A SURVEY OF THE CREDIT POLICIES IN THE INSURANCE COMPANIES IN KENYA

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DECLARATION

I, the under signed, declare that this research project is my original work and has not been presented for the award of any other degree in any other university other than the University of Nairobi.

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DEDICATION

To my beloved brother,

John Muhia.

ABSTRACT

The purpose of the study was to establish the credit control policies used by the insurance companies in Kenya. Credit control is a vital component in the process of controlling cash flow. Many companies have failed in the past because management did not distinguish between profitability and cash flow. Credit control policy is the general guideline governing the process of giving credit to the firm's customers.

The research design used was descriptive using census survey approaches to assist us get the objectives of the study. The population of interest consisted of all the insurance companies headquartered in Nairobi and who are members of the Association of Kenyan Insurers (AKI) which are 41 in number as registered by AKI in 2009. The sample size of this study was 41 and the researcher conducted a census study. Data was collected using a combination of "drop and pick later" & "self administered" structured questionnaires. The data collected was analysed by use of frequencies and percentages.

By way of recommendation, insurance firms need to come up with technique to be used to measure and control the credit risks identified or exposed by brokers. Moreover, the structure, management, and organization of the insurer's risk management function(s), including an overview of the insurer's risk management strategy should be well laid down and known. The personnel involved in formulation of credit control policies should also be highly qualified.

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CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The past decade has seen a dramatic rise in the number of insolvent insurers. The perceived causes of these insolvencies were myriad. Some of the insolvencies were precipitated by rapidly rising or declining interest rates. Mispricing of insurance policies, natural catastrophes, changes in legal interpretations of liability and the filing of false claims among others. The "churning" of policies by unscrupulous sales agents, insolvencies among the reinsurers backing the policies issued, noncompliance with insurance regulation, and malfeasance on the part of officers and directors of the insurance companies affected some as well (Baldoni, 2008). But despite the numerous and disparate apparent causes of these insolvencies, the underlying factor in all of them were the same: inadequate risk management practices. In response to this, insurers almost universally have embarked upon an upgrading of their financial risk management and control systems to reduce their exposure to risk and better manage the amount they accept. In short, the industry has turned to financial risk management techniques as a way to improve performance (Carey, 2001).

Credit control is a vital component in the process of controlling cash flow. Many companies have failed in the past because management did not distinguish between profitability and cash flow (Baldoni, 2008). An otherwise profitable enterprise can fail if it runs out of readily available funds with which to meet its commitments and failure to

control credit is a frequent cause of this situation. The supplier's funds are being used to finance customers' or clients' businesses rather than the business of the supplier. The granting of excessive credit, whether in terms of amount or of duration, can also have an impact on profit, even if funds are readily available (Parrenas, 2005).

Awarding credit is a journey, the success of which depends on the methodology applied to evaluate and award the credit (Thygerson, 1995). This journey starts from the application for credit and ends at the time the credit extended from the credit process are fully paid. Like any human journey, the credit management process has got smooth paths, impediments and detours before the destination is reached. Therefore, credit needs to be effectively controlled for it to succeed eventually. Credit control can rightly be said to start when the client walks into the office. If during the discussion with the client, the credit manager agrees to grant credit, the lender has embarked on a journey called credit control and the nature of the journey will be influenced by the quality of the decision (Clarke et al, 1999).

Credit control policy is therefore the general guideline governing the process of giving credit to the firm's customers. The policy sets rules on who should get what credit and when and why. In addition the policy defines the repayment arrangements and necessary collaterals. The method of assessment and evaluation of risk for each prospective applicant are part of a credit control policy (Thygerson, 1995). There is need for an effective credit control policy at all times to manage credit risk in order to ensure a fairly

healthy credit management program, with minimal expensive bad debts and minimized credit risk.

Insurers are in the risk business. In the process of providing insurance and other financial services, they assume various kinds of actuarial and financial risks. Market participants seek the services of insurers because of their ability to provide actuarial risk pooling through their major product lines of life, property/casualty and health insurance, pension products, annuities, and other financial instruments. At the same time, they are major providers of funds to the capital market, particularly to the fixed income sectors. In performing these roles they generally act as a principal in the transaction. As such, they use their own balance sheet to facilitate the transactions and to absorb the risks associated with them. Therefore, it is here that the discussion of risk control and the necessary procedures has centered. Accordingly, it is in this area that our review of credit control policies will concentrate.

1.1.1 The Insurance Industry in Kenya- An overview.

The concept of insurance has been around Africa for a long time. Members of a community pooled together resources to create a "social insurance fund". The "premiums" ranged from material to moral support or other payments in kind. From the fund, "drawings were made out" to support the few unfortunate members exposed to perils. However, the history of the development of commercial insurance in Kenya is closely related to the historical liberation of Kenya as a nation. With the conquest of

Kenya as a British colony, settlers initiated various economic activities, particularly farming, and extraction of agricultural products. These substantial investments needed some form of protection against various risk exposures. British insurers saw an opportunity in this, and established agency offices to service the colony's insurance needs. Prosperity in the colony soon justified expansion of these agencies to branch networks with more autonomy, and expertise to service the growing insurance needs. By independence, most branches had been transformed to fully-fledged insurance companies. Since then, Kenya's insurance industry has flourished (Maxon, 1993).

The insurance industry in Kenya is governed by the Insurance Act Chapter 487 which was enacted in the year 1985. After independence in 1963, the Government of Kenya saw the need to have control over the insurance industry, which was then dominated by branch offices of foreign companies particularly from Europe and India. During this period, insurance operations were governed by the Companies Act 1960, which was based on the United Kingdom legislation. There was, therefore no competent body to supervise the industry. There was a great need to localize the branch offices of foreign insurance companies in the country in order to benefit the local investors. This resulted to the need for statutory supervision of the industry. In 1978, the Minister for Finance issued a directive stopping the operations of branch offices of foreign companies and all insurance companies were required to be locally incorporated. Thereafter, in the early 1980's the Government with the support of United Nations Conference for Trade and

Development started the process of drafting a law to regulate the insurance industry (Maxon, 1993).

In 1986, the Insurance Act was enacted. The Act established the Office of the Commissioner of Insurance as the regulator of the insurance industry and stipulated the mandate and functions of the office. This office was created as a department in the Ministry of Finance and was mandated to supervise the insurance industry. In order to enhance the supervisory capacity of the regulator, the government delinked the department from the Ministry to give it some autonomy. The Insurance (Amendment) Act number 11 of 2006 established the Insurance Regulatory Authority (IRA) with the Commissioner of Insurance as the Managing Director and the Chief Executive Officer to take up the role of regulating, supervising and developing the insurance industry. This body replaced the functions of the Commissioner of Insurance. The role of the Authority is to ensure the effective administration, supervision, regulation and control of insurance and reinsurance business in Kenya (Insurance Amendment Act, 2006).

To license all persons involved in or connected with insurance business, including insurance and reinsurance companies, insurance and reinsurance intermediaries, loss adjusters and assessors, risk surveyors and valuers. To protect the interests of insurance policy holders and insurance beneficiaries in any contract of insurance. To promote the development of the insurance sector and to advice the government on the national policy to be followed in order to ensure adequate insurance protection and security for national

assets and national properties and undertake such other functions as may be conferred on it by this Act by any other written law. The Insurance Regulatory Authority also advocates for an effective regulatory framework to ensure a quick settlement of insurance claims without court cases. The regulatory authority thus advocates for the implementation of the no fault insurance system (Insurance Act Cap 487).

In 2008, there were a total of 42 insurance companies and 2 locally incorporate reinsurance companies that are licensed to operate in Kenya. Out of all the licensed companies, 20 were general insurers, 7 are long term insurers and 15 were composite handling both life and general, insurers. By the end of 2008 the combined assets of Kenya's 42 insurers amounted to KES146.12bn - or nearly US$2bn. Both the non-life and the life segments have had sustained double-digit growth over the last five years. Furthermore, there were about 201 licensed brokers, 21 medical insurance providers (MIPS), 2,665 insurance agents, 23 loss adjusters, 1 claims settling agents, 8 risk managers, 213 loss assessors or investigators and 8 risk managers (PriceWaterHouseCoopers 2008). Another indicator of the strength of Kenya's insurance sector is that non-life insurance has moved well beyond motor-related lines. Figures published by the Association of Kenya Insurers (AKI) indicate that private and commercial motor insurance respectively generated gross premiums of KES6,102.7mn and KES9,322mn in 2008 respectively. The next largest lines were personal accident (KES7,070mn), fire-industrial (KES4,322.7mn) and workers' compensation (KES2,145mn) (AKI, 2008).

Different studies showed that the short term business still continue to dominate the insurance market in Kenya, with its premiums making approximately 70% of the gross written premium which include deposit administration contributions. Furthermore, the gross premium written in 2007, which include deposit administration contributes amounted to Shs 47 billion (PriceWaterHouseCoopers 2008).

Kenya is also under-insured at a penetration rate of 2.6% for a population of 33.4 millions. Compares poorly with India at 3.7% penetration for a population of over a billion and contrasts with South Africa with a penetration of 14.6% for a population of 44 million. This shows the importance of having an insurance sector which can add more to the economic development of the country, which signifies a huge potential for the insurance business in the country. From 2002, the insurance sector of Kenya shows a steady growth (PWHC, 2008).

1.2 Statement of the Problem

Credit is relatively illiquid and exhibits the highest credit risk (Koch and MacDonald, 2000). The theory of asymmetric information argues that it may be impossible to distinguish good borrowers from bad borrowers (Auronen, 2003) which may result in adverse selection and moral hazards problems. Adverse selection and moral hazards have led to substantial accumulation of non-performing accounts in banks. The very existence of banks is often interpreted in terms of its superior ability to overcome three basic problems of information asymmetry, namely ex ante, interim and ex post. The

management of credit risk in the financial institution industry follows the process of risk identification, measurement, assessment, monitoring and control. It involves identification of potential risk factors, estimate their consequences, monitor activities exposed to the identified risk factors and put in place control measures to prevent or reduce the undesirable effects.

Effective Credit control involves establishing an appropriate credit risk environment; operating under a sound credit granting process; maintaining an appropriate credit administration that involves monitoring process as well as adequate controls over credit risk (Greuning and Bratanovic, 2003). Considerations that form the basis for sound credit control system include: policy and strategies that clearly outline the scope and allocation of credit facilities and the manner in which credit portfolio is managed, (Greuning and Bratanovic, 2003).

