EFFECTS OF MERGERS ON FINANCIAL PERFOMANCE OF INSURANCE COMPANIES IN KENYA

BY

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DECLARATION

STUDENT

I, the undersigned, declare that this is my original work and has not been submitted to any other university or institution for academic credit.

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This Research Project has been submitted for examination with my approval as the University supervisor.

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May our Almighty God bless you all abundantly.

DEDICATION

To my entire family,

My wife Wambui, sons Ndura, Mwangi, Ndura junior & Ngugi and my parents Ndura & Muguru

To my late wife Njambi, rest in peace

ABSTRACT

The objective of this research was to determine the effects of mergers on the financial performance of insurance companies in Kenya. Theoretically, its assumed that mergers improves company performance due to increased market power, enhanced profitability, and risk diversification. The research focused on the financial performance of the insurance companies which merged between 1995 and 2005 in Kenya.

Comparative analysis of the six insurance companies' financial performance for the pre and post merger periods was conducted to establish whether the mergers had led to an improved financial performance after the mergers. Secondary data from the financial statements was collected for 4 years before and after the mergers for 4 companies and 3 years before and after the merger for the other 2 companies due to unavailability of the old financial statements of these 2 companies. The data was then analyzed with the help of excel spreadsheets.

The study found that the mergers had no positive effect on the profitability of insurance companies in Kenya and that the profitability either remained the same as before the merger or deteriorated in the first four years after the merger. The study also found that the mergers had no effect on the level of capital adequacy and long term solvency of the merged insurance companies as 50% of the companies improved while the other 50% deteriorated. On the performance measures that are unique to the insurance industry, the study established that mergers have positive effect on the financial performance of insurance companies that transact general business while it has adverse effect on the financial performance of insurance companies that transact life business in Kenya.

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CHAPTER ONE

1.0 INTRODUCTION

1.1.1 BACKGROUND OF THE STUDY

A merger is a combination of two or more companies in which the resulting firm maintains the identity of the acquiring company. In a consolidation, two or more companies are combined to form an entirely new entity. A consolidation might be utilized when the firms are of equal size and market power. Companies may seek external growth through mergers in order to achieve risk reduction, improve access to the financial markets through increased size, or obtain tax carry-forward benefits. A merger may also expand the marketing and management capabilities of the firm and allow for new-product development. The motives for mergers are both financial and non-financial in nature (Poposki, 2007)

According to Horne (1991), a merger is a combination of two corporations in which only one survives. The merged corporation goes out of existence, leaving its assets and liabilities to the acquiring corporation. A merger must be distinguished from a consolidation, which involves the combination of two or more companies whereby an entirely new company is formed. The old companies cease to exist and shares of their common stock are exchanged for shares in the new company. When two companies of the same size combine, the usually consolidate and when two companies differ significantly in size, they usually merge.

Mergers are expected to improve the financial performance of the merged companies and the central strategy for most of the companies seeking mergers is to seek to become the leading player in the market area of the strategic business unit. A study carried out by Korir (2006) on the effects of mergers on financial performance of companies listed at the Nairobi Stock Exchange found that mergers improve performance of companies listed at the NSE.

Although companies restructured through mergers are expected to improve their financial performance, results have been negative in some cases. Due to the banking financial crisis of 1990s, bank mergers have been prevalent in Kenya as a strategy tools for saving weak banks. Chesang (2002) assessed the financial performance of merged banks using three financial measures; Capital Adequacy, Solvency, Profitability and earnings ratios. The results of the study however concluded that other than capital adequacy and solvency ratios which are legal requirements by Central Bank of Kenya, mergers have not improved the financial performance of the majority of the merged banks as their profitability declined after the mergers.

Shim (2010) explored the relationship between mergers and acquisitions, product diversification and financial performance using the sample of the U.S. property-liability insurers over the sample period 1989-2004. An acquirer's overall financial performance decreases and the volatility of its profit ratio increases following mergers and acquisitions. The study showed that the results are robust to alternative performance measures. One possible explanation is that expansion of the firm through mergers and

acquisitions has the potential to create financial inefficiency due to increased earnings volatility. As companies become larger and more complex, mergers and acquisitions benefits tend to be offset by the additional costs. Administrating and operating over wider geographical areas and integration of different information systems may lead to higher costs. Bonding different organizations has more potential to create managerial conflict and agency problems since managerial monitoring becomes more difficult. An alternative explanation is that the target companies may be considerably badly performing and thereby acquiring firms appears to perform poorly after merger transactions.

With changes in the overall economic environment, effective development of information technology and active globalization in different nations, worldwide development has become a goal of many enterprises. Merger activities are an important tool for attaining these goals and increasing competitive strength. The financial industry has also begun reforms in accordance with the merger trend, beginning with mergers of enterprises in the primary financial center nations in the world. In the USA, since the early 1900s, there have been six distinct waves of mergers and acquisitions, each with its distinct characteristics and outcomes, as per a Boston Consulting Group report released in July 2007 (based on a detailed analysis of more than 4,000 completed deals between 1992 and 2006 in USA). As per the report, “at the beginning of the twentieth century, Companies worldwide have been aggressively building new competencies and capabilities and going in for markets based diversification leading to increase in number of mergers and acquisitions globally (Liu, 2010).

Over the last decade, the insurance industry world wide experienced a large number of mergers and acquisitions transactions. The economic rationales for these operations include the insurers' will to increase their geographical reach, their products' range and benefit from scale and scope economies (Cummins, Tennyson, & Weiss, 1999). Furthermore, insurers could have initiated these transactions in order to benefit from financial synergies according to Tennyson and Chamberlain (1998) or reduce the riskiness and/or improve the amount/timing of their cash flow streams (Cummins, Weiss, & Zi, 2003).

1.1.2 INSURANCE INDUSTRY IN KENYA

The main players in the Kenyan Insurance Industry are: insurance companies, reinsurance companies, insurance brokers, insurance agents and the risk managers. The statute regulating the industry is the insurance Act; Laws of Kenya, Chapter 487. The office of the Commissioner of Insurance was established under its provisions to strengthen the government regulation under the Ministry of Finance. There also exists self regulation by the Association of Kenya Insurers (AKI). The professional body of the industry is the insurance institute of Kenya (IIK), which mainly deals with the training of professionals in the industry. Recently, Insurance Regulatory Authority (IRA) was established to supervise and regulate the insurance industry players in place of the commissioner of insurance. According to the (AKI) Insurance Industry Report for the year 2008, there were 42 licensed insurance companies by end of 2008 with 20 companies writing general insurance, 7 writing life insurance while 15 were composite. There were 142 insurance brokers, 19 medical insurance providers (MIPs), 3,356 insurance agents, 5 re-insurers (2

locally incorporated), 17 loss adjusters, 2 claims settling agent, 6 risk managers, 152 loss assessors/investigators and 19 insurance surveyors by end of 2008.

