a benchmark in analyzing the domestic companies’ achievements in the areas of corporate governance. A longitudinal study could be adopted based on the different concepts such as rule based corporate governance and relationship based corporate governance to determine which is most appropriate for the Kenyan environment.
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61


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APPENDIX 1 – QUESTIONNAIRE

Name of your company __________________________________

Nature of its business (General, Life or Composite) _______________________________

Type of company (i.e. public listed, public non-listed), : _________________________________________

Market share position in 2005 _________________________________________

Your designation: _________________________________________

Q1. To what extent did your company include in its 2005 annual report include a statement on the company’s corporate governance structures and disclosure practices (Indicate on a scale of 1 to 5, 1 representing no disclosures and 5 representing full disclosure).  

Q2. When did your company start reporting to its shareholders on its corporate governance structures and practices? (indicate financial year).

Q3. Please state which of the following codes of corporate governance your company has selected to guide its corporate governance practices. (Please tick)

<table>
<thead>
<tr>
<th>Capital Market Authority Guidelines</th>
<th>Principle of Corporate Governance by CCG</th>
<th>OTHER (Please specify)</th>
</tr>
</thead>
</table>

63
Q4. Please indicate the benefits you believe are likely to accrue to your company from reporting to your shareholders and other stakeholders on the corporate governance practices of your company. (Please tick as appropriate).

<table>
<thead>
<tr>
<th></th>
<th>Facilitate access to capital for your company</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>Enhance the share price of the company</td>
</tr>
<tr>
<td>(ii)</td>
<td>Improve the reputation of the company</td>
</tr>
<tr>
<td>(iii)</td>
<td>Improve internal communications in the company</td>
</tr>
<tr>
<td>(iv)</td>
<td>Avoid being penalized by regulators such as CMA/NSE</td>
</tr>
<tr>
<td>(v)</td>
<td>Other reasons (Please specify)</td>
</tr>
</tbody>
</table>

Q5. If your company did not report on its corporate governance structures and practices please indicate why it did not do so (Please tick as appropriate).

<table>
<thead>
<tr>
<th></th>
<th>Do not believe it is of any benefit to the company</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>The cost of adopting good corporate governance practices is prohibitive.</td>
</tr>
<tr>
<td></td>
<td>Shareholders have not demanded good corporate governance from the Board</td>
</tr>
<tr>
<td></td>
<td>Others reasons (Please specify)</td>
</tr>
</tbody>
</table>

Q6. In your opinion, to what extent do the laws and regulations governing the insurance sector contribute to effective controls and management and corporate governance practices in insurance companies (indicate on a scale of 1 to 5, 1 being low, and 5 being high) [ ]

If low, what provisions do not promote effective corporate governance?
### Shareholding and control

<table>
<thead>
<tr>
<th>Question</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Please indicate the number of issued shares.</td>
<td></td>
</tr>
<tr>
<td>2. Indicate whether the company has block shareholding i.e. individual</td>
<td></td>
</tr>
<tr>
<td>shareholders owning more than 20% of the shares (indicate Yes of No)</td>
<td></td>
</tr>
<tr>
<td>3. How many shareholders hold block shares?</td>
<td></td>
</tr>
<tr>
<td>4. What percentage of the shares is held by directors of the company?</td>
<td></td>
</tr>
<tr>
<td>5. How often is the Annual General Meeting held?</td>
<td></td>
</tr>
</tbody>
</table>

### Directors

<table>
<thead>
<tr>
<th>Question</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indicate the number of directors of the company</td>
<td></td>
</tr>
<tr>
<td>How many of the directors are independent (not connected with management</td>
<td></td>
</tr>
<tr>
<td>of the company and/or have no significant business ties)?</td>
<td></td>
</tr>
<tr>
<td>How many of the directors are executive?</td>
<td></td>
</tr>
<tr>
<td>Is the chief executive a member of the Board?</td>
<td></td>
</tr>
<tr>
<td>How often are board meetings held?</td>
<td></td>
</tr>
<tr>
<td>Indicate the mix of directors' professional qualifications (e.g. Accountants, lawyers etc)</td>
<td></td>
</tr>
<tr>
<td>Indicate the directors cumulative experience in the insurance business</td>
<td></td>
</tr>
<tr>
<td>How many directors have attended the directors training by the Centre for Corporate Governance?</td>
<td></td>
</tr>
<tr>
<td>Indicate whether the directors have a calendar including that of the committees</td>
<td></td>
</tr>
</tbody>
</table>
### Directors structure and responsibilities

<table>
<thead>
<tr>
<th>Question</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>that is agreed for the whole year in advance (indicate Yes or No)</td>
<td></td>
</tr>
<tr>
<td>Is there a directors' duties and responsibilities charter for the board? (indicate Yes or No)</td>
<td></td>
</tr>
<tr>
<td>Indicate whether the company has an audit committee (indicate Yes or No)</td>
<td></td>
</tr>
<tr>
<td>If there is an audit committee, does it have a charter which includes its terms of reference, composition, and delegated powers? (indicate Yes or No)</td>
<td></td>
</tr>
<tr>
<td>How many members does the audit committee have? (Indicate number)</td>
<td></td>
</tr>
<tr>
<td>How many of the members are independent non executive directors? (indicate number)</td>
<td></td>
</tr>
<tr>
<td>Comment where appropriate</td>
<td></td>
</tr>
<tr>
<td>Is there a member who is a member of ICPAK? (indicate Yes or No)</td>
<td></td>
</tr>
<tr>
<td>To what extent do the duties and responsibilities of the committee include the function listed below. (Indicate, against each item, on a scale of 1 to 5, 1 being no and 5 being fully includes all))</td>
<td></td>
</tr>
<tr>
<td>- Financial reporting and disclosure?</td>
<td></td>
</tr>
<tr>
<td>- Appointment of the external and determining their fees and scope?</td>
<td></td>
</tr>
<tr>
<td>- Internal control including internal audit review and reporting?</td>
<td></td>
</tr>
<tr>
<td>- Risk management?</td>
<td></td>
</tr>
<tr>
<td>Is there an evaluation of directors' performance? (indicate Yes or No)</td>
<td></td>
</tr>
</tbody>
</table>
Q9. Management structure

<table>
<thead>
<tr>
<th>Management structure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indicate whether the chief executive is a member of the board of director (indicate Yes or No)</td>
</tr>
<tr>
<td>Does the company have an executive management committee? (indicate Yes or No)</td>
</tr>
<tr>
<td>If the company has an executive management committee, who are the members (e.g. heads of departments or lines of businesses etc)</td>
</tr>
<tr>
<td>What other committees does the company have?</td>
</tr>
</tbody>
</table>

Q12. Internal control

<table>
<thead>
<tr>
<th>Does the company have an internal audit department (indicate Yes or No)</th>
</tr>
</thead>
<tbody>
<tr>
<td>If yes</td>
</tr>
<tr>
<td>Is the department headed by a qualified accountant?</td>
</tr>
<tr>
<td>To whom does the department report to (e.g. CEO, Audit committee etc)?</td>
</tr>
</tbody>
</table>