In recent years, credit control has attracted a lot of attention from the academic community (Miller, et al, 2003). The approaches to managing credit risk share a common feature: They can be used to optimize a credit exposure on a mid-term or a long-term basis. Therefore, for all institutions which did not foresee the recent turbulent times in the credit markets, these instruments were not of much use. When risk cannot be transferred, the focus naturally changes to controlling the current risk exposure on a short-term basis by managing credit limits. During a stock market downturn, the relevance of such a strategy becomes even more emphasized, since heavy losses in stock market values usually lead to pronounced liquidity problems for the organization's credit clients. Credit

control is a vital part of running any business — and especially any new business with limited cash resources.

Several authors have investigated the effects of credit on an organization. Meltzer (1960) examined whether firms increase their use of credit under adverse circumstances while Calomiris et al., 1995 said that credit works to mitigate the effects of firms' financial constraints.

In Kenya, Kimang'a, 1981 did a study on planning and controlling mercantile credit by firms in Kenya while Muturia, 1995 did a study on factors influencing credit delivery systems to small scale enterprises. These two studies failed to address the issue of credit control policies in their sample companies. To the researcher's knowledge, there is no study that has focused on credit control policies in the insurance industry in Kenya. This study seeks to fill this gap by looking into the credit control policies practiced and applied in the insurance industry in Kenya.

1.3 Objectives of the Study

i. To establish the credit control policies used by the insurance companies in Kenya.

1.4 Significance of the study

1.4.1 Insurance Companies

The Insurance companies will learn credit control management as a critical business function in assessing and evaluating credit risk to minimize non performing debts. They will also obtain information on problems of credit management in Kenya and the

strategies that need to be put in place to solve these problems and the experience of similar organizations in the other parts of the world in solving these problems.

1.4.2 The Government

The government is formulating policies that relate to the regulatory environment of the country as far as credit control activities in the insurance industry through Insurance Regulatory Authority are concerned. As the sector grows, the government has to come up with policies that address the various challenges within the sector, such as sharing of credit information through credit bureaus so as to reduce any resultant risks and to facilitate faster growth with minimum shortcomings. Results of this study can act as the source of information in which government policies on insurance premium debtors can be accessed.

1.4.3 Strategic Investors

The study will help strategic investors who provide funding for credit and need better understanding of the risk exposure and the best opportunity to invest their money and whether the insurance industry best practices guarantee insurance policies issued to institutions in covering diverse and various risks. Strategic investors should understand if their funds are reaching the desired objectives and whether institutions are putting in place safe guards to reduce payment defaults.

1.4.4 Academicians and Researchers

The area of credit control management is still suffering from a shortage of information. Research in the various component of this tool of managing debts will help to unearth unknown information that will go a long way in facilitating further understanding of the credit control policies in the insurance industry.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter is structured based on the research objectives. It reviews the relevant literature available that focuses on the concept of credit control policies that insurance companies can adopt. It also reviews various insurance credit risk policies in the insurance industry.

2.2 Review of Theories

2.2.1 Financing Theory

According this theory, suppliers have several advantages over financing institutions in offering trade credit to buyers. One such advantage is that the suppliers being in close contact with the buyer is in a superior position not only to evaluate credit worthiness of

their customers but also to monitor them almost on a day-to-day basis. Such an advantage is not available with a financial institution. The second advantage is that supplies have more effective and quicker ways of liquidating assets of defaulting buyer-firms than institutional financiers. If the goods supplied are durables in nature, it is easier for the supplier to repossess them through their network and sell the repossessed goods quickly with or without additional processing. It has been observed that if the goods have more value as collateral to sellers than the financial institution, the seller considers this as reduction of credit risk and therefore, can offer better credit terms than the financial institutions (Ng. et al, 1999). Suppliers can also threaten the buyers to stop supplies if the payment is delayed. Such an opportunity is not available with a bank or financial institution.

The financing theory does explain why the sellers would offer trade credit but it does not explain why the buyers will accept the trade credit vis-à-vis institutional finance. Several empirical investigations are made to answer this question. The theoretical foundation of such investigations is that trade credit exists because of inefficiency of financial market. All firms do not have equal access to institutional finance because perceived risks of some firms (may be, due to asymmetry of information) might be greater than the risk-tolerance limit of the financial institutions. Hence, these firms (which are mostly small businesses) would resort to trade credit. For this reason they are also prepared to bear high cost of trade credit. Wilner, (2000) found that firms with greater probability of default prefer trade credit to a loan from financial institution and consequently, trade credit interest rates exceed the credit market rate.

2.2.2 Liquidity Theory

This theory is an extension of financing theory discussed above. It holds that credit constrained firms are likely to use more trade credit than those having access to institutional finance. As large firms are more liquid and/or have lower cost of holding liquidity, they do not have the same incentive to use trade credit as others. It follows therefore, that liquid firms are more likely to be providers of trade credit (which may not be applicable in developing countries as we shall see later). This is more pronounced during a period of monetary restrictions when institutional credit is rationed. Nielson, (2002) using a sample of small firms found that such credit-rationed firms typically demand more trade credit from large companies.

2.2.3 Financial Distress Theory

This theory is based on "buyer opportunism" which was first noted by Petersen and Rajan, (1997) and further evidenced by Wilner, (2000). When a supplier cannot credibly threat to stop supplies e.g., when he is in financial distress, the buyer is found to pay less promptly. This opportunistic behaviour is more manifest when the buyer is one of the principal customer; the supplier simply cannot afford to make such threats. Indeed, as Wilner observed, majority of suppliers cannot even charge late payment penalty and even those firms which invoice the penalty half of them could not collect it. This is true across countries belonging to both the developed and developing world. Besides delaying payment, buyers also extract several other concessions, e.g., larger discounts, from the suppliers in financial distress.

Evans, (1998) found that suppliers (trade creditors) desiring to maintain enduring product market relationships are found to grant more concessions to a customer in financial distress, as compared to similarly positioned lending institutions. Wilner, (2000) also found that if the degree of dependence of the supplier on the customer is high, the customer in financial distress obtains larger concessions in renegotiation of credit terms.

2.2.4 Quality Guarantee Theory

This theory is based on asymmetry of information between buyer and seller. The buyer does not know the quality of the product he is buying. If he pays cash on delivery and the product turns out to be of poor quality, he ceases to have effective control over an errant supplier-- he loses the cash and the product as well. In other words, if the buyer cannot insure himself against malfunctioning of the product, he will discount the value he expects to gain from the purchase with his estimation of the risk factor. Hence the more risky the product, the lower is the expected value of the purchase (Horen, 2007).

Firms do offer warranties or even money-back guarantees. But enforcement of such warranties or even money-back guarantees often takes a long time during which period the buyer is deprived of the service of the product while his money is blocked. The seller may also be out of business by the time the defect in the product gets ascertained. If the buyer is a reseller, he may not get payment against such sale; most likely goods will be returned to him. Guarantee theory is valid for some types of manufacturers, for some category of products and for some time only (Horen, 2007).

Figure 2.1: Theoretical Framework

Theories   **Dependent Variable**

| Financing Theory |

| Liquidity Theory |

| Credit Control |

| Financial Distress Theory |

| Quality Guarantee Theory |
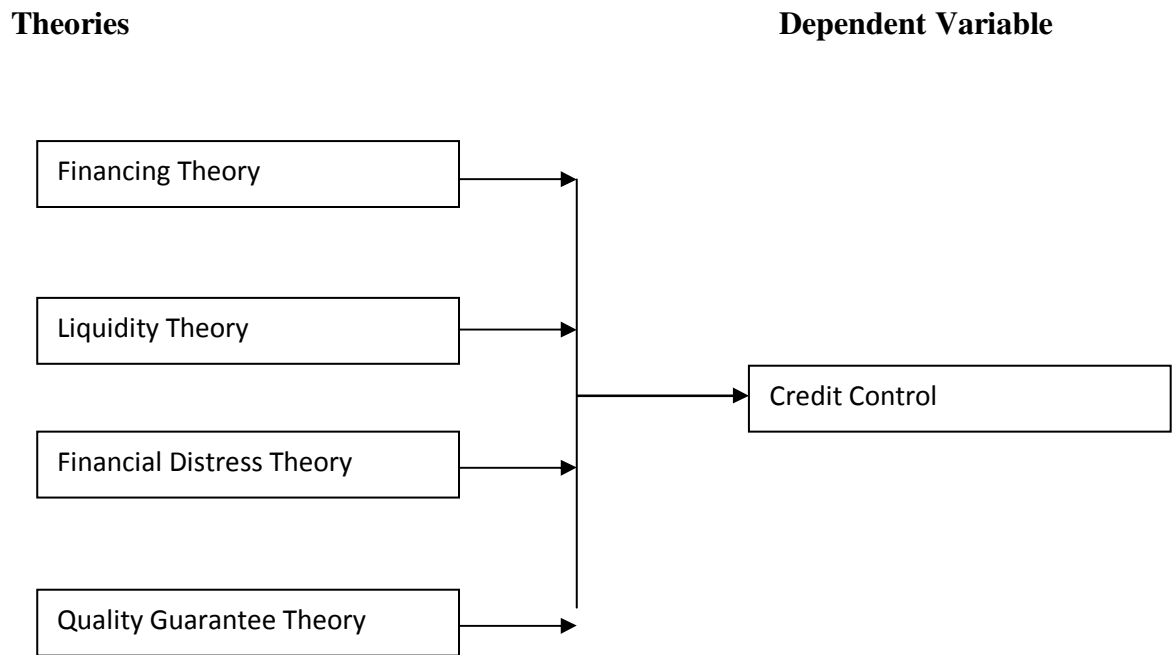
2.3 Credit Control Policies

2.3.1 The Credit Policy

The credit policy is the clear set of guidelines that set the terms and conditions for supply of goods or services on credit ,customer qualification criteria, procedure for making collections, and steps to be taken in case of customer defaults. It establishes the authority, rules and framework for the effective operation and administration of the credit. The policy should be communicated throughout the organization in a timely manner and effectively implemented through the use of appropriate procedures. It is critical that the policy be reviewed periodically (at least annually) to ensure that it remains effective and flexible, and continues to meet the institution's objectives. Changes in statutory and regulatory requirements should also be incorporated in the policy. A comprehensive credit policy that is effectively implemented enables the financial institution to: Maintain sound credit-underwriting standards; Assess, monitor and control credit risk; properly evaluate new business opportunities; and Identify, administer and collect problem credits (Baldoni, 2008).

