STRATEGIC RISK MANAGEMENT PRACTICES BY AAR INSURANCE KENYA LIMITED

BY

NDERI CHARLES NJOROGE

A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF THE MASTER OF BUSINESS ADMINISTRATION OF SCHOOL OF BUSINESS UNIVERSITY OF NAIROBI

NOVEMBER, 2013

DECLARATION

This project is my original work and has not been presented in any other university or institution for a degree or any other award.

Signature…………………………………………

Date ……………………………………………..

Nderi Charles Njoroge

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

Signature………………………………………….

Date …………………………………………

Midikira Churchill Kibisu

Senior lecturer university of Nairobi

Supervisor

ACKNOWLEDGEMENT

First and foremost I would like to thank our Almighty God whose powerful hand led me throughout the study period. I would also like to acknowledge the encouragement given by my family and friends throughout the study period and to all who in one way or another, contributed to the success of this study, I say, “God bless you all abundantly”. I also wish to acknowledge the entire University of Nairobi fraternity and particularly the humble contribution of my university supervisor for his scholarly comments and value added insights that guided me through the process of writing this research project.

DEDICATION

I dedicate this project to my wife, friends and family encouragement during the course of this work.

ABSTRACT

Strategic Risk Management is a process for identifying, assessing and managing risks and uncertainties, affected by internal and external events or scenarios that could inhibit an organization's ability to achieve its strategy and strategic objectives. The ultimate goal of strategic risk management is creating and protecting shareholder and stakeholder value. This study focuses on an area that has not been expressly addressed by other studies namely; strategic risk management in the context of insurance provision. This study was designed to fill this gap using a case study of AAR insurance Kenya Limited. This study sought to answer pertinent questions which included: What are the unique risks facing AAR as a health insurance service provider? How does AAR cope with the risks? And which pragmatic strategies that can be used to mitigate the perceived risks at both the firm and industry levels? This study employed case study research design. This is because the study intends to obtain an in depth understanding on the strategic management practices of firms in the insurance companies. The target population comprised of 40 senior management and middle level staff at AAR Insurance Kenya Limited drawn from the department of finance, underwriting and operation. The study adopted stratified random sampling. The sample of 14 from a population of 40 forms 35.00% of the target population which fulfils the minimum threshold. The study used interview guide to collect the data. The interview guides were checked for completeness and consistency of information at the end of every field data collection day and before storage. Data was later subjected to statistical analysis using SPSS computer software. Data was analyzed thematically using content analysis. According to the respondents reputation is considered the most significant risk facing their company. Reputational risk is seen to be the result of poor claims payments practices, the collapse or insolvency of industry players, low profitability, inadequate customer handling processes and poor-quality customer service, low contract certainty and a lack of proper complaints monitoring and handling processes. Based on the findings, external risk can arise at various stages, e.g., registration of clients, underwriting, reinsurance and the claims process. The severity of risk can range from a slight exaggeration to deliberately causing loss of insured assets. The study recommends that the Board should continue taking ownership and driving the risk agenda across the business. While senior management with support from the CRO/Head of audit are involved in managing risks, the oversight by the board cannot be delegated. It was also recommended that the organization should focus on new emerging risk types such as reputation, operational risks and IT security while not losing focus on the traditional risks such as credit and market risks. AAR should also define Risk Management framework and program which enables effective reporting and consolidation of data.

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LIST OF ABBREVIATIONS AND ACRONYMS

AKI-Association of Kenya Insurance

AAR-Africa Air Rescue

CAGR-Compound Annual Growth Rate

CBA-Cost Benefit Analysis

ICAEW-Institute of Chartered Accountants in England & Wales

IFA- International Federation of Accountants

ERM-Enterprise Risk Management

IRA-Insurance Regulatory Authority

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

In business, strategy is a design or plan for achieving a company's policy goals and objectives. Whereas, policy defines the company's goals and objectives and its operational domain, strategy decides how the company's goals and objectives will be achieved, what operational units will be used to achieve the company's goals and objectives, and how those operational units will be structured. Strategy also determines what resources will be needed to achieve the company's goals and objectives and how these resources will be acquired and used. Strategy is a design or plan that defines how policy is to be achieved.

This definition of strategy applies to corporate strategy and unit strategy. Unit strategies are plans for achieving the goals and objectives of an operating unit, an industry or geographical operating area, or a managerial or business function. Unit strategies include a company's marketing strategy, acquisition strategy, alliance or affiliation strategy, human resources recruitment and retention strategy, production strategy, and financial strategy. They also include a company's division strategies, subsidiary strategies, and country strategies. Corporate strategy, on the other hand, refers to strategy that is used to achieve corporate goals and objectives, that is, to achieve corporate policy.

1.1.1 Concept of Strategic Risk Management

Strategic Risk Management is a process for identifying, assessing and managing risks and uncertainties, affected by internal and external events or scenarios that could inhibit an organization's ability to achieve its strategy and strategic objectives. The ultimate goal of strategic risk management is creating and protecting shareholder and stakeholder value. Enterprise risk management is a process, effected by an entity's board of directors, management and other personnel, applied in strategy setting and across the enterprise. ERM is designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite and to provide reasonable assurance regarding the achievement of entity objectives (Freeman, 1984).

Today, directors and executives are seeing increased expectations from shareholders, regulators, rating agencies, and other stakeholders that they understand and are managing the organization's risk and risk management processes— including strategic risks—and that there is transparency in the risk management process. It appears that this reemergence of risk management, when coupled with the catastrophic losses incurred by some organizations, has fueled the current emphasis on "strategic risk management." Strategic risk management is focused on the most consequential and significant risks to shareholder value—clearly an area deserving the time and attention of executive management and the board of directors. Attributes for strategic risk includes management's view of the most consequential risk the firm faces, their likelihood, and potential effect; the frequency and nature of updating the identification of these top risks;

the influence of risk sensitivity on liability management and financial decisions; and the role of risk management in strategic decision making (Butt, 2010).