Insurance business is broadly classified into general and life. One serious challenge facing the life insurance is the increasing difficulty of managing the HIV/AIDS epidemic. Other challenges facing the insurance industry in Kenya include: structural weaknesses, (Kimura, 2002); fraud by both clients and employees (Mutiga, 2003), high claims, delays in claims settlement, delayed premium collection, lack of liquidity leading to the collapse of some firms, low economic growth (Ikiara, 2001), poor governance and industry saturation, (Makove, 2003).

The number of companies in the insurance industry in Kenya is quite large compared to the size of the economy. The Republic of South Africa which accounts for more than 90% of premium in Africa has only half the number of insurance companies in Kenya. Local insurance companies should merge to create fewer, bigger and stronger companies. Although the number of insurance companies in South Africa is half that in Kenya, mergers are still being encouraged in South Africa and the government has raised the capital bases for insurance companies from US $ 50 Million to US $ 500 Million, which will either lead to mergers or closures of weak companies (Olotch, 1999). This illustrates the importance of mergers among insurance companies on the global scene.

1.2 STATEMENT OF THE PROBLEM

Due to the importance of mergers globally, studies have been carried out to find out whether companies financial performance is better before or after the mergers and the results have been inconsistent.

Martynova, Oosting, & Renneboog (2007) researched the corporate takeovers in Europe and their impact on the economic performance and found that both the acquiring and acquired companies were outperforming the average companies before any takeover attempt, but this profitability decreased once the takeover was successfully completed. Mixed results were shown by Ikeda and Doi (1983) when they investigated the performance of the mergers of Japanese manufacturing firms using the measure of Return on Equity and found that half the sample had their Return on Equity increased post mergers and acquisitions and Return on Assets increased in half the cases.

Kithinji (2007)) carried out a study on the effects of mergers on financial performance of non listed banks in Kenya by focusing on the profitability of such banks which had merged between 1994 and 2001. The results of the analysis showed that three measures of performance: Profit, return on assets and shareholders equity/ total assets had values above the significance level of 0.05 with the exception of total liabilities/ total assets and therefore concluded that there was significant improvement in the performance of the non listed banks which merged compared with the non listed banks that had not merged within the same period.

Korir (2006) studied the effects of mergers on financial performance of companies listed at the Nairobi Stock Exchange and the timeframe for the study was between 1994 and 2005. The sample included 10 companies that had merged and 10 that had not merged over the 10 year period and the measures of performance used were turnover, volume,

market capitalization and profit and the results led to the conclusion that mergers improve performance of the companies listed at the Nairobi Stock Exchange.

Chesang (2002) assessed the financial performance of Kenyan banks restructured using the merger approach between 1993 and 2000. Measures of performance used in the study were Profitability and earnings, capital adequacy and solvency indicators. The study concluded that other than capital adequacy and solvency ratios which are legal requirements by Central Bank of Kenya, mergers have not improved the financial performance of the majority of the merged banks as their profitability declined after the mergers.

Review of various empirical studies show that different and inconclusive results have been obtained on the financial performance of companies' pre and post merger activities hence the need to carry out further research in the area. As discussed above, a number of studies have been carried out on the effects of mergers on financial performance of companies listed at the Nairobi Stock Exchange and banks in Kenya but none had been done for the insurance industry. This study was therefore necessitated by lack of local research on the effects of mergers on the financial performance of insurance companies in Kenya and its aim was to answer the question; what are the effects of mergers, if any, on the financial performance of insurance companies in Kenya?

1.3 OBJECTIVE OF THE STUDY

The objective of this study was to find out the effects of mergers on the financial performance of insurance companies in Kenya.

1.4 IMPORTANCE OF THE STUDY

The study is useful to the following:

To the insurance industry: the study is invaluable to the insurance industry in that it has shown whether the 42 insurance companies in Kenya can improve their financial performance through mergers considering that over 50% of them have been reporting underwriting losses in the recent past.

To the shareholders: It has provided relevant information to the shareholders on whether their wealth can be increased through mergers and therefore support any mergers proposed by the directors.

To the employees: The salaries and other benefits for the employees depend on the financial performance of the companies they work for. The results of this study has therefore been important to the employees since an increase in the financial performance of the merged company will lead to an increase in their salaries and other benefits and vice versa.

To the government: the study is useful to the government in policymaking regarding capital base, financial strength and other regulatory requirements of the insurance companies.

To the academicians: it has provided more insight into the relationship between mergers and companies financial performance and will be used as a basis of reference for any future study in the field of mergers, acquisition and restructuring of companies in the insurance industry.

CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 INTRODUCTION

This chapter summarizes the information from other researchers who have carried out their research in the same field of study. The specific areas covered here are theoretical background, concept of mergers, types of mergers and acquisitions, motives and benefits of mergers, empirical studies on mergers and measures of financial performance.

2.2 THEORETICAL BACKGROUND

2.2.1 Theory of efficiency

This theory suggests that mergers will only occur when they are expected to generate enough realizable synergies to make the deal beneficial to both parties; it is the symmetric expectations of gains which results in a 'friendly' merger being proposed and accepted. If the gain in value to the target was not positive, it is suggested, the target company's owners would not sell or submit to the acquisition, and if the gains were negative to the bidders' owners, the bidder would not complete the deal. Hence, if we observe a merger deal, efficiency theory predicts value creation with positive returns to both the acquirer and the target (Banerjee and Eckard, 1998). Chatterjee (1986) notes that it's important to distinguish between 'operative synergies' or 'efficiency gains' achieved through economies of scale and scope and 'allocative synergies' or 'collusive

synergies' resultant from increased market power and an improved ability to extract consumer surplus when commenting on value creation in mergers and acquisitions.

2.2.2 Theory of market power

Increased 'allocative' synergies is said to offer the firm positive and significant private benefits because, ceteris paribus, firms with greater market power charge higher prices and earn greater margins through the appropriation of consumer surplus. Indeed, a number of studies find increased profits and decreased sales after many mergers, a finding which has been interpreted by many as evidence of increasing market power and allocative synergy gains (Sapienza, 2002). From a dynamic point of view too, market power is said to allow for the deterrence of potential future entrants which can again afford the firm a significant premium, and so offer another long-term source of gain (Motta, 2004).

2.2.3 Theory of corporate control

In an efficient merger market the theory of corporate control provides another justification, beyond simply synergistic gains, why mergers must create value. It suggests that there is always another company or management team willing to acquire an underperforming company, to remove those managers who have failed to capitalize on the opportunities to create synergies, and thus to improve the performance of its assets (Weston, Mitchell & Mulherin, 2004). Managers who offer the highest value to the owners, it suggests, will take over the right to manage the company until they themselves

are replaced by another team that discovers an even higher value for its assets. Hence, inefficient managers will supply the 'market for corporate control' and managers that do not maximize profits will not survive, even if the competitive forces on their product and input markets fails to eliminate them. 'Hostile' takeovers should, as a result, be observed amongst poorly performing firms, and amongst those whose internal corporate governance mechanisms have failed to discipline their managers (Hasbrouck, 1985).