The credit policy should specify credit risk philosophy governing the extent to which the institution is willing to accept credit risk; Levels of authority to approve credits. Delegated credit authority should be subject to timely review to ensure that it remains appropriate to current market conditions and expertise of credit officers. A Credit Policy should be drawn up to give consistency to processes and procedures. The policy should be communicated to all those involved with customer terms and payments including

Sales agents so they can set the correct expectations with customers. An effective credit control policy should deal with mechanisms for approving credit for new customers, mechanisms for determining credit ratings and terms for new customers and procedures for taking action against customers where sums due are not paid.

Credit Control policies should also incorporate criteria to allow the business to determine the conditions of sale to be issued to customers. Businesses may wish to devise different conditions of sale to be issued depending on the risk involved with offering the customer credit, payment terms and conditions, interest payable to be applied to accounts which become overdue., details of any cash discounts ,details of assessing which credit ratings should apply to customers ,details of when accounts will be frozen and recovery action taken thereafter, details of the stage at which legal action should be raised against the debtor, whether or not credit data from external sources should be investigated and whether credit insurance should be taken out.

2.3.2 Credit Appraisal

According to Balduino (2000), this is the process of selecting the customers who will be granted credit and determining their individual credit limits. It is the initial stage in the operation of an effective credit management system. Usually, a set of criteria or checklists will be available to perform the initial credit screening. The process of credit selection and analysis is essentially an exercise in risk assessment that is, in assessing the probability of customer non-payment.

Sound credit selection procedures help to reduce customer default risk by eliminating unsuitable applicants at the outset, thus avoiding the costly process of chasing slow payments and incurring bad debts later. The old adage "prevention is better than cure" is appropriate here (Mc Menamin, 1999).

Institutions employ different credit appraisal methods that suit them in different circumstances which may be highly quantitative or qualitative. The key considerations in credit appraisal before granting credit are as discussed below:

2.3.2.1 Know your Customer

This is the maturity, honesty, trustworthiness, integrity, discipline, reliability and dependability of a customer. Good character is no doubt the most important quality of a client. A person of good character will pay his or her debt whether it is secured or not. Such a person will disclose all the facts of his deal because his intentions are to seek guidance and help from the organization. When in problems, such borrowers will adhere to the credit administrator's request for alternatives arrangements to pay his debt instead of hiding from his lenders. A person's character can be determined through personal interviews, reference from other institutions, using contacts of references who are acquainted with the client or personal knowledge of the client (Abedi, 2000).

2.3.2.2 Capacity

This refers to the client's ability to service his or her debt fully. Even if one has good intentions but has no funds, he or she will not be able to repay all the loan installments plus interest on time. This capacity can only be well measured through enquiring on the source of client's income and subtracting all the commitments. The credit officer may observe and analyze various ratios and trends in the audited financial statements. For venture capital, a common feature for micro and small enterprises, capacity is based on projections and hence the integrity and proper modeling of such financial projections is quite crucial (Abedi, 2000).

2.3.2.3 Condition

The decision to grant credit to a customer could be influenced by current economic and business conditions generally or by specific business conditions relating to the applicant or the lending firm itself. For instance, if the credit applicant is a small business and there is an economic recession in the country, the risk of small business failure in such circumstances is considerably increased. Alternatively, if the lending firm itself is finding sales for some of its products slow, it may take a more relaxed view to granting credit to a potential customer. Condition refers to the overall environment. Is the commercial, social-economic, technological and political environment conducive to a successful implementation of the project? Are there any impediments and detours to the successful implementation of the project? (Abedi, 2000).

2.3.2.4 Collateral

This is a security given to secure the loan, in terms of non-encumbered assets. A lender considers the ratio of the value of the collateral, against the amount of the loan. This is the most talked about but it is the least important especially in lending to micro and small enterprises. In addition some collateral are difficult to dispose off to recover the loan and in some industries, there are lots of differences that make it hard to dispose off collateral (Abedi, 2000).

2.3.2.5 Contribution/Capital

This is the client's commitment to the project at hand. Is he willing and able to make a contribution? If a client is having difficulty raising the deposit, he is likely to be unable to repay his installments regularly. Is the client willing to contribute his time to the management of the projects or assets? Absentee management has been the main cause of failure of many projects in micro and small enterprises sector (Abedi, 2000).

2.3.2.6 Common Sense

This is the natural ability to make good judgment and behave in a practical and sensible way. It refers to being prudent and reasonable in analyzing, presenting, using and interpreting financial data and other related business information. In addition, common sense is the reasonableness of the financial information provided to support the case for financing a project as an indication of the ability of the project to pay itself (Abedi, 2000).

While each of the above factors is important, they should not be considered in isolation. While adverse record on each one is enough to reject an application, good reports on all the aspects improve the probabilities of success. Therefore, these elements can be used individually or in combination, depending on the level of quality of credit appraisal required and the amount of credit involved. The 6 C's model is meant to help credit providing institutions in Kenya to thoroughly evaluate and assess the creditworthiness of existing and potential customers before awarding new or further credit, hence enabling them to avoid non-performing loans. The 6 C's model covers the entire area of credit risk and hence its application in credit risk appraisal will ensure that lending institutions protect their assets against loss (Abedi, 2000).

2.3.3 Collection Policy

These include systems and procedures, which a company has in place to secure payment from its customers when payment becomes due. This policy sets out the follow up and late payment chasing procedures, such as letters and telephone calls, which will come into operation when a customer's account become overdue. It is only when payment has been obtained from a customer that a sale is complete. There is a saying among accountants that "a sales is not a sale until it is paid for" Detweiler (2004).

Collection policy is a critical part of the overall credit management process. An effective collection policy is essential to control investment in debtors and also to reduce the risk of financial loss and illiquidity through slow payment. Yet if the collection policy is too

stringent, it may antagonize customers and they may seek alternative suppliers Detweiler (2004). It is a business reality that there will be late payers in every customer base. When a payment is regarded as late, a range of procedures and tactics can be adopted to obtain payment.

Mc Menamin (1999) notes that the actual collection stage can often be quite tricky and requires a certain range of interpersonal skills on the part of the collection staff. The company may not wish to offend a customer and destroy otherwise harmonious customer relations, particularly if the customer is large. However, the company needs to protect its cash flow and will have to investigate collection procedures when a payment is regarded as overdue (Mc Menamin, 1999).Typical policy collection procedures include letters and telephone calls which are normally written as reminders are issued when a customer's payment is late. This may be accompanied by a telephone call directly. If payment is still not forthcoming then sterner reminders and telephone calls will be required Kabiru (2002).

Secondly, personal visits in some cases, according to Kabiru (2002) companies' sales staff may be responsible for regularly collecting payment when they call to refresh orders. In others cases, where a visit is not part of a sales routine, then a special personal visit to the customer by a member of the sales or accounts staff is usually productive. Thirdly collecting agencies can be used. Kabiru (2002) asserts that if the company's internal attempts to obtain payment prove unsuccessful, then the account may be passed over to a collection agency. However this is a high cost method in terms of fees normally

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charged by such agencies. In some organizations, the entire credit collection process has been outsourced to collection agencies.

Lastly legal action is usually taken as a last resort to recover outstanding debts when all other efforts have failed. Sometimes, a solicitor's letter which threatens legal action and sets out the consequences of non-payment is sufficient to secure payment. This method is also expensive and so the costs of collection have to be borne in mind. The amount of the debt and the possibility of recovery have to be weighed against the costs of pursuing recovery through the courts. In some instances it may be a case of "throwing good money after bad" (Mc Menamin, 1999)

2.3.4 Credit Administration

Credit administration includes steps undertaken from decisions made to grant credit to a customer, evaluation and appraisal, granting and follow up procedures for payment. Considerations that form the basis for sound lending policies include: limit on total outstanding credit and the limit on the total outstanding debt portfolio which is usually expressed relative to total debtors. Credit administration includes Management information systems; Loan committee oversight; Policies/procedures, lines of authority; Implementation of policies related to: Problem loan management, Loan presentations, Underwriting, Nonaccrual practices, Troubled-debt restructures, Impairment analysis, Appraisal practices, Stress testing and Ongoing loan monitoring processes (Carey, 2001).

2.3.5 Credit Risk Monitoring

Effective risk management requires a reporting and review structure to ensure that risks are effectively identified and assessed and that appropriate controls and responses are in place (IRM, AIRMIC and ALARM; 2002). Risk monitoring can be used to make sure that risk management practices are in line and proper risk monitoring also helps organization management to discover mistake at early stage (Al-Tamimi and Al-Mazrooei, 2007).

Monitoring is the last step in the corporate risk management process (Pausenberger and Nassauer, 2005). According to them, control has to be established at different levels. The control by the management board will not be enough to ensure the effective functioning of the risk monitoring system, because the management board members do not have time on their hands to exercise extensive control. Hence, the management board will install an independent unit to complete the task of internal supervision. This task is the responsibility of the internal audit. Also, the supervisory board is obliged to control the risk management process. The supervisory board is supported by the auditor. If the auditor discovers a defect, he will have to inform the supervisory board and the management board. Finally, the shareholders of the corporation can use their rights to demand information in order to judge the efficiency of the risk management system (Al-Tamimi and Al-Mazrooei, 2007). The director's report enables the shareholders to assess the status of the corporation knowledgeably and thoroughly.

Khan and Ahmad (2001) conducted a survey of risk management practices and found that on average the lowest percentage is on the measuring, mitigating and monitoring risk, 69% score as compared to risk management policies and procedures, 82.4%, and internal control of Islamic organizations, 76%. Al-Tamimi and Al-Mazrooei (2007) found that there is significant difference between UAE national and foreign organizations in risk monitoring and controlling. Also, the UAE commercial organizations have an efficient risk monitoring and controlling system and it has positive influence on risk management practices. Finally, risk monitoring is important process to ensure that risk management effectively been practiced by organizations.

2.4 Empirical Studies

Just as bank debtors have hit the skids over their indebtedness, insurance consumers are experiencing hard times over their premium debts to insurance companies. Though that of banks relates to borrowers who took loans, insurance premium debtors are the insured who have enjoyed cover on their risks without paying for them. Ordinarily, insurance by the guidelines establishing it should operate on no premium no cover principle, but because of the competition in the market, low level market penetration, low awareness about insurance and lack of market disciplines, this has not been possible. The outstanding premium trend that has been a major challenge for insurance companies, recently took a new dimension when the Nigerian Insurance Regulatory Authority, the National Insurance Commission (NAICOM), came up with a guidelines that companies

must from their profit provide for any outstanding premium carried in their books (Business day online, 2009).