Strategic risk management is increasingly being viewed as a core competency at both the management and board levels. The exact steps that an organization should take will depend on the level of maturity of its overall ERM processes. For some organizations that have already started to implement ERM, the focus on strategic risks will be a refinement and evolution of their activities. For those just starting or just considering an ERM effort, an initiative focused on strategic risks may be a good starting point.

1.1.2 Insurance Industry in Kenya

According to AKI (2010), the Insurance industry in Kenya has 47 players in total, 22 in general/short-term insurance, 9 in life insurance and 14 composite companies. The short-term insurance space is fragmented with the top 5 companies controlling 40% of the market (single largest market share of 10.98% held by Jubilee Insurance; in the financial year 2011, listed firms accounted for 27.8% of industry premiums). However, the life market is concentrated as the top 5 companies account for 70% of premiums (FY11: listed firms accounted for 69.4% of industry premium).

The Insurance Regulatory Authority (IRA) normally extracts and publishes the official insurance industry statistics for all licensed insurance companies in Kenya. The data is normally extracted from annual audited accounts and returns submitted by insurance and reinsurance companies to the Authority in compliance with the provisions of the Insurance Act. The report aims at providing progress on the working of the Insurance

Act. The insurance industry in Kenya consists of a number of players namely; insurance and reinsurance companies, intermediaries and other service providers. According to Insurance Regulatory Authority (2010), the registered insurance industry players per each category include: 47 insurance companies, 2 reinsurance companies, 161 insurance brokers, 24 medical insurance providers, 115 insurance investigators, 78 motor assessors, 3931 insurance agents, 26 insurance surveyors, 21 loss adjusters, 2 claim settling agents and 10 risk managers.

The industry has witnessed rapid growth over the last decade with CAGR in total written premiums at 15.1%. Though the impressive growth in written premiums has mirrored increased incomes and change in perception towards need for insurance, penetration has remained low (currently at 3.03% vs. 11.6% in South Africa). Key challenge for the industry has been negative market sentiment following closure of at least 5 insurance providers over the past 5 years due to insolvency arising from high claims (avg. 61%). Underwriting profits (sector average e.g. 3% over the past 4 years) have however remained low due to weak pricing and increased fraudulent claims. The largest business class under short-term is motor commercial accounting for 25.7% of total premiums, followed by motor private at 19.1%. Within life insurance, deposit administration and pension accounts for 34.6% of premiums followed by ordinary life accounting for 34% of premiums. Motor commercial class also ranks first with respect to underwriting profits (58% of industry short-term underwriting profits in 2011). In the past 3 years (2009-2011) motor private class has registered the highest CAGR of 16.6% in gross written premiums AKI, 2010).

1.1.3 AAR Insurance Kenya Ltd

In order to understand the strategic risk management practices of insurance companies, this research will use AAR insurance Kenya as a case study. AAR started operating in 1984 and its primary business was evacuation of medical and accident casualties, both by road and air. As the membership increased, so did the needs of clients, creating more opportunities to comprehensively provide healthcare packages for clients. AAR is today the largest and most successful private healthcare company with a footprint in the East African region. AAR has 18 health centres spread over Kenya, Uganda and Tanzania; through which it provide preventative and curative healthcare to clients. AAR also offer rescue and evacuation services to members from anywhere in the world. With a current membership of close to 100,000, AAR is not only leaders in healthcare but is also the preferred provider for both the public and private sectors in East Africa.

1.2 Research Problem

Regulatory and market forces are generating incentives for insurance companies to reexamine and enhance strategies, processes, and infrastructures for measuring performance and analyzing risk. Leading insurers evaluate risk management by aligning the risk management model to the business model and focusing on aggregate exposures (gross and net) and product. This allows risk managers to understand their organization's accumulations across the business model and to mitigate those exposures as economically or efficiently as possible.

Since 1985, the insurance industry in Kenya has undergone a metamorphosis that has seen a number of changes being introduced and adopted. It is worrying to note that eight insurance firms have either collapsed or have been placed under statutory management; representing an average of one insurance company after every four years. These include:- Kenya National Assurance Company, United Insurance Company, Lake Star Assurance Company, Standard, Assurance, Access Insurance Company, Stallion Insurance, Invesco Assurance and Blue Shield Insurance Company (Mbogo, 2009). In response to this trend, the government of Kenya responded by establishing the Insurance Regulatory Authority (IRA) which is the prudential regulator of the insurance industry in Kenya (formerly the Department of Insurance). IRA became autonomous on 1st May, 2007 through an Act of Parliament.

As recent market statistics by Insurance Regulatory Authority (IRA) show, risk management and adoption by insurance companies in Kenya is far from ideal. Insurance companies often fail because of risks inherent in the business such as reserving risk that outstanding claims may cost more than anticipated and therefore more than the reserves set against liabilities, pricing risk that business is written at inadequate premium rates, interest rate that assumed yield are not achieved, and investments risk of significant fall in equity, property or bond values. Others are risk of default of loans, currency and liability risk of mismatch between assets and liabilities due to currency fluctuation or timing of maturity of some asset (cash flow problem), reinsurance risk, and catastrophe risk of large random shocks.

This study focuses on an area that has not been expressly addressed by other studies namely; strategic risk management in the context of insurance provision. For instance Abuya (2008) undertook a study on strategic risk management practices among state corporations in Kenya. Other studies done locally include: A survey on strategic risk management practices by large commercial banks in Kenya by Njeri (2010) and Gitonga (2009) in his study on the long and short of Private Health Insurance (PHI) in Kenya. Additionally Kabiru (2010) studied the effect of risk management practices on the financial performance of commercial banks in Kenya. All these studies did not shed light on the strategic risk management practices of insurance companies. This study was designed to fill this gap using a case study of AAR insurance Kenya Limited. This study sought to answer pertinent questions which included: What are the unique risks facing AAR as a health insurance service provider? How does AAR cope with the risks? And which pragmatic strategies that can be used to mitigate the perceived risks at both the firm and industry levels?