From the bidder's perspective, the theory of corporate control is partially based on efficiency theory, although there are two important differences. First, it does not assume the existence of synergies between the corporate assets of both companies, but rather between the bidder's managerial capabilities and the targets assets. Hence, corporate control predicts managerial efficiencies from the re-allocation of under-utilized assets. Second, it implies that the target's management team is likely to resist takeover attempts, as the team itself and its managerial inefficiency is the main obstacle to an improved utilization of assets. Typical bidders are either private investors or 'corporate raiders' who bring in more competent management teams, or more efficient companies with better growth prospects and superior performance (Palepu, 1986).

2.2.4 Theory of managerial hubris

Roll (1986) suggests that managers may have good intentions in increasing their companies' value but, being over-confident, they over-estimate their abilities to create synergies. Over-confidence increases the probability of overpaying and may leave the

winning bidder in the situation of a winner's-curse which dramatically increases the chances of failure (Dong et al., 2006). Berkovitch and Narayanan (1993) found strong evidence of hubris in US takeovers, and Goergen and Renneboog (2004) found the same in a European context. The latter estimate that about one third of the large takeovers in the 1990s suffered from some form of hubris. Malmendier and Tate (2005) show that overly optimistic managers, who voluntarily retain in-the-money stock options in their own companies, more frequently engage in less profitable diversifying mergers, and Rau and Vermaelen (1998) found that hubris is more likely to be seen amongst low book-to-market ratio firms – that is, amongst the so-called 'glamour firms' – than amongst high book-to-market ratio 'value firms'.

2.2.5 Theory of managerial discretion

Jensen's (1986) theory of managerial discretion claims that it is not over-confidence that drives unproductive acquisitions, but rather the presence of excess liquidity, or free cash flow (FCF). Firms whose internal funds are in excess of the investments required to fund positive net present value projects, it is suggested, are more likely to make quick strategic decisions, and are more likely to engage in large-scale strategic actions with less analysis than their cash-strapped peers. High levels of liquidity increase managerial discretion, making it increasingly possible for managers to choose poor acquisitions when they run out of good ones (Martynova and Renneboog, 2008). Moreover, it is suggested that the other stakeholders in the firm will be more likely to give management the benefit of the doubt in such situations, and to approve acquisition plans on the basis of fuzzy and subjective concepts such as managerial 'instincts', 'gut feelings' and 'intuition', based on

high past and current cash flows (Rau and Vermaelen, 1998). Thus, like the hubris theory, the theory of FCF suggests that otherwise well-intentioned managers make bad decisions, not out of malice, but simply because the quality of their decisions are less challenged than they would be in the absence of excess liquidity. Of course, as the degree of managerial discretion increases in FCF, or in high market valuations (as in the case of 'glamour firms' above), or in other proxies, so, too, does the opportunity for self-interested managers to pursue self-serving acquisitions. It is generally agreed that managerial self-interest does play a role in mergers and acquisition; research has shown that bidder returns are, for example, generally higher when the manager of the acquiring firm is a large shareholder and lower when management is not (Harford, 1999).

2.2.6 Theory of managerial entrenchment

Shleifer and Vishny, (1989) claims that unsuccessful mergers occur because managers primarily make investments that minimize the risk of replacement. It suggests that managers pursue Projects not in an effort to maximize enterprise value, but in an effort to entrench themselves by increasing their individual value to the firm. Entrenching managers will, accordingly, make manager-specific investments that make it more costly for shareholders to replace them, and value will be reduced because free resources are invested in manager-specific assets rather than in a shareholder value-maximizing alternative. Amihud and Lev (1981) support this notion, and suggest that managers pursue diversifying mergers in order to decrease earnings volatility which, in turn, enhances corporate survival and protects their positions. Entrenchment is not only

pursued for job security itself, but also because entrenched managers may be able to extract more wealth, power, reputation and fame.

2.3 CONCEPT OF MERGERS

Mergers can be defined as any transaction that forms one economic unit from two or more previous ones. Takeovers and related activities in the 1980s were much broader in scope and raised more fundamental issues than previous merger movements. Thus the traditional subject of merger and acquisition has been expanded to include takeovers and related issues of corporate restructuring, corporate control and changes in the ownership structure of firms (Thomas & Weston, 1992).

Humprey and Value (2004) note that mergers and acquisitions are a global phenomenon, with an estimated 4,000 deals taking place every year. Four periods of high merger activity, also known as merger waves occurred in the United States (1897-1904, 1916-29, 1965-69 and 1984-89) before the current one began in the early 1990s. This later wave has attained exceptional levels in terms of sheer value and volume of transactions.

Weiss, Cummins and Mary (2004) argued that the result of deregulation and other economic drivers of financial sector integration have been an unprecedented wave of mergers and acquisitions of European financial institutions. They reported 2,549 consolidation transactions involving European financial firms valued at $504 billion from 1990 through 1999. This total included 507 insurance transactions, valued at $127 billion. Significant consolidation occurred at both cross-border and within-border as financial services firms sought to consolidate their positions within national markets and take

advantage of deregulation and monetary union to open up or expand their markets in neighboring countries.

2.4 TYPES OF MERGERS

Tambi (2007) in his study on impact of mergers and amalgamation on the performance of Indian companies argues that mergers can be classified based upon the objective profile of such arrangements as Horizontal, Vertical, Circular and Conglomerate mergers.

A horizontal merger is the combinations of two competing firms that belongs to the same industry and are at the same stage of business cycle. These mergers are aimed at achieving Economies of Scale in production by eliminating duplication of facilities and operations and broadening the product line, reducing investment in working capital, eliminating competition through product concentration, reducing advertising costs, increasing market segments and exercising better control over the market. It is also an indirect route to achieving technical economies of large scale, for example merger of Pan Africa Insurance Limited and Apollo Insurance Limited. Another example is the acquisition of ABSA (a big bank in South Africa) by Barclays Bank which is one of the biggest banks in South Africa. In many parts of South Africa, the merger will reduce the number of competitors leaving Barclays Bank as the only major bank in the area (Owino, 2005).

A vertical merger is one where companies at different product or business life cycle combines. It can be Backward Integration where company merges its suppliers or Forward Integration where it merges its customers. The basic motive of these sorts of

mergers is to reduce cost and dependence. Merger of Reliance Petrochemicals Limited with Reliance Industries Limited in India is one example (Tambi, 2007).