Now, with the guidelines, companies for the first time have had to under compulsion provide from their profit to take care of the outstanding, and this has to a large extent affected many companies bottom line. The implication therefore is that companies in the coming year would be cautious of the businesses they accept in their books, as many if not all would insist on premium paid businesses (Business day online, 2009).

According to Onyeagocha (2001), the term credit is used specifically to refer to the faith placed by a creditor (lender) in a debtor (borrower) by extending a loan usually in the form of money, goods or securities to debtor. Essentially, when a loan is made, the lender is said to have extended credit to the borrower and he automatically accepts the credit of the borrower. Credit can therefore be defined as a transaction between two parties in which the creditor or lender supplies money, goods and services or securities in return for promised future payments by the debtor or borrower.

There are three major types of credit. These are commercial credit, consumer credit and investment credit. Commercial credit can be bank credit such as overdraft, loans and advances; trade credit from suppliers; commercial papers (or note); invoice discounting; bill finance; hire purchase; factoring, etc. Consumer credit is a kind of permission granted an individual or a household to purchase goods like refrigerator, television, car, electronic

sets, which could not be paid for immediately but for which installment payments are made over a period of time (Onyeagocha, 2001).

The functions of credit are primarily two: it facilitates the transfer of capital or money to where it will be most effectively and efficiently used; and secondly, credit economizes the use of currency or coin money as granting of credit has a multiplier effect on the volume of currency or coin in circulation. Despite the important role played by credit in economic and development growth of the country, it is associated with a catalogue of risks. According to Obalemo (2004), credit risk is an assumed risk that a borrower won't pay back the lender as agreed. The various types of credit risks include management risk, geographical risk, business risk, financial risk and industrial risk. The probable occurrence of partial or total default requires a thorough risk assessment prior to granting of loans.

The devastating effect of credit loss which is the aftermath of non-performing debts and advances makes sound evaluation of credit request paramount in all financial institutions. The Credit Officers of financial institutions need to properly evaluate and articulate the projects, the customers and the prevailing economic situations.

Mather (1962) described three basic principles for evaluating credit as safety, suitability and profitability. In the first instance, safety of any advance or loan is of utmost importance. Financial institutions must emphasize among other things, the character

(honesty, integrity and reliability) of borrowers. The probability that the amount granted would be repaid from the cash flows generated from the operations of the company must as a matter of requirement be high. The borrower must be able to provide acceptable security, which will serve as something to fall back on if the expected source of repayment fails.

Insurers are in the risk business. In the process of providing insurance and other financial services, they assume various kinds of actuarial and financial risks. Over the last decade much has been written of the role of insurers within the financial sector (Weiss, 1990). Suffice it to say that market participants seek the services of insurers because of their ability to provide actuarial risk pooling through their major product lines of life, property/casualty and health insurance, pension products, annuities, and other financial instruments. At the same time, they are major providers of funds to the capital market — particularly to the fixed income sectors. In performing these roles they generally act as a principal in the transaction. As such, they use their own balance sheet to facilitate the transactions and to absorb the risks associated with them. Therefore, it is here that the discussion of risk management and the necessary procedures for risk control has centered (Lamm-Tennant, 1989). Accordingly, it is in this area that our review of risk management procedures will concentrate.

The risks contained in the insurer's product sales, i.e., those embedded in the products offered to customers to protect against actuarial risk, are not all borne directly by the

insurer itself. In many instances the institution will eliminate or mitigate the actuarial and financial risk associated with a transaction by proper business practices; in others it will shift the risk to other parties through a combination of reinsurance, pricing and product design (Gennotte, 1991). Only those risks that are not eliminated or transferred to others are left to be managed by the firm for its own account. This is the case because the insurance industry recognizes that it should not engage in business in a manner that unnecessarily imposes risk upon it, nor should it absorb risks that can be efficiently transferred to other participants. Rather, it should only manage risks at the firm level that are more efficiently managed there than by the market itself or their owners in their own portfolios. In short, it should accept only those risks that are uniquely a part of the insurer's array of services (Abedi, 2002).

However, there are two classes of activities where the risk inherent in the activity must and should be absorbed at the insurance firm level. In these cases, risk management must be aggressive and good reasons exist for using firm resources to manage insurance-level risk. The first of these includes actuarial exposures where the nature of the embedded risk may be complex and difficult to communicate and transfer to third parties. A similar situation may arise on the asset side of the business where the insurer holds private placements and other complex, proprietary assets that have thin, or even non-existent, secondary markets. Communication in such cases may be more difficult or expensive than hedging the underlying risk. Moreover, revealing information about the customer may give competitors an undue advantage. The second case includes risk positions that

are central to the insurer's business purpose and are absorbed because they are the *raison d'être* of the firm. Actuarial risk inherent in the key insurance lines where the insurer may enjoy a competitive advantage or a market niche is a clear case in point. In all such circumstances, risk is absorbed and needs to be monitored and managed efficiently by the institution. Only then will the firm systematically achieve its financial performance goal (Babbel, 1994).

In general, the management of an insurance firm relies on a variety of techniques in their risk management systems. However, it appears that common practice has evolved such that four elements have become key steps to implementing a broad based risk management system (Babbel, 1994). These include: standards and reports; underwriting authority and limits; investment guidelines or strategies, and; incentive contracts and compensation. These tools are established to measure risk exposure, define procedures to manage these exposures, limit exposures to acceptable levels, and encourage decision makers to manage risk in a manner that is consistent with the firm's goals and objectives.

The account management structure and pricing of the advance must commensurate with the risk involved. There is going to be a cut-off score or grade below which any loan request will be approved. Risk ratings should be assigned at the inception of lending and retrieved at least half-yearly and when adverse events occur (CBN 2005). However, whenever deterioration in risk is noted, the score assigned to a borrower facility should be immediately changed. The model does not approve or reject application but rather takes a closer look.

Every financial institution has to develop and implement comprehensive procedures and Information systems to follow up the condition of individual credits. An effective loan monitoring system according to Odufuye (2007) will include measures to: Monitor compliance with established covenants, Assess, where applicable, collateral coverage, relative to creditor's current condition, Identify contractual payment delinquencies and classify potential credits on a timely basis, and, Direct actions at solving problems promptly for remedial management.

2.9 Conclusion

This review identifies non-performing credit as the major threat to the profitability of financial institutions. It is emphasized that financial institutions should embrace the concept of credit control in order to improve their credit administration and management which will eventually increase their profitability.

It is no gainsaying that effective credit processing, good credit scoring, aggressive recovery are the foundation upon which the superstructure of sound financial system is built. Financial institutions must therefore receive sufficient information to enable a detailed assessment of the true risk profile of the borrowers. The inexistence of a credit bureau, which engenders paucity of necessary information, has been the bane of the Kenya's financial institutions' credit administration and management.

Effective credit control policies will ensure: The efficiency and effectiveness of credit operations including monitoring, good documentation of credit, contractual requirements, legal covenants and collaterals; The accuracy and of course, timeliness of information

provided; Good management information systems; Adequate segregation of duties; Effective internal control over all "back office" procedures; Religious compliance with the financial institution's management policies and procedures and where necessary laws and regulations in the system; and more importantly, Sincerity and transparency of the financial institution's staff involved in the process of credit administration.

As stated in this chapter this can only be achieved if a sound credit policy document is in place with its variable credit standards, credit period and credit limits well defined. In addition, systematic credit risk assessment and credit appraisal is very important for credit risk exposures minimization. Therefore credible credit history as regards credit partners should be obtained, objectively analyzed through credit rating and scoring hence objective credit decision making. After credit decision is reached it is very important to have a clear collection policy so that default risks and bad debts are minimized leading to the main objective of this study which is to investigate credit control policies in the Kenyan insurance industry.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter discusses the methodology that will be used in gathering the data. Here the researcher's aim is to explain the methods and tools for presenting data and data analysis to get proper and maximum information related to the subject under study.

3.2 Research design

Research design is the plan and structure of study to be used so as to obtain answers to research questions. The plan is the overall scheme or program of the research (Robson, 2002). According to Cooper & Schinder (2003), there are many definitions of research design but no one definition impacts the full range of important aspects. However, all definition provides answers for questions such as; what techniques will be used to gather data? What kind of sampling will be used? How will time and cost constraints be dealt with? The study design therefore includes an outline of what the investigator will do from writing hypotheses and their operational implications to the final analysis of data (Leedy, 1989; Knox, 2004).

The research design will be descriptive using census survey approaches to assist us get the objectives of the study. Mugenda and Mugenda, (1999) the descriptive survey is a method which involved making decisions on what type of data was required, where the

data were found, techniques of data collection, analysis and interpretation. According to Saunders (2003) he states that census study examines the whole population without sampling it. It is considered the best researcher design since it gives total presentation there by producing highly reliable information. However it is time consuming and utilises a lot of resource.

Hence, this study will be a census study since it will seek to describe the current status of credit control policies in insurance companies in Kenya. The researcher chooses this method since the population is small and the area can be accessible.

3.3 Target Population and Sampling Procedure

3.3.1 Population

"A population is an entire group of individuals, events or objects having common characteristics that conform to a given specification." (Mugenda & Mugenda, 2003: 9). According to Saunders (2003) the population is the full set of cases from which a sample is taken.

The population of interest will consist of all the insurance companies headquartered in Nairobi and who are members of the Association of Kenyan Insurers (AKI) which are 41 in number as registered by AKI in 2009.Since the population is small I will endeavored to include the entire population in the study.

3.3.2 Sampling Procedure and Sample Size

Sampling is the process of selecting a number of individuals for a study in such a way that the individual selected represents the large group from which they are selected Chandran, (2003). The sample size of this study will consist of all insurance companies currently registered with AKI and operating in Nairobi. This is because majority of the insurance companies have headquarters in Nairobi. Nairobi is also the commercial and capital city of Kenya. Nairobi province was also selected due to time constraint to cover the whole republic.

The sample size of this study will be 41 and the researcher therefore will conduct a census study. According to Cooper & Schindler (1998) a census is feasible when the population is small and necessary when the elements are quite different from each other. When the population is small and variable, any sample we draw may not be representative of the population from which it is drawn. Therefore for this case of this study will be appropriate for researcher to choose census method to be used because the population is small and the institutions are easily assessable to be reach. Noting that most of the credit control is mainly under the credit department, the researcher will interview the credit managers from the selected insurance companies. Where the insurance company has no credit manager, the manager will be interviewed.