1.3 Research Objectives

This study was out to achieve the following objectives.

i. To identify the strategic risk management practices of AAR as well as the risks facing the company.

ii. To determine the risk management strategies employed by AAR to mitigate the identified risks.

1.4 Value of the Study

The study will aid various stakeholders; AAR as well as other insurers will obtain details on the risks facing the industry and the details of responses of mitigation measures. In addition the study will provide a justification to the responses adopted depending on the success obtained. The policy makers will obtain knowledge of the insurance industry dynamics and the responses that are appropriate; they will therefore obtain guidance from this study in designing appropriate policies that will regulate the sector.

The study will also benefit the regulator to reconsider the laws that guide operations of the insurance service providers to better address capital requirements and distribution channels. The study will also benefit the scholars who would wish to undertake further studies aimed at improving strategic risk management in the insurance sector. The academicians and researchers in the field of strategic management and environment in the insurance industry will be able to use this study as a source of reference in forming their future research topics and studies.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter looks at the issues related to strategic risk management in the insurance industry. The chapter develops theoretical framework to justify the need for the current study and the empirical review of literature on key concepts. The chapter also looks at the research gaps.

2.2 Theoretical Foundation

According to Kothari (2004), a theory is a coherent group of tested propositions commonly regarded as correct that can be used as principles of explanation and prediction for class of phenomena. In line with this definition, the study used decision theories that help explain the arguments advanced in this study. The theoretical framework of the study is a structure that can hold or support a theory of a research work. It presents the theory which explains why the problem under study exists. Thus, the theoretical framework is but a theory that serves as a basis for conducting research.

2.2.1 Decision Theory

Decision Theory is implicitly contained by the risk management process, since risk management depends on rules derived from general knowledge and precepts of Decision Theory (Vaughan 1997). One of the most well-known methods for rational decision

making is Cost Benefit Analysis (CBA). According to Williams and Giardina (1993), every rational decision maker faces the problem of seeking solutions which could enable him to maximize his net benefit. For this purpose, in order to determine whether or not it is advantageous to adopt a particular choice, a decision maker would try to define and quantify its possible effects. The origins of this theory can be traced in Economic theory, particularly in the theory of social welfare and resource allocation, ideas that could assist a decision maker in the objectives of finding the best solution through adding up values of all of the good and bad consequences of a decision.

Concepts of rational neoclassical economic theory are used in this method to assess preferences, particularly as they are revealed in market behaviour. Thus, CBA seeks to value the expected impacts of an option in monetary terms. Consequently, the valuations should consider the willingness to pay of potential gainers for the benefits they will receive as a result of the option, and the willingness of potential losers to accept compensation for the losses they will incur. The latter implies that rational (optimal) decisions require selecting a set of strategies in such a way that, given the constraints imposed by their decisions possibility. Therefore in terms of this criterion, a strategy is desirable if the benefits exceed the losses, appropriately discounted over time.

CBA applied to the discipline of risk management, seeks to measure the contribution that a risk technique or response makes to the risk management process by determining whether, and by how much, the technique benefits exceed the cost to implement it. The greater the benefits for a given cost, or the lower the cost for a given level of benefits, the

more cost effective the particular technique and response is thought to be (Vaughan 1997). Consequently, risk managers might weigh several factors that include cost and risk. Consequently, an insurance company manager would have to weigh the importance of risk and cost and the availability of resources to respond when applying CBA for decision making and would also make use of the information on risk-based developed in the previous stage of the risk management process, where risks where identified and analyzed in respect of their likelihood (frequency) and impact.

Moreover, as discussed by Ayyub (2003), economic efficiency could be pertinent to determine the most effective means of expending resources taking into account that at some point, the costs for risks reduction (controls) might not provide adequate benefits. Thus, CBA applied to risk management compares the costs and risks to determine where the optimal risks value is on a cost basis. Following this approach then, the optimal value occurs when costs to control risks are equal to the risk cost due to the consequences (loss). Therefore, investing resources to reduce risks below this equilibrium point would not provide additional financial benefits.

2.3 Empirical Literature

The following section reviews the empirical literature on strategic risk management as documented by other scholars in this area of study.

2.3.1 Business/Corporate Strategies

A strategy is a plan of action designed to achieve a specific goal. Strategy is all about gaining (or being prepared to gain) an advantage over adversaries or best exploiting

emerging possibilities. As there is always an element of uncertainty about the future, strategy is more about determining and prioritizing a set of options ("strategic choices") rather than about crafting a fixed plan (Mintzberg, 1994).

Ansoff (1965) develops a matrix that helps businesses identify growth opportunities in the market. The product/market growth matrix describes a combination of a firm's activities in current and new markets with existing and new products. It outlines four types of growth strategies, namely market penetration, product development, market development, and diversification. In market penetration, a firm tries to grow with existing products in its current market. Firms that follow a market development strategy try to sell existing products in new market segments. Under product development strategy, a firm develops a new product for existing markets. Finally in diversification, a firm tries to enter a new market with new products.

Butt (2010) classifies business strategies into three broad groups: building, holding and harvesting. Building strategies are based on active efforts to increase market share by new product introductions, new marketing programs and so on. Holding strategies are focused on maintaining the existing level of market share. Harvesting strategies are designed to gain short-term earnings by allowing market share to decline.

After analyzing various works on business strategy in the literature, five generic strategies can be identified, although their names are different. These strategies are cost Strategies, differentiation strategies, focus strategies, hybrid (Combination) strategy and

No definite strategy Faulkner and Campbell, 2006). Cost strategies are about cost reduction. By referring to the literature, it is possible to divide cost strategies into two groups. The first group is cost leadership. Porter (1980) broadly propounded this strategy for the first time. Cost leadership aims at reducing costs throughout the value chain and reaching the lowest cost structure possible. The second group follows a cash flow maximization strategy. Firms rather aim to extract provide maximum revenue out of the product in the maturity or decline stages of the product-life cycle. Mostly, enterprises operating in low growth-rate sectors, with high market shares or with low market shares and which are considering ending their operations in the present business soon, follow this strategy. A differentiation strategy occurs when a firm gains an unprecedented position within the sector of operation by differentiating its products or services. It is possible to observe one sort of differentiation strategy in all the studies analyzed.