In circular combination, companies producing distinct products in the same industry seek amalgamation to share common distribution and research facilities in order to obtain economies by eliminating costs of duplication and promoting market enlargement. The acquiring company obtains benefits in the form of economies of resource sharing and diversification (Ansoff & Weston, 1962). Here we can cite the merger of CFC Bank and Stanbic Bank which formed CFC Stanbic Bank.

Conglomerate mergers are the ones where companies belong to different or unrelated lines of businesses. The basic motive of these mergers is to reduce risk through diversification. It also enhances the overall stability of the acquirer and improves the balances in the company's total portfolio of diverse products and production processes. It also encourages firms to grow by diversifying into other markets (Tambi, 2007). Here we can cite the example of Family Bank Group, which identified insurance business as one of the growing field, acquired shareholding in Kenya Orient Insurance Limited in order to diversify the risk of its existing line of banking business.

2.5 MOTIVES AND BENEFITS OF MERGERS

Brealey and Myers (1996) notes that there are several benefits that accrue to a firm because of engaging in merger activity such as maintaining or accelerating a company's growth, enhancing profitability through cost reduction resulting from economies of scale,

operating efficiency and synergy, diversifying the risk of the company, reducing tax liability because of the provision of setting off accumulated losses and unabsorbed depreciation of one company against the profit of the other and limiting the severity of competition by increasing the company's market power.

Poposki (2007) notes that the most frequently cited rationale for a takeover is economies of scale i.e. Firms expand to obtain optimal operating scale and thereby reduce average unit costs of production. The usual source of cost scale economies is the spreading of fixed costs over a broader output base. For insurers, important fixed costs include computer systems and software development costs. The actuarial, underwriting, and investment operations of insurers also have fixed cost components that can be sources of scale economies. Another source of scale economies that is expected to be particularly important for insurers is earnings diversification.

Scale economies are also found in the life insurance industry (Grace & Timme, 1992); (Cummins & Zi, 1998). Cummins, Tennyson and Weiss (1999) argue that operating at larger scale can lead to decrease in company's cost of capital if earnings volatility is inversely related to firm size. Cost scope economies can arise from the shared use of resources such as information technology, customer databases, managerial expertise, marketing distribution systems, and brand names. Revenue scope economies are often said to arise from the opportunities of "one-stop shopping" that can reduce consumer search costs and improve service quality (Gallo, Apilado, & Kolari, 1996).

Mergers and acquisitions can be efficient way to achieve financial synergies. Myers and Majluf (1984) suggest that value may be created in mergers when companies rich in financial slack acquire slack poor firms. More specifically, a combination of a firm with excess cash and limited investment opportunities with a firm that has limited cash and high-return investment opportunities can yield higher value for both slack-rich and slack-poor firms. The slack-poor firm could gain from the merger by implementing positive net present value projects that might otherwise have been passed up due to costly external financing. The slack-rich firm can also create value by the investment opportunities brought about by the merger.

Reduction of tax burden is another reason why companies merge. This arises where one firm has made losses and another one has made profits. The loss making firm pays no tax but the tax burden for the profit making one will be smaller if the two firms merge which make their aggregate net profit lower leading to lower tax liability. Incase of increased borrowings, the merged firms may enjoy lower tax liability because of the debt interest expense which is tax deductible. This in turn helps to increase the profits/ value of the shares of the firm (Reid, 1968).

Some mergers might occur due to statutory requirements. The Association of Kenya Insurance report of 2008 shows that a number of insurance companies could not meet the minimum solvency margins in certain classes of businesses. The government, through the Insurance Regulatory Authority has therefore been encouraging such insurance

companies to merge so that they can have a better and stronger resource base to develop and be able to meet the required solvency margins.

2.6 EFFECTS OF MERGERS ON FINANCIAL PERFORMANCE: EMPIRICAL EVIDENCE

Kithinji (2007) carried out a study on the effects of mergers on financial performance of non listed banks in Kenya by focusing on the profitability of such banks which had merged between 1994 and 2001. The study covered 14 non listed banks which had merged over the 8 year period. Comparative analysis of the banks' performance for the pre and post merger periods of 5 years was conducted using secondary data which was analysed with the aid of statistical tools. The results of the analysis showed that three measures of performance: Profit, return on assets and shareholders equity/ total assets had values above the significance level of 0.05with the exception of total liabilities/ total assets. The study concluded that there was significant improvement in the performance of the non listed banks which merged compared with the non listed banks that had not merged within the same period.

Korir (2006) studied the effects of mergers on financial performance of companies listed at the Nairobi Stock Exchange and the timeframe for the study was between 1994 and 2005. The sample included 10 companies that had merged and 10 that had not merged over the 10 year period and the secondary data used was from Nairobi Stock Exchange and other published reports for the period under study. The measures of performance used were turnover, volume, market capitalization and profit. After the results were

analyzed, the study concluded that mergers improve performance of the companies listed at the Nairobi Stock Exchange.

Chesang (2002) in her study on merger restructuring and financial performance of commercial banks in Kenya sought to assess the financial performance of Kenyan banks restructured using the merger approach between 1993 and 2000. Measures of performance used in the study were Profitability and earnings, capital adequacy and solvency indicators and the secondary data obtained from financial statements and various publications was analysed with the aid of Microsoft Excel statistical package. The study covered 23 mergers and concluded that other than capital adequacy and solvency ratios which are legal requirements by Central Bank of Kenya, mergers have not improved the financial performance of the majority of the merged banks as their profitability declined after the mergers.

Chamberlain and Tennyson (1998), in their article investigated the prevalence of financial synergies as a motive for merger and acquisition activity in the property-liability insurance industry. Their hypotheses were tested via analysis of accounting ratios of acquisitions targets in the period from 1980 to 1990 in relation to those of non-acquired firms of similar characteristics, and via analysis of acquisition characteristics. The hypothesis that financial synergies are a motive for mergers following negative industry capital shocks received strong support.

Aduloju, Awoponle and Oke (2008) carried out a survey on recapitalization, mergers and acquisitions of the Nigerian insurance industry and one of their key objectives was to ascertain whether insurance companies can improve their performance through mergers and acquisitions. The survey involved 22 insurance companies listed on the Nigeria Stock Exchange and found that mergers would lead to growth by generation of large capital base to enhance technical marketing, management and business opportunity, efficiency, image and reputation. It would also strengthen the local insurance firms to be able to underwrite oil and gas risks. All these factors would lead to better performance after the mergers.

The study entitled, "Effect of mergers on corporate performance in India", by Pawaskar (2001), examined the impact of mergers on corporate performance. The study involved a comparison of the pre- and post- merger operating performance of the corporations involved in merger between 1992 and 1995 to identify their financial characteristics. The study identified the profile of the profits. The regression analysis explained that there was no increase in the post- merger profits. The study of a sample of firms, restructured through mergers, showed that the merging firms were at the lower end in terms of growth, tax and liquidity of the industry. The merged firms performed better than industry in terms of profitability.