3.4 Data Collection Methods

Data collection is gathering empirical evidence in order to gain new insights about a situation and answer questions that prompt undertaking of the research (Flick, 1998). Primary and secondary data are the types of data collected. Primary data is defined as first hand information received from a respondent. Data that has been already collected and passed through the statistical process is secondary data (Chandran, 2003). This section is about the different types of data we can collect. There are two main types of data: *qualitative* and *quantitative* (Ramenyi et al. 2003, Zikmund 2003). Data collection methods involve operationalising the research design into instruments of data collection with a view to collecting data in order to meet the research objectives. They include questionnaires, interviews, focus groups, observations and review of documents (Chandran, 2004).

Primary data will be collected using a combination of "drop and pick later" & "self administered" structured questionnaires. In the questionnaire both open ended and closed questions will be asked. According to Chandran (2003), questionnaire is a series of written questions on a topic about which the respondents' opinions are sought. Questionnaires provide a high degree of data standardization and adoption of generalized information amongst any population. They are useful in a descriptive study where there is need to quickly and easily get information from people in a non-threatening way.

Follow ups will be made to ensure collection of the questionnaires in time, as well as assisting respondents in any difficulties encountered in completion of questionnaires. In

each insurance company, credit managers will be required to fill the questionnaires. A structural questionnaire will be used since it is easier to administer, analyze and economical in terms of time and money. Mugenda and Mugenda (1999) notes that a questionnaire is one of the best tools for collecting primary data.

3.5 Research Procedures

3.5.1 Pilot Testing

The questionnaire will be developed by the researcher and a pilot test will be carried out before the actual study takes place. The sample of the pretest will be a total of 6 managers and assistant managers of an insurance company. The results from the pretest group will not be presented in the final results.

3.5.2 Administration of the Questionnaire

The questionnaires will personally be administered by the researcher with the help of two research assistants both of whom will be trained in research methods. This method of administration is justified as it results in a higher response rate than the drop and pick method of administration. Further, personal administration of the questionnaires will help in carrying out data cleaning while on the field ensuring that data collected will be adequate for the purposes of the research.

A letter introducing the purpose of the study and copies of the questionnaires will be given to the respondents. Where necessary the researcher and the assistants will discuss the questionnaires with the respondents to further clarify the answers.

3.5.3 Data Analysis

The whole process which starts immediately after data collection and ends at the point of interpretation and processing data is data analysis (Cooper & Schindler, 2003). Chandran (2004), defines statistics as a discipline that provides the tools of analysis in research and one which refers to facts, information or data and to a system of data collection and analysis. Mugenda (2003) points out it as a process of bringing order, structure and meaning the mass information collected. Therefore, editing, coding, classifying and tabulating are the processing steps to be used to process the collected data for a better and efficient analysis.

The survey is set out to determine the credit control policies applied by insurance companies. After data collection, examination for completeness, reliability and consistency will be done on the data. To determine credit control policies, this study will undertake analysis of data collected by use of frequencies and percentages to determine factors affecting credit management and their consideration. The statistical package for social sciences (SPSS), Version 17 will be used; whereby mean, standard deviations, variance correlation coefficient and frequencies generated from the various data categories will be computed and shown in different graphs and tables. For the purpose of

this study, permission will first be sought from relevant authorities and a letter granted to

allow the researcher to carry out the research.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION.

4.1 Introduction

This chapter entails the findings of the study based on the data collected from the field. The Analysis focused on establishing the credit policies used by insurance companies in Kenya. A sample size of 41 insurance companies in Kenya was used and 33 of them successfully responded. The data was analyzed using Statistical Package for social sciences (SPSS) and the information was presented in form of pie charts, bar graphs and tables.

4.2 Response rate

Table 4.1 Response Rate

	Frequency	Percentage
Non- respondents	8	20
Actual response	33	80
Targeted population	**41**	**100**

The study targeted 41 respondents who were a representation of 100% of the total sample size. However, the study managed to successfully collect data from 33 respondents who represented 80% of the total sample size. This sample size was reliable to meet the objectives of the study. Only 20 % of the respondents did not respond.

4.3 Demographic information

In order to capture the general information of the respondents, issues such capacity within the company, gender, department, duration worked at the organization and highest level of education were addressed in the first section of the questionnaire. This was important because it enhanced reliability and gave the basic understanding of the respondents.

4.3.1 Capacity within the company

The study sought to establish the capacity the respondents held in the company and the following figure 4.1shows the results of the findings.

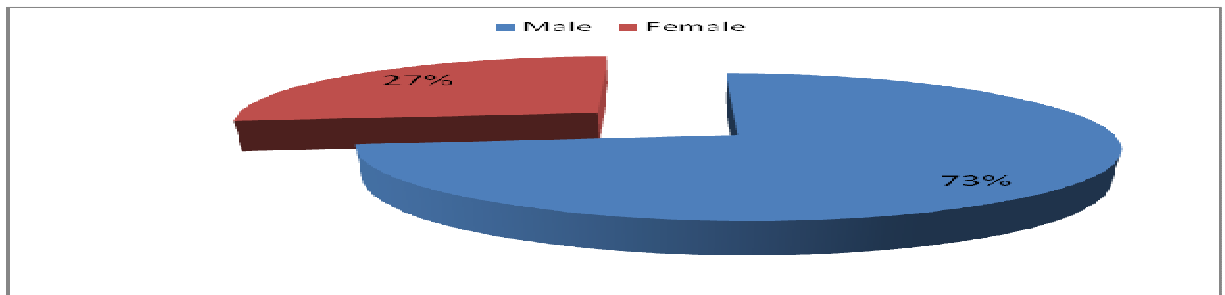**Figure 4.1 Capacity within the company**
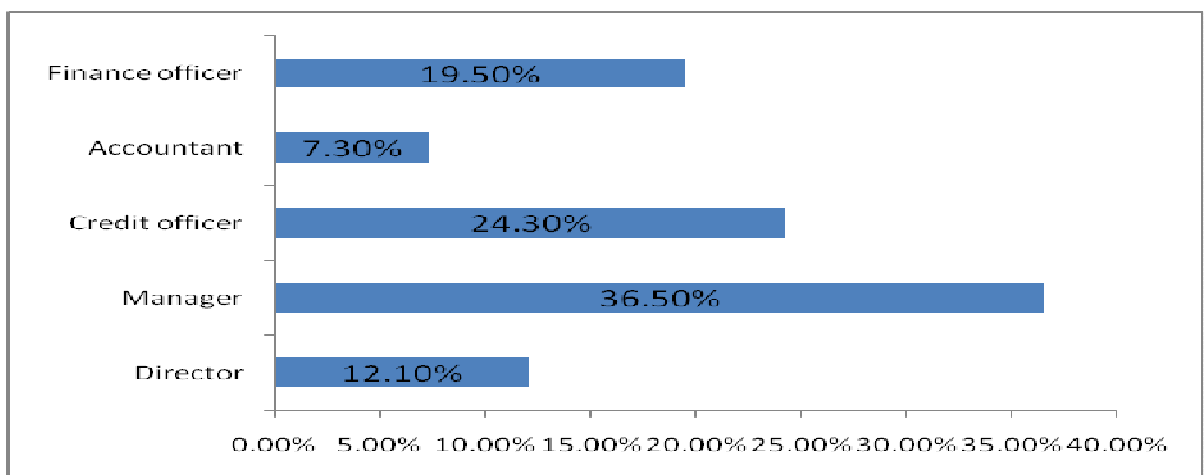
From the figure, the study established that majority of those who participated in the study had capacities as managers and they were represented by 36.5%, followed by credit officers who were 24.3%, finance officers were 19.5%, directors were 12.1% and accountants who were represented by 7.3%

4.3.2 Gender

This section of the study sought to find out the genders of the respondents and the following figure 4.2 shows the findings.

Figure 4.2 Gender

The study established that majority of those who participated in the study were male and they represented by a percentage of seven three and the female were represented by 27% respectively.

4.3.3 Department in the company

The study further sought to establish the departments that the respondents held in the company and the following figure 4.3 shows the results of the findings.

Figure 4.3 Department in the company
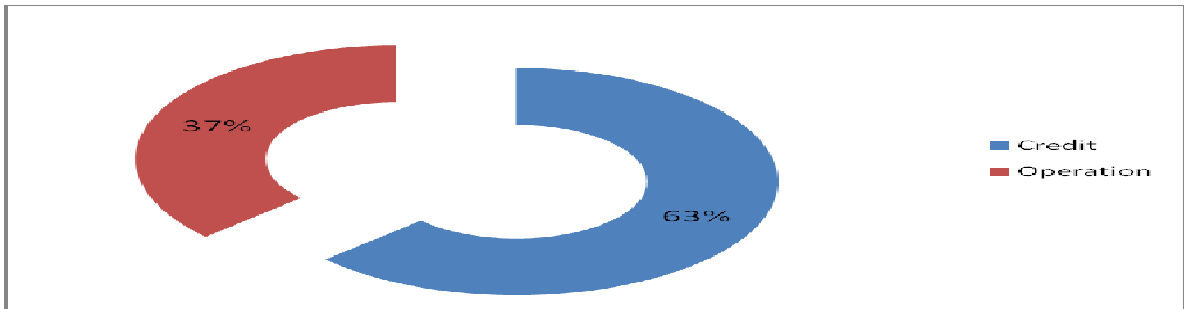
From the study it was established that majority of the respondents belonged to the credit departments and they were represented by 63% while those in the operations department were 37% respectively.

4.3.4 Duration worked in the organization

The following figure 4.4 sought to show the period that the respondents had worked in the insurance companies.

Figure 4.4 Period worked in the company

The study indicated that majority of the respondents had worked in the organization for a period of 6-9 years and they were represented by 56%, others indicated that they ha been there for 3-5 years and had a percentege of twenty four while those who had worked for a duration of 0-2 years and over 10 years were represented by 12% and 7% respectively.