The focus strategy differs from the other strategies in one aspect. While in the differentiation and cost strategies wide fractions of customers are being appealed to, the firms that follow a focus strategy prefer to appeal to a certain geographical area or a certain fraction of customers. Firms in no definite strategy group do not follow a certain strategy. For this reason, they unstably adapt to *c*hanges in the business environment. Some of them chase their successful rivals. Such strategies can be considered as counterfeiting (Mintzberg, 1988). Generally, these kinds of enterprises cannot develop a compatible strategy with the structure and processes of the organization (Miles et al., 1978). The three business strategies Porter (1980) propounded (cost leadership, differentiation and focus) specify the basic approaches that could be implemented in a

competitive environment. According to Porter, it is impossible to succeed if a firm does not prefer one of these three strategies or implement two of them simultaneously. Porter defines this situation as being "stuck in the middle".

2.3.2 Basics concepts of strategic management

Strategic management is the set of managerial decision and action that determines the long-run performance of a corporation. It includes environmental scanning (both external and internal), strategy formulation (strategic or long range planning), strategy implementation, and evaluation and control. The study of strategic management therefore emphasizes the monitoring and evaluating of external opportunities and threats in lights of a company's strengths and weaknesses.

Strategic management has now evolved to the point that it is primary value is to help the organization operate successfully in dynamic, complex environment. To be competitive in dynamic environment, companies have to become less bureaucratic and more flexible. In stable environments such as those that have existed in the past, a competitive strategy simply involved defining a competitive position and then defending it. Because it takes less and less time for one product or technology to replace another, companies are finding that there are no such thing as competitive advantage. According to Chapman and Ward, (2002) firms must develop strategic flexibility: the ability to shift from one dominant strategy to another. Strategic flexibility demands a long term commitment to the development and nurturing of critical resources. It also demands that the company become a learning organization: and organization skilled at creating, acquiring, and

transferring knowledge and at modifying its behaviour to reflect new knowledge and insights.

Learning organizations avoid stability through continuous self-examinations and experimentations. People at all levels, not just top the management, need to be involved in strategic management: scanning the environment for critical information, suggesting changes to strategies and programs to take advantage of environmental shifts, and working with others to continuously improve work methods, procedures and evaluation techniques. Strategy formulation is the development of long-range plans for they effective management of environmental opportunities and threats, taking into consideration corporate strengths and weakness. It includes defining the corporate mission, specifying achievable objectives, developing strategies and setting policy guidelines.

2.3.3 Concept of Risk

According to Mun (2004), "risk is any uncertainty that affects a system in an unknown fashion whereby the ramifications are also unknown but bears with it great fluctuation in value and outcome". Risk can be defined as the combination of the probability of an event and its consequences. According to ICAEW (1999), risk is defined as real or potential events which can reduce the likelihood of achieving business objectives. Risk has also been defined as: uncertain future events which could influence the achievement of the organization's strategic, operational and financial objectives. Risk is all about events and their consequences which can happen in the future. As at now, we do not

know what event will occur in the next hour, tomorrow or next year and if it does occur what its consequences will be. In other words, how likely it is that an event will happen and how bad it will be if it happens.

Risks and uncertainty are closely related to each other but totally different in meaning. Risk is when future events occur with measurable probability whereas uncertainty involves things that are completely unknown, for example the ash cloud case. This distinction denotes risk as a positive probability of something bad happening, while uncertainty does not necessarily imply a ranking of the possible outcomes (Chapman and Ward, 2002). The problems that risk and uncertainty pose are very serious and not easily overcome especially when the risk and uncertainty involve things that people are deeply concern about. This is where risk management helps choose among alternative causes of actions to reduce the effects of risks. Risk management and internal controls are means by which businesses' opportunities are maximized and potential and material losses are reduced.

2.3.4 Risk Management

Recent years have seen heightened concern and focus on risk management, as a result of series of business scandals and failures where investors, company personnel and other stakeholders suffered tremendous loss. This resulted in the publication of books, journals, articles and a series of government documents that draw attention to the need for better risk management and how to set up a risk management system. The Sarbanes-Oxley Act in the US, the Basel II Capital Accord and the revised Combined Code (2003) in the UK

are all examples of governance reforms with the intention of minimizing the risk of future major corporate failures through tighter regulation of internal control systems. Risk management is viewed as a corner stone of good corporate governance and therefore results in better service delivery, more efficient and effective use of scarce resources and better project management. It has to do with identification, analysis and control of such risks that threaten resources, assets, personnel and the earning capacity of a company (Courtney, 2001).

Risk management is the logical development and implementation of a plan to deal with potential losses. It is important for an organization to put in place risk management programmes so as to manage its exposure to risks as well as protect its assets. The essence is to prepare ahead of time on how to control and finance losses before they occur.

Risk management is: a process of understanding and managing the risks that the entity is inevitably subject to in attempting to achieve its corporate objectives. For management purposes, risks are usually divided into categories such as operational, financial, legal compliance, information and personnel. One example of an integrated solution to risk management is enterprise risk management. The Institute of Risk Management also provided a more detailed definition of risk management as: the processes by which organizations methodologically address the risks to their activities with the goal of achieving sustained benefit within each activity and across the portfolio of all activities.