Tambi (2007) evaluated the impact of mergers and amalgamation on the performance of Indian Companies through a database of 40 Companies selected using paired t-test for mean difference for four parameters; Total performance improvement, Economies of scale, Operating Synergy and Financial Synergy. The conclusion of the study shows that

Indian companies are no different from the other companies in other parts of the world and mergers have failed to contribute positively in the performance improvement.

2.7 MEASURES OF FINANCIAL PERFORMANCE

Performance is the ability to sustain income, stability and growth. It is a measurement of relative investment and can be relative to one of the following factors; assets, capital adequacy, liabilities, number of employees and other size matters (Kithinji, 2007). According to Pandy (1999), Brealey and Myers (1996), Thygerson (1995), the following are the main measures of financial performance;

2.7.1 Profitability Analysis

This is the most common measure of financial performance and it's used to assess how well management invests the company's total capital. Profitability is the most important measure of financial performance to the management and shareholders as it cushions them against adverse conditions such as losses due to huge claims or unexpected adverse changes to the investment portfolio. Return on equity and Return on Assets are the most common profitability ratios used to assess financial performance of companies.

2.7.2 Capital adequacy ratios

They relate to the company's overall use of financial leverage. Generally, companies with high financial leverage experience more volatile earnings behaviour. These ratios indicate the extent to which a company's capital base covers the risks inherent in its

operations. Important capital adequacy ratios include Shareholders' equity to total assets and Shareholders equity to Total loans. The study concentrates on shareholders' equity to total assets ratio.

2.7.3 Long Term solvency

Solvency refers to the ability of a company to survive over a long period of time i.e. for more than one year. It's the same concept as liquidity except that it is for long term rather than short term. Long term solvency ratios measure the riskness of the company and include Total Liabilities to Total Assets which measures the proportion of assets financed by creditors, Shareholder's equity to total assets which indicates the proportion of assets financed by the owners of funds and Shareholders' equity to Total Loans which gives an indication of the proportion of loans covered by the owners of funds. The two ratios used in this study are total liabilities to total assets and shareholder's equity to total assets.

2.7.4 Performance measures unique to the insurance industry

The other performance measures which are unique to the insurance industry according to Poposki (2007) are;

Loss ratio = Net incurred claims: Net earned premium

It measures the ability of the company to settle the claims incurred from the premiums generated from the policyholders (Poposki 2007).

Expense ratio = Management expenses: Gross written premium

It indicates how efficient the management is in generating premiums from the business written by the company (Poposki 2007).

Combined ratio = Claims and expenses: Net earned premium

It measures the ability of the company to meet the policyholders' claims when they occur and the day today expenses of running the company (Poposki 2007).

Solvency ratio = Policyholder's surplus: Assets

Policyholders' surplus is the excess of the value of the firm's assets over liabilities (net of initial capital paid in) and hence represents the firm's net worth. This ratio thus shows the percentage of assets which are not required for the payment of losses or other liabilities; the larger this ratio, the less likely the firm is to go bankrupt (Poposki 2007).

Liquidity Ratio = Liquid assets (cash and marketable securities): Total reserves

It's intended to capture the ability of the company to pay off claims reserves.

If mergers relieve financial constraints, one would expect acquired firms to exhibit low values of the solvency and liquidity ratios, and for these measures to increase following mergers (Poposki 2007).

Underwriting leverage = Premium revenues net of reinsurance transactions: Policyholders' surplus.

This ratio is inversely related to the capacity of companies to write additional business because new policies generate liabilities, which must be supported by surplus due to the limited liability of insurance companies. Hence, a high volume of premiums relative to surplus means that the capacity to write new business is low (Poposki 2007).

Reserve leverage = Total loss and loss adjustments expense reserves: Policyholders' surplus

This ratio represents an insurer's major unpaid obligations as a percentage of net worth, and is inversely related to the firm's ability to bear loss shocks and errors in loss forecasting (Poposki 2007).

2.8 CONCLUSION

A study on merger activity in the insurance industry conducted by Poposki (2007) found that the insurance industry has been known for its high-cost distribution system and lack of price competition, but insurers are increasingly faced with more intensive competition from non-traditional sources such as banks, mutual funds, and investment firms. The increased competition has narrowed profit margins and motivated insurers to seek ways to reduce costs. Technological advances in sales, pricing, underwriting, and policyholder services have forced insurers to become more innovative; and the relatively high fixed costs of the new systems may have affected the minimum efficient scale in the industry.

These developments suggest that financial synergies and potential efficiency gains may provide a major motivation for the recent mergers and acquisitions in the insurance industry, enhancing the efficiency of the target firm and/or the combined post-merger entity. In addition, the mergers and acquisitions in the insurance industry appear to be driven for the most part by economically viable objectives and have had a beneficial effect on efficiency in the industry. More consolidation in the industry should be expected in the future because many insurers are burdened with costly agency distribution systems that in the long-run will lose out to non-traditional competitors, the need to offset slowing revenue growth, compete in a converging financial services marketplace, cut costs, and achieve economies of scale.

Mergers and acquisitions in the Kenyan Insurance industry are expected to increase due to the regulatory measures that have been put in place by the government hence there was a need to examine whether they have any effect in the financial performance of insurance companies before and after the mergers.

CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 INTRODUCTION

This chapter comprises of the research design, population of interest to the research, description of data collection and description of data analysis procedures.

3.2 RESEARCH DESIGN

The research covered all the 6 insurance companies that had merged between 1995 and 2005 and their performance was analyzed before and after the merger to determine whether the mergers had any effects on their financial performance.

3.3 POPULATION

The population used in this study was all the 42 insurance companies in Kenya while the sample included the 6 insurance companies that had merged between 1995 and 2005. The reasons for choosing insurance companies for the research was because there had been no local research carried out on them yet many studies have been done internationally. Earlier studies on mergers by Chesang (200), Korir (2006) and Kithinji (2007) were cross sectional and studied companies listed at the Nairobi Stock Exchange and the ones in the Kenyan banking industry. Secondly the insurance companies were recently the focus of the ministry of finance policy makers due to the frequency with which they had been declared insolvent by the Insurance Regulatory Authority and which

led to the increase in their share capital by the minister for finance in his 2007 budget speech.

3.4 DATA COLLECTION

The study used secondary data from the published financial statements of the insurance companies and other publications from the Association of Insurers of Kenya. The data collected was on the financial performance of the insurance companies 4 years for 4 companies and 3 years for 2 companies before and after the merger. Income statement, balance sheet, cash flow statements and revenue accounts were used in the collection of the specific data required for the computation of the various measures of performance. The data collected for the companies covered in the study was their net profit, shareholders equity, total assets, total liabilities, net incurred claims, net premiums, net earned premiums management expenses, total liquid assets (marketable securities), total claims reserves and policyholders surplus.