4.3.5 Highest level of education

This section of the study sought to establish the highest level of education that the respondents had attained.The following figure 4.5 shows the results of the findings.
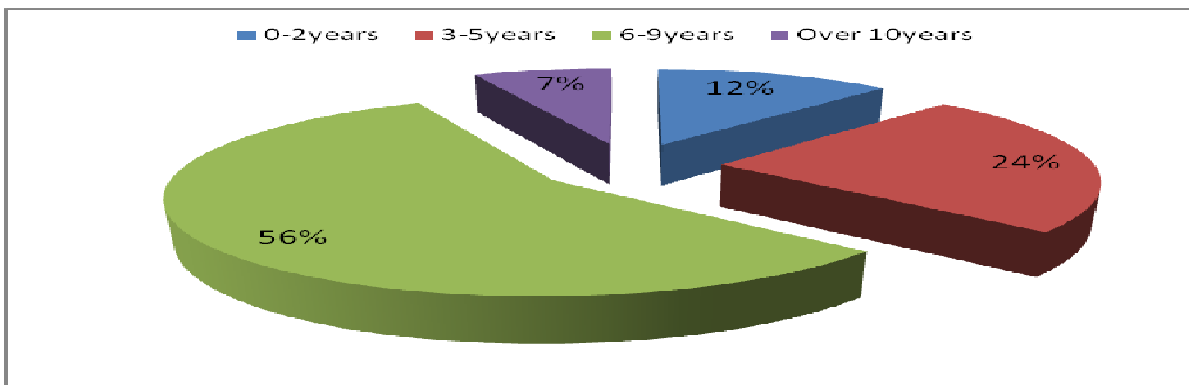
Figure 4.5 Level of education
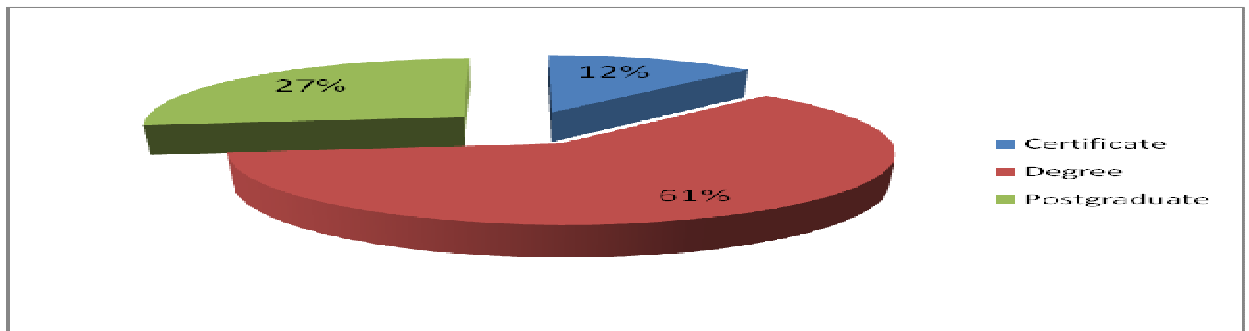
The study established that those respondents who took part in the study had attained their degrees and this was represented by 61% while those who had attained their postgraduate had a percentage of twenty seven. In addition those who had attained certificate as their highest level of education were represented by 12%.

4.4 Credit Evaluation/Administration

The study sought to establish how the insurance companies evaluate/assess the creditworthiness of new brokers, written approved documentation and the financial information of the insurance broker in the insurance companies.

4.4.1 Information used by the customers to assess the creditworthiness of a broker

This section of the study sought to establish the minimum information the new customers used to assess the creditworthiness of the insurance broker. Table 4.1 shows the findings.

Table 4.2 Information used by new customers to assess creditworthiness of an insurance broker

Information	Frequency	Percentage
Credit agency reports	5	15
Trade references	10	30
Organization reports	3	9
Audited financial statements	15	45
Total	**33**	**100**

Table 4.1 shows that most (45%) of the respondents indicated that their companies used information from the audited financial statements to assess the credit worthiness of the insurance brokers. 30% indicated that the used information from trade references, 15%

said that they used information from the credit agency reports. Only 9% indicated that they used information from the organization reports.

4.4.2 Information required in reviewing the credit worthiness of the insurance broker (premium debtors)

The respondents indicated that they used information from the audited financial reports and the organization reports to review the credit worthiness of the existing insurance brokers.

4.4.3 Intervals at which the insurance brokers files are updated.

Majority of the respondents indicated that the insurance brokers files were updated monthly, a few of them said that the updates were done weekly while a lesser number indicated that that the files were updated yearly.

## 4.4.3.1 Intervals at which the credit limits are reviewed

The study established that majority of the respondents indicated the credit limits were reviewed yearly.

4.4.3.2 Recording of the credit limits

This section of the study sought to establish whether credit limits are recorded in the insurance brokers (premium debtor) file and the figure 4.6 shows the findings.

Figure 4.6 Recording of the credit limits
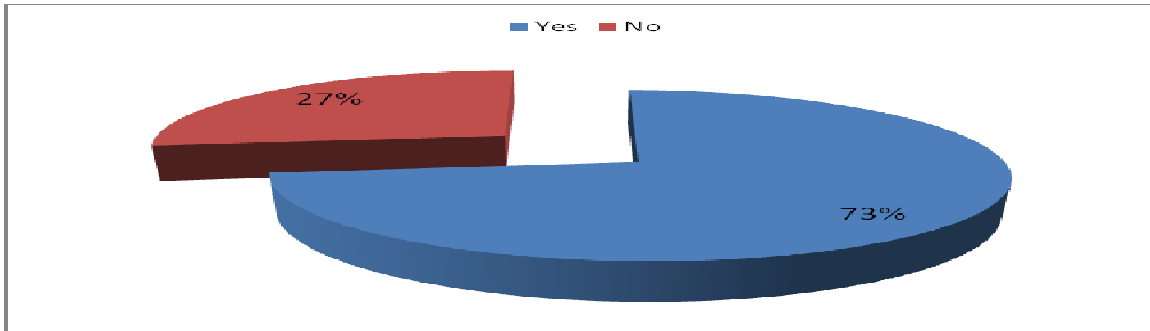
The study established that majority of the respondents (73%) were in agreement that credit limits were recorded in writing in the insurance brokers (premium debtors) file. However 27% stated that they were not recorded in writing.

4.4.3.3 Written credit approval documentation

From the study majority of the respondents indicated that the offer letter was a written credit approval documentation that had to appear in each insurance broker (premium debtor) file.

4.4.4 General guidelines used to evaluate insurance broker's financial information to determine creditworthiness

The study sought to establish the general guidelines used in evaluating the insurance broker's financial information to determine credit worthiness. The table 4.2 shows the results of the findings.

Table 4.3 Guidelines used to evaluate insurance broker's financial information to determine creditworthiness

Guidelines	Frequency	Percentage
Net worth to size of credit limit	5	15
Minimum current or debt ratio	3	9
Whether a first or repeat insurance broker	17	54
Annual turnover	8	22
Total	**33**	**100**

The study revealed that majority of the respondents (54%) indicated that they used whether a first or repeat insurance broker in evaluating insurance broker's financial information to determine creditworthiness.22% indicated that they used annual turnover, 15% said that they used net worth to size of credit limit while 9% said that they used minimum current or debt ratio.

4.4.5 Personal visits to the premium debtors

The study sought to establish whether regular personal visits were made to the premium debtors and figure 4.7 shows the findings.

Figure 4.7 Personal visits to the premium debtors
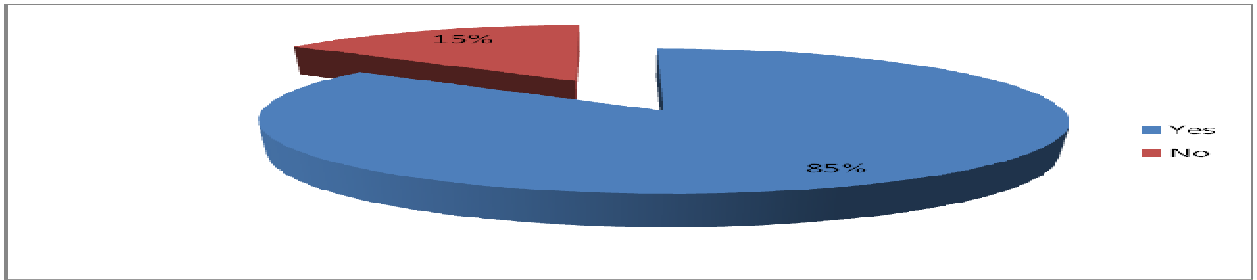
From the study it was esatblished that majority (85%) of the respondents indicated that regular personal visits were made to the premium debtors. However 15% stated that they did not make any visit.

4.4.5.1 Visits reports produced

The following figure 4.8 shows that visit reports are produced once made to the premium debtors.

Figure 4.8 Visits reports produced
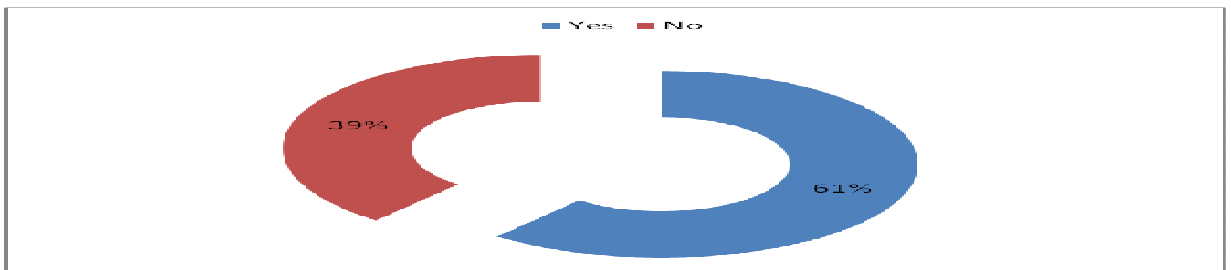
From the study majority (61%) of the respondents indicated that visits reports were produced ones visits are made to the premium debtors. However 39% indicated that the reports were not produced.

4.4.6 Identifaction of high risk premium debtors and their reviewal

The study established that majority of the respondents indicated that high risk premium debtors were identified through credit appraisal process and they were reviewed monthly.

4.5 Credit monitoring

This section of the study sought to establish how the premium debtor accounts were generated, monitored and reviewed.

4.5.1 Account system

The study sought to show the system that the premium debtor accounts used and figure 4.9 shows the results of the findings.