2.4 Summary

In a world that is constantly changing and with every change bringing about new ways of doing business with different outcomes, risk and how to manage it has become a critical issue. The recent global financial crisis served as a reminder that risk management and how the same is practiced is fundamental if performance objectives are to be consistently achieved. It has emerged that as business owners and managers strive to improve and sustain performance they are now also required to consider what risk management practices their organizations have adopted to avoid falling short of their strategic objectives (Arun and Steiner, 2008). Business entities, including insurance companies, are today under more pressure than ever to manage costs and deliver services more efficiently. As operating budgets are scrutinized, management search for creative means of cutting costs, maximizing the productivity of existing staff, and working smarter to serve the customers interests. In order to fulfill their purpose, many organizations have crafted strategies to guide them in the competitive environments in which they operate. Pursuing such strategies comes with risk (Embrechts, McNeil and Straumann, 1999). This risk is occasioned by the fact the strategies are achieved through decision-making about strategic choices characterized by complexity arising out of ambiguous and non-routine situations. The underlying premise of strategic risk management is that every entity, as it seeks to provide value for its stakeholders, faces uncertainty, and the challenge for management is to determine how much uncertainty to accept as it strives to grow stakeholder value. Strategic risk management enables management to effectively deal with uncertainty and associated risk and opportunity, thus enhancing the capacity to build value. Within the health insurance arena, an area that presents a significant

opportunity for improved decision-making capabilities and cost savings measures is strategic risk management.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

The methodology section gives details regarding the procedures used in conducting the study. Pertinent issues discussed in this section include the research design, population design, data collection and data analysis.

3.2 Research Design

A research design is the plan, structure of investigation conceived to obtain answers to research questions that includes an outline of the research work from hypothesis, methods and procedures for collecting and analysing data and presenting the results in a form that can be understood by all (Mugenda & Mugenda, 2003).

This study employed case study research design. This is because the study intends to obtain an in depth understanding on the strategic management practices of firms in the insurance companies.

3.3 Population

A population is the ‘aggregate of all cases that conform to some designated set of specifications (Paton, 2002). The study compiled a substitute list with a complete listing of all sampling units in the population. The target population comprised of 40 senior management and middle level staff at AAR Insurance Kenya Limited drawn from the department of finance, underwriting and operation.

3.4 Sample Design

The study adopted stratified random sampling. The sample of 14 from a population of 40 forms 35.00% of the target population which fulfils the minimum threshold sample suggested by Patton (2002) who recommended 30% of the target population as an adequate sample size in a descriptive case study survey. This is supported by Neuman (2000).

Table 3.1: Sample Design

Department	**Population**	**Sample size**	**Percentage**
Finance	14	5	35.71
Operations	10	3	30.00
Underwriting	16	6	37.50
Total	**40**	**14**	**35.00**

3.5 Data Collection

The study used interview guide to collect the data. The researcher conducted in-depth interviews. In-depth interviews are a useful qualitative data collection technique that can be used to collect qualitative data. In-depth interviews are most appropriate for situations in which you want to ask open-ended questions that elicit depth of information from relatively few people (as opposed to surveys, which tend to be more quantitative and are conducted with larger numbers of people).

3.6 Data Analysis

The interview guides were checked for completeness and consistency of information at the end of every field data collection day and before storage. Data was later subjected to

statistical analysis using SPSS computer software. Data was analyzed thematically using content analysis based on analysis of meanings and implications emanating from respondents information and documented data. As observed by Kothari (2004) qualitative data provides rich descriptions and explanations that demonstrate the chronological flow of events as well as often leading to serendipitous (chance) findings. The findings will be presented in the form of charts, tables and pie charts.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents data analysis, interpretations and discussions. Information in this chapter is divided into two sections. This chapter details the analysis of data on the two objectives based on descriptive statistics.

4.2 Response Rate

The sample of the study comprised of 14 respondents which comprised of AAR employees in the department of finance, operation and underwriting. The researcher interviewed the respondents using an interview guide. Some of the respondents could not be accessed due to work commitment while others were on leave. Out of the sample of 14 employees AAR, the researcher managed to interview 10 giving a response rate of 71.43%.

According to Mugenda and Mugenda (2003) a 50% response rate is adequate, 60% good and above 70% rated very good. This also concurs with Kothari (2004) assertion that a response rate of 50% is adequate, while a response rate greater than 70% is very good. This implies that based on this assertions; the response rate in this case of 71.43% is very good.

Table 4.1: Response rate

Department	Questionnaires administered	Questionnaires Returned	Percentage
Finance	5	4	80
Operations	3	3	100
Underwriting	6	3	50
Total	**14**	**10**	**71.43**

Source-researcher

4.3 Risk Management in Insurance Sector

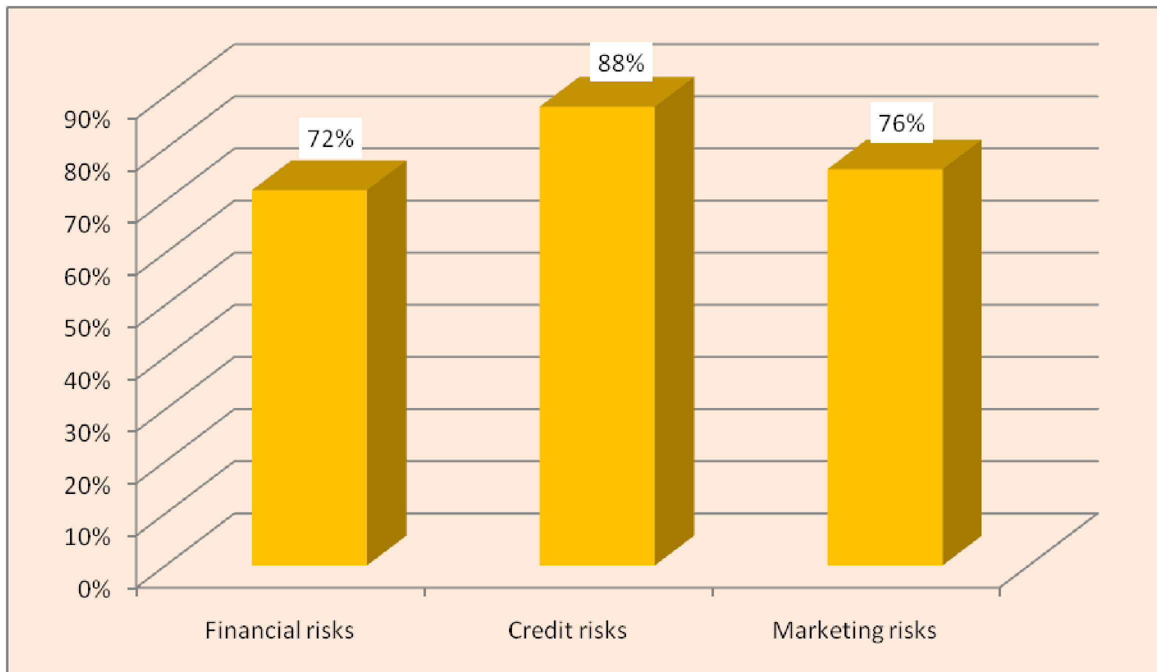
The study indicated that the insurance sector in entirety considers risk management control in its strategic objectives. The employees who participated in the study agree almost unanimously that the insurance sector includes risk control among its strategic objectives. However, they also point out that the sector's behaviour is not aligned with said objectives, since only nearly half of the companies consider that the companies in the sector allocate part of their budget to risk management. In line with these facts, and considering the existence of a risk management reserve in the company, it is observed that the company declares the existence of this item in their 2012 budget.