3.5 DATA ANALYSIS

The study focused on the financial performance of the merged insurance companies before and after the merger. Four categories of critical financial ratios were used in this study as explained here below.

3.6 MEASURES OF FINANCIAL PERFORMANCE

Performance is the ability to sustain income, stability and growth. It is a measurement of relative investment and can be relative to one of the following factors; assets, capital adequacy, liabilities, number of employees and other size matters (Kithinji, 2007). According to Pandy (1999), Brealey and Myers (1996), Thygerson (1995), the following are the main measures of financial performance;

3.6.1 Profitability Analysis

This is the most common measure of financial performance and it's used to assess how well management invests the company's total capital. Profitability is the most important measure of financial performance to the management and shareholders as it cushions them against adverse conditions such as losses due to huge claims or unexpected adverse changes to the investment portfolio. Return on equity and Return on Assets are the most common profitability ratios used to assess financial performance of companies and are the ones that were used in this study.

3.6.2 Capital adequacy ratios

They relate to the company's overall use of financial leverage. Generally, companies with high financial leverage experience more volatile earnings behaviour. These ratios indicate the extent to which a company's capital base covers the risks inherent in its operations. Important capital adequacy ratios include Shareholders' equity to total assets

and Shareholders equity to Total loans. The study concentrated on shareholders' equity to total assets ratio.

3.6.3 Long Term solvency

Solvency refers to the ability of a company to survive over a long period of time i.e. for more than one year. It's the same concept as liquidity except that it is for long term rather than short term. Long term solvency ratios measure the riskness of the company and include Total Liabilities to Total Assets which measures the proportion of assets financed by creditors, Shareholder's equity to total assets which indicates the proportion of assets financed by the owners of funds and Shareholders' equity to Total Loans which gives an indication of the proportion of loans covered by the owners of funds. The two ratios used in this study were total liabilities to total assets and shareholder's equity to total assets.

3.6.4 Performance measures unique to the insurance industry

The other performance measures which are unique to the insurance industry according to Poposki (2007) and which were used in this study are;

Loss ratio = Net incurred claims: Net earned premium

It measures the ability of the company to settle the claims incurred from the premiums generated from the policyholders (Poposki 2007).

Expense ratio = Management expenses: Gross written premium

It indicates how efficient the management is in generating premiums from the business written by the company (Poposki 2007).

Combined ratio = Claims and expenses: Net earned premium

It measures the ability of the company to meet the policyholders' claims when they occur and the day today expenses of running the company (Poposki 2007).

Solvency ratio = Policyholder's surplus: Assets

Policyholders' surplus is the excess of the value of the firm's assets over liabilities (net of initial capital paid in) and hence represents the firm's net worth. This ratio thus shows the percentage of assets which are not required for the payment of losses or other liabilities; the larger this ratio, the less likely the firm is to go bankrupt (Poposki 2007).

Liquidity Ratio = Liquid assets (cash and marketable securities): Total reserves

It's intended to capture the ability of the company to pay off claims reserves.

If mergers relieve financial constraints, one would expect acquired firms to exhibit low values of the solvency and liquidity ratios, and for these measures to increase following mergers (Poposki 2007).

Underwriting leverage = Premium revenues net of reinsurance transactions: Policyholders' surplus.

This ratio is inversely related to the capacity of companies to write additional business because new policies generate liabilities, which must be supported by surplus due to the limited liability of insurance companies. Hence, a high volume of premiums relative to surplus means that the capacity to write new business is low (Poposki 2007).

Reserve leverage = Total loss and loss adjustments expense reserves: Policyholders' surplus

This ratio represents an insurer's major unpaid obligations as a percentage of net worth, and is inversely related to the firm's ability to bear loss shocks and errors in loss forecasting (Poposki 2007).

The comparative analysis for the two periods; The financial performance measures explained above were computed for the 4years for 4 companies and 3 years for 2 companies for both pre and post merger periods. The average of the two periods measures were then compared, analyzed and conclusion made from the comparative analysis.

CHAPTER FOUR

4.0 DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 INTRODUCTION

This chapter presents the data analysis and interpretations of the findings. Data was analyzed using excel and summarized using tables and percentages. The research covered all the insurance companies which were involved in mergers between 1995 and 2005.

4.2 ANALYSIS, RESULTS AND DISCUSSION

4.2.1 Profitability Analysis

The aim of this section was to find out if the profitability of the merged insurance companies improved, declined or stagnated after the merger. The results are shown in the table below.

Table 1: Profitability ratios

RATIO	APA			PIONEER			THE HERITAGE AII		
	PRE %	POST %	CHANGE %	PRE %	POST %	CHANGE %	PRE %	POST %	CHANGE %
Return on equity	0	28	**28**	2	1	**1**	33	20	**13**
Return on assets	-1	9	**10**	2	1	**1**	10	13	**3**

Source: Research data

Performance improved

Performance declined

No significant change

The data in table 1 shows that both measures of profitability i.e. return on equity and return on assets improved for only APA Insurance and did not change for Pioneer Insurance Limited while The Heritage AII Limited return on equity declined and return on asset did not change after the merger.

4.2.2 Capital adequacy and Long Term solvency Analysis

The objective of this section was to find out whether the capital adequacy and long term solvency ratios for the merged companies improved, declined or stagnated after the mergers. The results are shown in the table below.

Table 2: Capital adequacy and long term solvency ratios

RATIO	APA			PIONEER			THE HERITAGE AII		
	PRE %	POST %	CHANGE %	PRE %	POST %	CHANGE %	PRE %	POST %	CHANGE %
Shareholder's equity to total assets	38	30	**8**	84	67	**17**	30	40	**10**
Total liabilities to total assets	62	70	**8**	100	86	**14**	71	59	**12**

Source: Research data

Performance improved

Performance declined

No significant change

From the data presented in the table above, Shareholders equity to total assets ratio declined by 8% for APA Insurance Limited and by 17% for Pioneer Insurance Limited

but improved by 10% for The Heritage AII Limited. Total liabilities to total assets declined by 8% for APA Insurance Limited but improved for both Pioneer Insurance Limited and The Heritage AII Limited by 14% and 12% respectively.

4.2.3 Performance measures that focus on solvency, liquidity and leverage which are unique to the insurance industry

This section aimed at investigating the financial synergies of the merged companies by finding out if the solvency, liquidity and leverage ratios improved, declined or stagnated after the mergers.