Figure 4.9 Account system
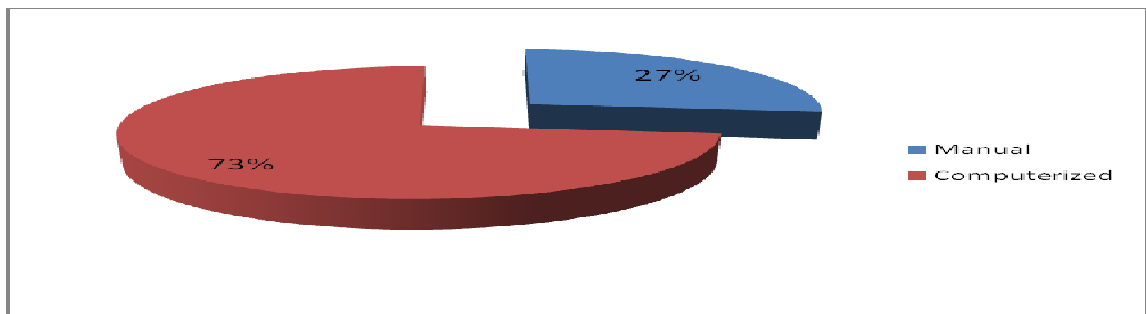
The study established that majority of the respondents indicated that premium debtors used computerized account system and this was represented by a percentage of seven three while 27% indicated that the debtor used manual accounts sysytem**.**

4.5.2 Debtors accounts checked against credit limits

The study sought to establish whether the premium debtors accounts were checked against credit limits and the table 4.3 shows the results of the findings.

Table 4.4 Debtors accounts checked against credit limits

	Frequency	Percentage
When orders on insurance cover are received	7	21
When orders for insurance cover are ready	26	79
Total	**33**	**100%**

Majority of the respondents (79%) indicated that the debtors' accounts were checked against credit limits when orders for insurance cover were ready while 21% indicated that the accounts were checked against credit limits when orders on insurance cover were received.

4.5.3 Aging analysis

From the study majority of the respondents indicated that an aging analysis was produced at a least once a week after the accounts had been consolidated.

4.5.4 Aging analysis on the statements of accounts

This section of the study sought to find out whether the aging analysis was shown on the statements of accounts. The following figure 4.10 shows the findings.

Figure 4.10 Aging Analysis on the Statements of Accounts
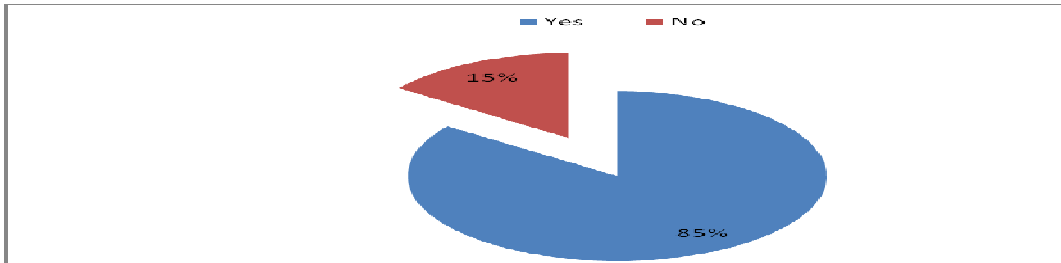
Majority of the respondents (85%) were in agreement that an aging analysis was shown on the statements of accounts while 15% revealed that the aging analysis was not shown in the accounts.

4.5.5 Intervals at which the reports of premium debtor accounts are generated and reviewed

The study also shows that majority of the respondents indicated that reports of premium debtor accounts were generated and reviewed monthly.

4.8 Collection practices

This section of the study sought to show the status of overdue premium debtors in terms of overdue days and amounts, the procedures used for overdue accounts and the persons responsible.

4.8.1 Status of overdue premium debtors in terms of overdue days and amounts

The study sought to establish status of overdue premium debtors in terms of overdue days and amounts and the following table4.4 shows the results of the findings.

Table 4.5 Status of overdue premium debtors in terms of overdue days and amounts

Overdue	Amount '000'
0-30 Days	8,000
30-60 Days	15,000
60-90 Days	20,000
Above 90 Days	35,000

Majority of the respondents indicated that the status of overdue premium debtors was above 90 days and had an average of 35 million, followed by those who said that their debtors overdue was between 60-90 days with an average of 20 million, others indicated that their debtors overdue was between 30-60 days and 0-30 days, they were represented by an average of 15 million and 8 million respectively.

4.8.2 Procedures used for overdue accounts

The following table 4.5 sought to show the procedures used by the respondents for overdue accounts.

Table 4.6 Procedures used for overdue accounts

	Frequency	Percentage
Reminder by telephone	20	61
Reminders in writing	7	21
Stop deliveries	-	-
Legal action	-	-

Collection Agencies	6	18
Total	**33**	**100**

From the table, majority indicated that reminders by telephone were the commonly used procedures for overdue accounts and they were represented by a percentage of sixty one. Others indicated that they used reminders in writing and they were 21% while those that used collection agencies were represented by 18%.

4.8.3 Third parties used locally to assist in collection efforts

The study sought to establish whether the third parties were used locally to assist in collection efforts and the following figure 4.11 shows the findings.

Figure 4.11 Third parties used locally to assist in collection efforts
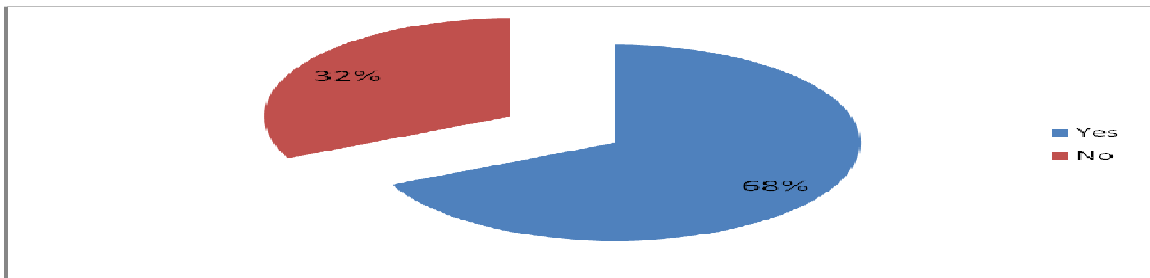
Majority of the respondents 68% indicated that third parties were used locally to assist in collection efforts while a few 32% felt that third parties were not used.

4.8.4 Persons responsible for collection

54

The following figure 4.12 shows the persons that would be responsible in collection efforts if third parties were to be used.

Figure 4.12 Persons responsible for collection
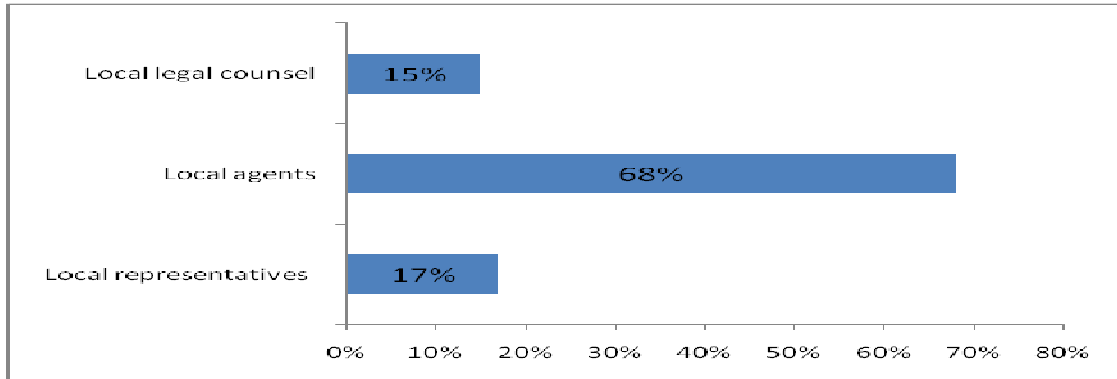
The study established that majority of the respondents (68%) indicated that local agents would be preferred if third parties were to be used in collection efforts, while 17% and 15% indicated that local representatives and the local legal counsel could also be used as third parties.

CHAPTER FIVE

5.0 SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter provides a summary of the findings of the research, the conclusion and the recommendations of the study which sought to establish the credit control policies practiced and applied in the insurance industry in Kenya.

5.2 Summary of Findings

The main purpose of the study was to establish the credit control policies used by the insurance companies in Kenya summarized from credit evaluation, credit monitoring and collection practices as discussed below;

5.2.1 Credit Evaluation/Administration

The study shows that most of the respondents revealed that their companies used information from the audited financial statements and trade references to assess the credit worthiness of new insurance brokers. A number also indicated that their companies used

information from the credit agency reports and information from the organization reports to assess the creditworthiness of new brokers. For existing brokers, majority of the respondents indicated that their companies used information from the audited financial reports and the organization reports to review the credit worthiness. Further, majority of the respondents indicated that the insurance brokers (premium debtors) files were updated monthly while a few indicated that the files updates were done weekly and yearly respectively. On credit limits, majority of the respondents indicated they were reviewed yearly and that they were recorded in writing in the insurance brokers (premium debtors) file. Moreover, majority of the respondents indicated that offer letter was a written credit approval documentation that had to appear in each insurance broker (premium debtor) file.

On the general guidelines that the companies used in evaluating insurance broker's financial information to determine creditworthiness, majority of the respondents indicated that they used whether a first or repeat insurance broker. However, a number also indicated that their companies used annual turnover, net worth to size of credit limit and minimum current or debt ratio respectively in order to determine the credit worthiness of brokers. Further, majority of the respondents indicated that visits were made to the premiuum debtors and that premium reports were produced ones visits were made. High risk premium debtors were identified through credit appraisal process and they were reviewed monthly.

5.2.2 Credit monitoring

The study also sought to find out how the insurance companies monitor the premium debtors accounts. Majority of the respondents indicated that premium debtors used computerized account system. Further, majority the respondents revealed that debtors' accounts were checked against credit limits when orders for insurance cover were ready while a number also indicated that the accounts were checked against credit limits when orders on insurance cover were received. The study also found out that an aging analysis was produced at least once a week after the accounts had been consolidated. An aging analysis was shown on the statements of accounts as revealed by majority of the respondents. It was also revealed that majority of the companies generated and reviewed reports of premium debtor accounts monthly.