The findings of the study concur with Courtney, (2001) who indicated that risk management is the logical development and implementation of a plan to deal with potential losses. It is important for an organization to put in place risk management programmes so as to manage its exposure to risks as well as protect its assets. The essence is to prepare ahead of time on how to control and finance losses before they occur.

4.4 Types of risks

The respondents indicated that there are three risks considered important in the insurance sector. These risks are broadly classified as financial, credit risk and marketing risks as supported by 72%, 88% and 76% respectively. The findings are displayed in figure 4.1.

Figure 4.1: Types of risks



The respondents cited price undercutting as a significant concern. A lack of actuarial expertise also contributes to the perception of pricing as a source of risk, as does a poor understanding of internal operations and operational risk. Weak product innovation also contributes to poor pricing and product differentiation.

Among AAR respondents, fraud is perceived as a risk insofar as it relates to fraudulent claim activity. The fundamental transactions and activities occurring in the banking and insurance industries are similar, which implies that banking risks like technology fraud

and internal fraud might also be risks for insurance companies. While fraud registered significantly among respondents, it was poorly understood to what extent insurance companies have been affected. In insurance markets where the industry is still relatively immature, like Kenya, an increasing incidence of fraud will test the capacity of insurance claims settlement procedures and consumer protection laws.

Actuarial standards are perceived to be lagging behind strategic needs. According to the respondents, outdated actuarial assumptions in regulations, a shortage of qualified actuaries and the use of inaccurate data in the actuarial processes contribute to the perception of risk. It was revealed that AAR insurance Kenya limited has very few fully-qualified actuaries. Most companies in the insurance industry requiring actuarial services have to rely on external actuarial firms for the service. External actuaries, while qualified, may not have sufficient internal knowledge of working companies. An over-reliance on external actuarial expertise could result in inappropriate pricing strategies on incorrect assumptions in the valuation of policyholder contracts. The Kenya insurance market suffers not only from a lack of actuarial expertise but also from factors like demographic shifts, climate change and political volatility that further complicate actuarial modelling.
According to the respondents reputation is considered the most significant risk facing their company. Reputational risk is seen to be the result of poor claims payments practices, the collapse or insolvency of industry players, low profitability, inadequate customer handling processes and poor-quality customer service, low contract certainty and a lack of proper complaints monitoring and handling processes.

According to Mun (2004), “risk is any uncertainty that affects a system in an unknown fashion whereby the ramifications are also unknown but bears with it great fluctuation in value and outcome”. Risk can be defined as the combination of the probability of an event and its consequences.

4.5 Risk control measures

As Kenya’s insurance industry matures, risk management is a major concern for insurers and business leaders. AAR insurance Kenya limited continuously reassesses their policies to manage and mitigate the risk. Risk in the insurance value chain can emanate from internal and external factors. The risk of employees misusing confidential information and colluding with fraudsters is on the rise and insurers will need to put in place internal checks and balances to minimize such issues.

Based on the findings, external risk can arise at various stages, e.g., registration of clients, underwriting, reinsurance and the claims process. The severity of risk can range from a slight exaggeration to deliberately causing loss of insured assets. The essential components of fraud risk are the intent to deceive and the desire to induce an organization to pay more than it otherwise would.

Risk detection and management should be a proactive process, which includes identification of suspicious claims that have a high possibility of being fraudulent, through a computerized statistical analysis. AAR insurance portfolios need reinsurance and identification of high value policies to monitor and investigate risk, which mitigates such risks to a large extent. As a control measure, AAR has put in place fraud

investigation teams (with the right credentials) that work in tandem with law enforcement agencies to weed out fraudulent claims. It is worth noting that the company did not have a specific reserve for risk control allocated in the 2013 budget.

The findings of the study corroborates Chapman and Ward, (2002) who observed that the problems that risk and uncertainty pose are very serious and not easily overcome especially when the risk and uncertainty involve things that people are deeply concern about. This is where risk management helps choose among alternative causes of actions to reduce the effects of risks and take appropriate control measures.

4.6 Risk governance

Risk governance can be defined as the approach for directing the management and control of risk, which may be overseen by the board of directors as a whole or through a board risk committee. The role of clear and active risk governance has gained currency in the recent past as a result of corporate governance breaches, fraud and related malfeasance coupled with increasing focus by regulators who are now insisting on proper oversight by the board.