Table 3: Insurance industry specific solvency, liquidity and leverage ratios

RATIO	APA			PIONEER			THE HERITAGE AII		
	PRE %	POST %	CHANGE %	PRE %	POST %	CHANGE %	PRE %	POST %	CHANGE %
Loss ratio	62	72	10	87	42	45	65	58	7
Expense ratio	28	16	12	46	53	8	30	58	7
Combined ratio	107	102	5	104	116	12	66	101	35
Solvency ratio	6	24	18	84	53	31	24	24	0
Liquidity ratio	63	131	68	47	54	7	186	158	29
Underwriting leverage	179	204	25	35	70	35	179	157	22
Reserve leverage	215	189	26	14	34	21	165	144	21

Source: Research data

Performance improved

Performance declined

No significant change

The data presented in the table above shows that APA Insurance Limited improved its performance on 5 ratios namely expense ratio by 12%, combined ratio by 5%, solvency ratio by 18%, liquidity ratio by 68% and reserve leverage by 26%. The company's performance however declined in terms of loss ratio by 10% and underwriting leverage by 25%.

Pioneer Insurance Limited improved its performance only on loss ratio by 45% and liquidity ratio by 7% but declined on all the others i.e. expense ratio by 8%, combined ratio by 12%, solvency ratio by 31%, underwriting leverage by 35% and reserve leverage by 21%.

The Heritage AII Limited performance improved on loss ratio by 7%, expense ratio by 7%, underwriting leverage by 22% and reserve leverage by 21% and declined only on combined ratio by 35% and liquidity by 29%. Solvency ratio was however the same before and after the merger.

CHAPTER FIVE

5.0 SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 INTRODUCTION

This chapter presents the summary of the findings from chapter four, conclusions, limitations and recommendations based on the objectives of the study.

5.2 SUMMARY OF THE FINDINGS AND CONCLUSION

The study sought to establish the effects of mergers on the financial performance of insurance companies that had merged in Kenya for a period of 10 years between 1995 and 2005. The analysis of the financial performance of the six companies that merged over that period provided different results. The financial performance indicators for APA Insurance Limited which resulted from the merger of Apollo Insurance Limited and Pan Africa Insurance Limited general business showed that the company's performance improved on 7 key ratios but declined on 4. The company's profitability improved after the merger as shown by the increase in return on equity by 28% and return on assets by 10%. The company's overall solvency, liquidity and leverage also improved as indicated by the increase in 5 out of the 7 ratios used in the study. The expense ratio improved by 12%, combined ratio by 5%, solvency ratio by 6%, liquidity ratio by 68% and reserve leverage by 26%. The only ratios in this category that worsened with the merger were loss ratio by 10% and underwriting leverage by 25%. Capital adequacy and long term solvency for the company got worse with the merger as both the shareholders' equity to total assets ratio and total liabilities to total assets ratio decreased by 8%.

The study found that the merger of the life businesses of Pioneer Assurance Limited and Fidelity Shield Insurance Limited into Pioneer Assurance Limited had adverse effects on the financial performance of the merged company since 6 of the 11 financial performance indicators worsened while 2 did not register any significant change after the merger. The profitability of the merged company stagnated as shown by the decrease in both return on equity and return on assets by 1%. Capital adequacy of the company decreased by 17% while the long term solvency improved by 14% mainly because the assets of the merged businesses were 100% financed by liabilities. The company's solvency, liquidity and leverage levels deteriorated after the merger as 5 out of the 7 ratios in this category worsened. These ratios were expense ratio which increased by 8%, combined ratio by 12%, solvency ratio by 31%, underwriting leverage by 35% and reserve leverage by 21%. The only ratios that improved in this category were loss ratio by 45% and liquidity ratio by 7%.

The study also established that the overall financial performance of the Heritage AII Limited improved after the merger meaning that the merger had positive effects on the merger. This was supported by the research findings which found 6 out of the 11 financial performance indicators improved, 3 declined while 2 had no significant change. The profitability of the company deteriorated as the return on equity decreased by 13% while the return on assets stagnated as the change was only 3%. The capital adequacy and long term solvency of the company improved after the merger with the shareholders' equity to assets improving by 10% and total liabilities to total assets by 12%. The financial performance indicators unique to the insurance industry which improved after

the merger were loss ratio and expense ratio which improved by 7%, underwriting leverage by 22% and reserve leverage improved by 21%. The two ratios which deteriorated in this category were the combined ratio by 35% and liquidity ratio by 29% while the solvency ratio remained at the same level as before the merger.

The study concluded that the mergers had no positive effect on the profitability of insurance companies in Kenya and that the profitability of the merged companies either remained the same as before the merger or deteriorated in the first four years after the merger.

The study also concluded that the mergers had no effect on the level of capital adequacy and long term solvency of the merged insurance companies as 50% of the companies improved while the other 50% deteriorated effectively canceling out each other.

On the performance measures that are unique to the insurance industry and which focus on solvency, liquidity and leverage, the study concluded that mergers have positive effect on the financial performance of insurance companies in Kenya that transact general insurance business while it has adverse effect on the financial performance of insurance companies in Kenya that transact life business.

5.3 LIMITATIONS OF THE STUDY

Due to time considerations, this study was restricted to 4 years for 4 companies and 3 years for 2 companies before and after the mergers. A longer period of 10 years may

have provided a clearer picture of the effects of mergers on financial performance of the merged insurance companies.

The study was limited in scope as it covered the mergers in the insurance industry in Kenya where the last merger occurred in January 2004. The study results may not therefore benefit the insurance sectors in the other East African countries where the Kenyan insurance companies have established subsidiaries.

The study considered only the merger in evaluating the financial performance of the merged companies and other factors such as the performance of the economy, size of the merged companies, market share and the different cultures of the companies were not included in the study.

The study was only on the insurance companies which operate in the financial sector which also includes the banking, pensions and microfinance institutions. A study on the whole of financial sector may have provided more detailed results on the effects of mergers on the financial performance of the companies in the sector.

The research used only 11 measures of financial performance of the insurance companies that merged yet there are many other alternative measures that may have provided different results from the ones provided by the 11 measures used.

5.4 SUGGESTIONS FOR FURTHER RESEARCH

Further research should be carried out on the effects of mergers on the financial performance of the insurance companies in Kenya for a longer period of may be 20 years in order to get more representative results.

The study was restricted to the Kenyan insurance companies yet many of these Kenyan companies have either subsidiaries or associates in the other East African countries. Research should therefore be carried out to cover all the insurance companies that have been involved in mergers in the whole of East African region.

As the research only considered the event of merger in evaluating the financial performance of the merged insurance companies, it may be important for another study to be carried out on the performance of the merged companies before and after the merger but include other variables in the study such as the size of the merged companies, market share and performance of the economy before and after the merger.

Further research should be carried out on the financial performance of all the companies that have merged in the financial sector since the study only considered the insurance sub sector which is just one of the many sub sectors of the overall financial sector in Kenya.