5.2.3 Collection Practices

Majority of the respondents indicated that overdue premium debtors was above 90 days and had an average of 35 million. On the other hand, a number indicated that the overdue premium debtor was between 60-90 days with an average of 20 million, others indicated that it was between 30-60 days and with an average of 15 million. Majority of the respondents further indicated that reminders by telephone were the commonly used procedures for overdue accounts. Only a few indicated that they used reminders in writing and collection agencies. Moreover, the respondents indicated that third parties would be used locally to assist in collection efforts. Majority of the respondents further indicated that local agents would be preferred if third parties were to be used in collection

efforts while a number revealed that local representatives and the local legal counsel would be most preffere as third parties in collection effforts.

5.3 Conclusions

The purpose of the study was to establish the credit control policies used by the insurance companies in Kenya. The following are the major conclusions based on the summary of findings.

The study established that most companies used information from the audited financial statements and trade references to assess the credit worthiness of new insurance brokers. However, there are also a few insurance companies that used information from the credit agency reports and information from the organization reports. On the other hand, majority of the companies used information from the audited financial reports and the organization reports to review the credit worthiness for existing brokers. The study also revealed that majority of insurance firms the insurance brokers updated the (premium debtors) files monthly with only a few firms updating the files weekly and others yearly. On credit limits, it was established that majority of the companies reviewed them yearly and they were recorded in writing in the insurance brokers (premium debtors) file. It was also noted that an offer letter mainly the written credit approval documentation that had to appear in each insurance broker (premium debtor) file.

There are also laid down guidelines that the insurance companies used in evaluating insurance broker's financial information to determine creditworthiness. Majority of the firms as revealed by the study used whether a first or repeat insurance broker. Annual

turnover, net worth to size of credit limit and minimum current or debt ratio were guidelines that were also used but to a low extent. The study also revealed that insurance firms made visits to premiuum debtors and that premium reports were produced ones visits were made. High risk premium debtors were also identified through credit appraisal process and they were reviewed monthly.

The study further established that insurance companies monitored the premium debtors accounts. premium debtors used computerized account system. Further, majority the respondents revealed that debtors' accounts were checked against credit limits when orders for insurance cover were ready while a number also indicated that the accounts were checked against credit limits when orders on insurance cover were received. The study also found out that an aging analysis was produced at least once a week after the accounts had been consolidated. An aging analysis was shown on the statements of accounts as revealed by majority of the respondents. It was also revealed that majority of the companies generated and reviewed reports of premium debtor accounts monthly

The study also sought to find out how the insurance companies monitor the premium debtors accounts. Majority of the respondents indicated that premium debtors used computerized account system. Further, majority the respondents revealed that debtors' accounts were checked against credit limits when orders for insurance cover were ready while a number also indicated that the accounts were checked against credit limits when orders on insurance cover were received. The study also found out that an aging analysis was produced at least once a week after the accounts had been consolidated. An aging

analysis was shown on the statements of accounts as revealed by majority of the respondents. It was also revealed that majority of the companies generated and reviewed reports of premium debtor accounts monthly.

Reminders by telephone were the commonly used procedures for overdue accounts. Through telephone it is easy to get an immediate feedback as compared to reminders in writing or stop deliveries or legal action. The study also established that third parties would be used locally to assist in collection efforts; local agents would be most preferred if third parties were to be used in collection efforts. However, the firms also have options of using either sales representatives or the local legal counsel in collection of overdue accounts. It was also established that most overdue premium debtors were above 90 days and had an average of 35 million.

5.4 Recommendations

The following recommendations were made based on the findings and conclusions of the study.

Experience from around the world indicates that poor credit quality coupled with weak credit risk management practices continues to be a dominant factor in insurance firms' failures and insurance crises. Therefore, it is clear that information on insurance' credit risk profiles, including the quality of their credit exposures and the adequacy of their credit risk management processes, is crucial in market participants' and supervisors' assessment of their condition, performance and ability to survive in the long-run. Such

information is also important in assessments of the overall safety and soundness in the insurance industry.

The insurance firms need to come up with technique to be used to measure and control the credit risks identified or exposed by brokers; that is, risk mitigation techniques should be employed. Moreover, the structure, management, and organisation of the insurer's risk management function(s), including an overview of the insurer's risk management strategy should be well laid down and known. The personnel involved in formulation of credit control policies should also be highly qualified.

Though most companies are highly exposed to credit risk, especially the risk that a counterparty or intermediaries can be unable to pay amounts in full when due. There are still key areas where the company is exposed to credit risk and where insurance companies should focus on. These are reinsurers' share of insurance liabilities, amount due from reinsurers in respect of claims already paid, amounts due from insurance contract holders and counterparty risk with respect to derivative transactions.

Moreover, the company should provide comprehensive and accurate policies on; Accounting policies and practices, Credit risk management, Credit exposures, Credit quality, Earnings.

Through surveys and other fact-finding initiatives, the companies can continue to monitor the extent to which they are making progress in enhancing the appropriate credit policies are applied to avoid any credit risk that may arise.

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APPENDICES

Appendix I: Letter of Introduction

Dear Respondent,

This questionnaire is designed to gather information on **"A survey of credit control policies in the insurance industry in Kenya"**. The study is being carried out for a Project Proposal paper in partial fulfillment of requirements for the degree of **Master of Business Administration** from the University of Nairobi.

The information in the questionnaire will be treated with confidentiality and in no instance will your name be mentioned in this research. The information provided will not be used for any other purpose other than for this research.

Your assistance in facilitating the same will be highly appreciated.

Thank you in advance.

Yours sincerely,

…………….....................……

Joseph Mwaniki Karanja

MBA Student

Appendix II: Questionnaire

Part 1: Background Information

1. Kindly indicate your full names

……………………………………………………………………………………………

2. For and on behalf of: (Name of the company)

…………………………………………………………………………………………

3. Capacity within the company:

Owner   [ ]   Director   [ ]   Manager   [ ]

Other (specify)   [ ]………………………………………………………

4. What is your gender ?

    Male   [ ]   Female   [ ]

5. Which   department do you work from?

    Credit department   [ ]   Operations department   [ ]

    Other (Specify)   [ ]………………………………………………….

6. How long have worked in this organization

    0-2 years [ ]   3-5 years   [ ] 6-9 years   [ ]   Over 10 years   [ ]

7. Kindly indicate your highest qualification attained.

    Certificate   [ ]   Degree   [ ]   Postgraduate [ ]

    Other (specify)   [ ]…………………………………………..

Credit Evaluation/Administration

8. For new customers, what is the minimum information required to assess the creditworthiness of a broker? Do you use:

Credit Agency Reports   [ ]   Trade References   [ ]   Organization Reports [ ]

Audited Financial Statements   [ ]   Other Sources [ ]

9. For existing insurance brokers, what is the minimum information required to review the creditworthiness of the insurance broker (premium debtors)?

…………………………………………………………………………………………………
………………………….

10 (i). How often are insurance brokers (premium debtors)files updated?

……………………………………………………………………………………………..

(ii) How often are credit limits reviewed?

…………………………………………………………………………………………………
…………………………………

(iii) Are credit limits recorded in writing in the insurance brokers (premium debtors) file?

      Yes   [ ]   No   [ ]

(iv) What written credit approval documentation must appear in each insurance broker (premium debtors) file:

…………………………………………………………………………………………………
………………………….

11. What general guidelines do you use in evaluating insurance broker's financial information to determine creditworthiness?

     Net worth to size of credit limit   [ ]   Minimum current or debt ratio [ ]

Whether a first or repeat insurance broker   [ ]   Annual turnover   [ ]

All the above   [ ]

12. Are regular personal visits made to the premium debtors?

Yes   [ ]   No   [ ]

(b) If yes, are visit reports produced?

Yes   [ ]   No   [ ]

13. How are high risk premium debtors identified, and how often are they reviewed?

……………………………………………………………………………………………

………………………………………………………..

Credit Monitoring

14. Is the premium debtor account system

Manual   [ ] or computerized   [ ]

15. Are premium debtors accounts checked against Credit Limits?

When orders on insurance cover are received: [ ]   when orders for insurance cover are ready: [ ]

16 (i). Is an aging analysis produced

At least once a week [ ]   if not, how often……………………….

(ii) is an aging analysis shown on the statements of accounts

Yes   [ ]   No   [ ]

(iii) How often are reports of premium debtor accounts generated and reviewed,

………………………………………………………………………………………………

………

Collection Practices

17. Kindly indicate the status of overdue premium debtors in terms of overdue days and amounts;

Overdue	Amount
0-30 Days	
30-60 Days	
60-90 Days	
Above 90 Days	

17. Which of the following procedures are used for overdue accounts

Reminder by telephone   [ ]   Reminder(s) in Writing   [ ]

Stop Deliveries   [ ]   Legal Action   [ ]   Collection Agencies

    [ ].

18. Would third parties be used locally to assist in collection efforts?

    Yes   [ ]   No   [ ]

19. If yes who are involved

    Sales representatives [ ]   local agents   [ ]   local legal counsel   [ ]

THANK YOU FOR PARTICIPATION!!!

Appendix III: List of insurance companies registered with AKI

1. African Merchant Assurance Company (AMACO)
2. APA Insurance Company
3. Apollo Life Assurance Company
4. Blue Shield Insurance Company
5. British American Insurance Company
6. Cannon Assurance Company
7. CFC Life Assurance Company
8. Chartis Kenya Insurance Company
9. Concord Insurance Company
10. Co-operative Insurance Company
11. Corporate Insurance Company
12. Directline Assurance Company Ltd
13. Fidelity Shield Insurance Company
14. First Assurance Company
15. Gateway
16. Geminia Insurance Company
17. General Accident Insurance Company
18. Heritage Insurance Company
19. Insurance Company of East Africa (ICEA)
20. Intra Africa Assurance Company
21. Jubilee Insurance Company
22. Kenindia Assurance Company
23. Kenyan Alliance Insurance Company
24. Kenya Orient Insurance Company
25. Lion of Kenya Insurance Company
26. Madison Insurance Company

27. Mayfair Insurance Company

28. Mercantile Insurance Company

29. Metropolitan Life Insurance Kenya Ltd.

30. Monarch Insurance Company

31. Occidental Insurance Company

32. Old Mutual Life Assurance Company

33. Pan Africa Life Assurance Company

34. Pacis Insurance Company Ltd

35. Phoenix of East Africa Assurance Company

36. Pioneer Life Assurance Company

37. Real Insurance Company

38. Tausi Assurance Company

39. Trident Insurance Company

40. Trinity Life Assurance Company

41. UAP Provincial Insurance Company