Half of the respondents indicated that the companies risk governance models was at the stage of implementation with only 29% indicating that the companies models was already implemented. In AAR insurance Kenya limited, the board of directors receives and reviews regular reports on the risk management program and approves the ERM policy and framework. Approximately half of the respondents indicated that the board is involved in approving the risk appetite statement. This could be due to the fact that

approximately a third of the respondents (34%) indicated that they have not yet defined a statement of the company's risk appetite. 82% of the respondents indicated having a Chief Risk Officer (CRO) or equivalent with only 6 respondents indicating that they do not have this executive in place. Aligning compensation and incentive plans with appropriate risk taking is undertaken in AAR insurance Kenya limited.

The Board should continue taking ownership and driving the risk agenda across the business. While senior management with support from the CRO are involved in managing risks, the oversight by the board cannot be delegated. Risk management should be infused throughout the organization; not only at enterprise and business unit level; but also in strategic and operational decisions.

The study found that many financial institutions have taken a variety of actions in response to the increased focus on risk governance. The most common action, taken by the organization, was to improve the process for reporting of risk information to their boards of directors and to their management risk committees. In addition, formation of risk management committees- both at management and board level- has been undertaken by approximately two thirds of the respondents. Establishment of the Chief Risk Officer (CRO) position and development of a risk dashboard report were also prominent activities undertaken.

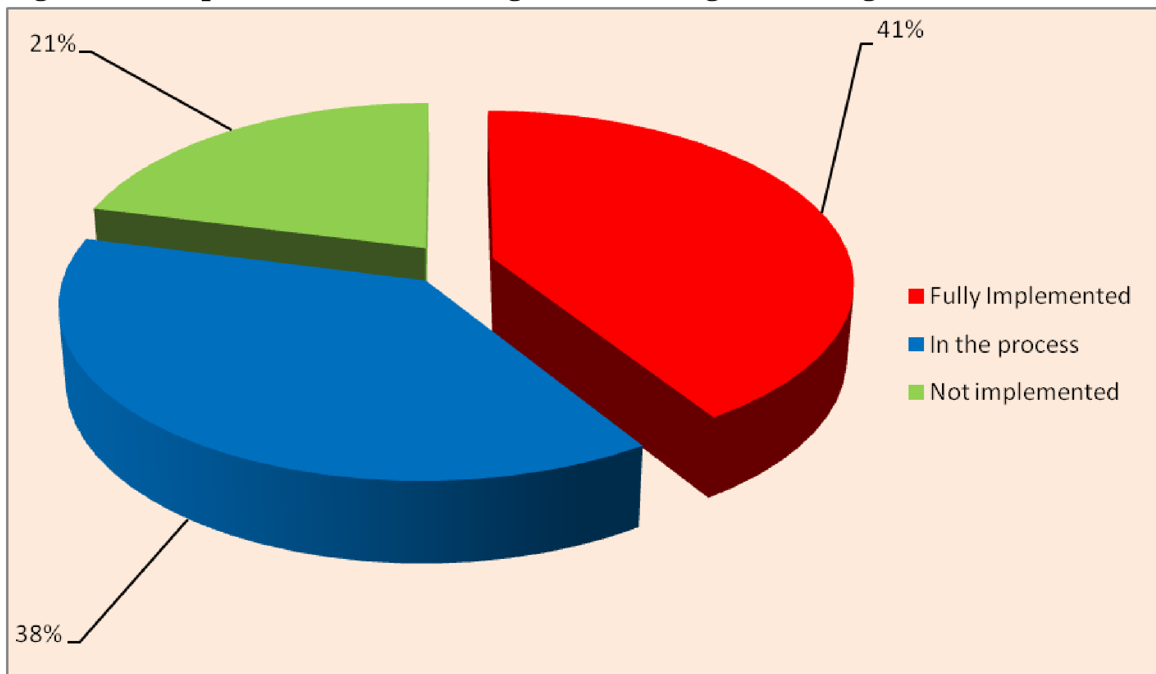
4.7 Strategic Risk Management Practices

Strategic risk management aims to bring a holistic organization-wide and standardized risk management process to financial institutions and provide them with an integrated view of risks they face. By adopting a comprehensive approach to risk identification and

assessment, Strategic Risk Management can help identify many dependencies or inter-relationships among risks that might otherwise go unnoticed. In addition, it is easy to gain new insights and provide transparency into the overall impact of risk on the institution.

The study indicated that implementation of strategic risk management is fairly limited with only 41% of the respondents indicating that they have a fully implemented Risk Management program. However 38% of respondents indicated that they are in the process of implementing one while 21% were not aware. Figure 4.2 shows the findings of the study to this effect.

Figure 4.2: Implementation of Strategic Risk Management Programs



Among study respondents, Risk Management programs almost always covered the major traditional risk categories of credit risk (92%), liquidity risk (90%) regulatory/compliance (90%), and market risk (85%). New risk categories such as operational risks (95%),

strategic (80%), reputation (83%) and IT security (75%) have also emerged as critical focus areas. Enterprise management is integrated and linked to the Internal Audit Plan as supported by 59% of the respondents. A further 25% indicated that this is not formalized as yet. AAR insurance Kenya limited has their risk appetite both quantitatively and qualitatively defined.

AAR insurance company is already recording gains of strategic risk management. This is evidenced by the fact that 85% of the respondents felt that the value of their risk management was greater than its cost; however many conceded that it was difficult to quantify this value.

4.8 Management of Key Risks

A critical challenge facing risk management is achieving a comprehensive view of all the varied risks a financial institution faces. AAR insurance Kenya limited as a player in the insurance industry has much more to achieve in this regard. Most of the respondents rated the effectiveness of their risk management programs as fair. This implies most program implementations are still work in progress. In terms of specific risk types, the respondents felt that their risk management programs were most effective in managing liquidity and financial/budgeting risk. Credit risks, tax and regulatory were identified as areas where strategic risk management is growing in effectiveness, possibly due to the already existing regulatory oversight.