Another research on the effects of mergers on financial performance of the insurance companies should be carried out using different measures of financial performance other than the 11 used in this study in order to find out if the results would be the same or different.

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APPENDICES

Appendix 1: Mergers in the Insurance Industry in Kenya between 1995 and 2005

MERGED COMPANIES		NEW COMPANY	MERGER DATE
Apollo Insurance Limited (general businesses)	PanAfrica Insurance Limited (general businesses)	APA Insurance Limited	1st January 2004
Pioneer Assurance Limited (Life business)	Fidelity Shield Insurance Limited (Life business)	Pioneer Assurance Limited	1st January 2002
Heritage Insurance Limited	African International Insurances (AII) Limited	The Heritage AII Insurance Limited	1st January 1997

Appendix 2: Apollo Insurance Limited ratio analysis

	RATIO	2000 %	2001 %	2002 %	2003 %	MEAN %
1	Return on equity	13	2	-2	24	9
2	Return on assets	4	0.6	1	7	3
3	Shareholders equity to	33	32	27	28	30
4	Total liabilities to total	67	68	73	72	70
5	Loss ratio	49	55	65	66	59
6	Expense ratio	20	21	21	17	20
7	Combined ratio	91	94	98	98	95
8	Solvency ratio	23	16	9	20	17
9	Liquidity ratio	82	100	105	87	93
10	Underwriting leverage	152	263	495	189	275
11	Reserve leverage	144	243	369	201	239

Appendix 3: Pan Africa Insurance Limited ratio analysis

	RATIO	2000 %	2001 %	2002 %	2003 %	MEAN %
1	Return on equity	-4	-24	-4	-5	-9
2	Return on assets	-5	-11	-1	-3	-5
3	Shareholders equity to	46	44	31	65	46
4	Total liabilities to total	55	56	69	35	54
5	Loss ratio	63	66	60	72	65
6	Expense ratio	36	45	28	33	36
7	Combined ratio	107	123	105	144	120
8	Solvency ratio	-7	0	0	-18	-6
9	Liquidity ratio	32	36	31	31	33
10	Underwriting leverage	80	79	52	118	83
11	Reserve leverage	185	91	316	164	190

Appendix 4: APA Insurance Limited ratio analysis

	RATIO	2004 %	2005 %	2006 %	2007 %	MEAN %
1	Return on equity	15	52	46	-0.22	28
2	Return on assets	3	15	18	-0.08	9
3	Shareholders equity to	17	29	40	36	30
4	Total liabilities to total	83	71	60	64	70
5	Loss ratio	78	71	69	73	72
6	Expense ratio	16	17	15	14	16
7	Combined ratio	108	102	99	101	102
8	Solvency ratio	11	24	33	27	24
9	Liquidity ratio	82	110	177	155	131
10	Underwriting leverage	385	174	105	153	204
11	Reserve leverage	364	173	92	125	189

Appendix 5: Pioneer Assurance Limited Life Business ratio analysis

	RATIO	1998 %	1999 %	2000 %	2001 %	MEAN %
1	Return on equity	5	0.3	-1	1	1
2	Return on assets	4	0.2	-1	1	1
3	Shareholders equity to	77	72	71	69	72
4	Total liabilities to total	100	100	100	100	100
5	Loss ratio	38	38	35	33	36
6	Expense ratio	68	60	62	63	63
7	Combined ratio	131	158	121	120	132
8	Solvency ratio	77	72	71	69	72
9	Liquidity ratio	56	49	52	49	51
10	Underwriting leverage	44	58	63	44	52
11	Reserve leverage	18	23	31	27	25

Appendix 6: Fidelity Shield Life Business ratio analysis

	RATIO	1998 %	1999 %	2000 %	2001 %	MEAN %
1	Return on equity	19	8	8	-23	3
2	Return on assets	18	8	8	-22	3
3	Shareholders equity to	95	95	97	96	96
4	Total liabilities to total	99	99	99	99	99
5	Loss ratio	76	103	93	279	138
6	Expense ratio	27	24	27	33	28
7	Combined ratio	106	130	29	34	75
8	Solvency ratio	94	95	78	118	96
9	Liquidity ratio	40	69	47	17	43
10	Underwriting leverage	19	18	15	18	18
11	Reserve leverage	3	3	2	3	3

Appendix 7: Pioneer Assurance Limited life business after merger ratio analysis

	RATIO	2002 %	2003 %	2004 %	2005 %	MEAN %
1	Return on equity	-3	2	1	2	1
2	Return on assets	-2	2	1	1	1
3	Shareholders equity to	70	70	68	60	67
4	Total liabilities to total	85	85	85	87	86
5	Loss ratio	35	41	44	46	42
6	Expense ratio	69	54	47	43	53
7	Combined ratio	122	115	114	111	116
8	Solvency ratio	55	55	54	48	53
9	Liquidity ratio	36	66	56	60	54
10	Underwriting leverage	62	67	74	76	70
11	Reserve leverage	31	32	37	38	34

Appendix 8: The Heritage Insurance Company Limited ratio analysis

	RATIO	1994 %	1995 %	1996 %	MEAN %
1	Return on equity	30	32	27	29
2	Return on assets	10	10	9	10
3	Shareholders equity to total assets	28	31	36	31
4	Total liabilities to total assets	76	69	64	70
5	Loss ratio	73	64	59	66
6	Expense ratio	25	27	27	26
7	Combined ratio	99	94	93	95
8	Solvency ratio	22	21	28	23
9	Liquidity ratio	159	166	202	176
10	Underwriting leverage	178	184	137	166
11	Reserve leverage	182	182	121	162

Appendix 9: The African International Insurances Company Limited ratio analysis

	RATIO	1994 %	1995 %	1996 %	MEAN %
1	Return on equity	39	36	33	36
2	Return on assets	7	10	13	10
3	Shareholders equity to	17	27	39	28
4	Total liabilities to total	83	73	61	72
5	Loss ratio	85%	53	54	64
6	Expense ratio	28	35	39	34
7	Combined ratio	31	41	37	37
8	Solvency ratio	14	23	36	25
9	Liquidity ratio	166	195	230	197
10	Underwriting leverage	299	173	107	193
11	Reserve leverage	247	164	96	169

Appendix 10: The Heritage AII Limited ratio analysis

	RATIO	1997 %	1998 %	1999 %	MEAN %
1	Return on equity	21	23	16	20
2	Return on assets	10	23	7	13
3	Shareholders equity to	37	41	41	40
4	Total liabilities to total	62	59	55	59
5	Loss ratio	58	65	51	58
6	Expense ratio	17	19%	26%	21%
7	Combined ratio	97	102	103	101
8	Solvency ratio	18	25	29	24
9	Liquidity ratio	121	169	183	158
10	Underwriting leverage	200	143	128	157
11	Reserve leverage	189	140	102	144