Operational risk areas of business continuity, IT security, legal, human capital and data integrity risks were highlighted as areas where the risk management programs have not

been effective. Most respondents indicated that the organization have strengthened their liquidity risk management function (60% of respondents) or amended their liquidity management policies (40% of respondents). The findings of the study are shown in table 4.2.

Table 4.2: Management of Liquidity Risk

Response	Frequency	Percentage
strengthened their liquidity risk management function	**6**	**60%**
amended their liquidity management policies	**4**	**40**
Total	**10**	**100**

Capability of the operational risk management technology platforms was rated as 'somewhat capable' by a majority of the respondents. Scenario analysis and operational risk capital calculations were identified as key challenges in these technology solutions. The respondents also indicated that regulatory reform has resulted in an increase in the cost of compliance and the need to hold higher capital levels.

Recent years have seen heightened concern and focus on risk management, as a result of series of business scandals and failures where investors, company personnel and other stakeholders suffered tremendous loss (Courtney, 2001).

4.9 Risk Management Systems and Infrastructure

Information technology is a vital element of risk management capabilities and acts as a key enabler to the effectiveness of the risk management. The study revealed that AAR insurance Kenya limited has a dedicated risk management technology solution. Most of the respondents, however clarified that they have several sub-systems, at various levels of sophistication that address specific risks. Legacy risk management system (incorporating

a spreadsheet solution) was rated as the most prevalent in the industry while credit management systems were identified as the second most common solution. Credit management solutions could be due to the need to score and evaluate the credit rating of potential customers. Possibly as a consequence of their perceived prohibitive cost, employees of AAR were of the view that high cost of maintenance and vendor fees was a major concern over the technology systems. Integration, a long standing issue when it comes to technology, was rated as the second most significant concern by the employees. Other issues tied to this were lack of sufficient risk data, data integrity issues and inability to extend the current legacy systems.

4.10 Identification of Risks

The respondents were asked to indicate whether they identify risks by fuction/product/process or are a combination. In their business and product approval process, almost all respondents reported considering more than traditional major risk types - operational (95%), regulatory (89%) and market (81%).

Also considered with increasing importance were strategic, liquidity, foreign exchange volatility and country risk. While these were not rated, they were highlighted as part of the 'Other' category to indicate their relative importance during decision making. In particular, liquidity and foreign exchange volatility is critical as the companies operate as regional entities with their head offices being in one of the country and therefore have to consider the impact of any foreign exchange translation whether for revenue, tax or intercompany transactions settlement and reporting.

New product launches, mostly riding on mobile-commerce, coupled with greenfield or acquisition-related regional expansion has characterized the insurance services industry in the recent past. These events have an important bearing on risk management with regulators and media analysts increasing their focus in this area. 87% of the respondents indicated that risk considerations are incorporated during these strategic decisions and new product launches.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary of the findings and conclusions based on the study findings. The chapter also presents recommendations for policy and practice, besides presenting recommendations for further research.

5.2 Summary of Findings

The respondents indicated that there are three risks considered important in the insurance sector. These risks are financial, credit risk and marketing risks. The respondents cited price undercutting as a significant concern. A lack of actuarial expertise also contributes to the perception of pricing as a source of risk, as does a poor understanding of internal operations and operational risk. Weak product innovation also contributes to poor pricing and product differentiation. According to AAR respondents, fraud is perceived as a risk insofar as it relates to fraudulent claim activity. The fundamental transactions and activities occurring in the banking and insurance industries are similar, which implies that banking risks like technology fraud and internal fraud might also be risks for insurance companies.

According to the respondents reputation is considered the most significant risk facing their company. Reputational risk is seen to be the result of poor claims payments practices, the collapse or insolvency of industry players, low profitability, inadequate customer handling processes and poor-quality customer service, low contract certainty

and a lack of proper complaints monitoring and handling processes. Based on the findings, external risk can arise at various stages, e.g., registration of clients, underwriting, reinsurance and the claims process. The severity of risk can range from a slight exaggeration to deliberately causing loss of insured assets. The essential components of fraud risk are the intent to deceive and the desire to induce an organization to pay more than it otherwise would.

Half of the respondents indicated that the companies risk governance models was at the stage of implementation with only 29% indicating that the companies models was already implemented. In AAR insurance Kenya limited, the board of directors receives and reviews regular reports on the risk management program and approves the ERM policy and framework. Approximately half of the respondents indicated that the board is involved in approving the risk appetite statement. This could be due to the fact that approximately a third of the respondents indicated that they have not yet defined a statement of the company's risk appetite. A significant proportion of the respondents indicated having a Chief Risk Officer (CRO) or equivalent with only a few respondents indicating that they do not have this executive in place. Aligning compensation and incentive plans with appropriate risk taking is undertaken in AAR insurance Kenya limited. AAR insurance Kenya limited is already recording gains of strategic risk management. This is evidenced by the fact that majority of the respondents felt that the value of their risk management was greater than its cost; however many conceded that it was difficult to quantify this value.

Operational risk areas of business continuity, IT security, legal, human capital and data integrity risks were highlighted as areas where the risk management programs have not been effective. Most respondents indicated that the organization have strengthened their liquidity risk management function or amended their liquidity management policies. The study revealed that AAR insurance Kenya limited has a dedicated risk management technology solution. Most of the respondents, however clarified that they have several sub-systems, at various levels of sophistication that address specific risks. Legacy risk management system (incorporating a spreadsheet solution) was rated as the most prevalent in the industry while credit management systems were identified as the second most common solution. In their business and product approval process, almost all respondents reported considering more than traditional major risk types - operational, regulatory and market. Also considered with increasing importance were strategic, liquidity, foreign exchange volatility and country risk. While these were not rated, they were highlighted as part of the 'Other' category to indicate their relative importance during decision making.

5.3 Conclusions

In view of the findings of the study, the following conclusions are drawn:

Risk is the core business of insurers but risk management practices are new to the insurance industry in Kenya. Awareness and training are very important for top and middle managers. –Audit and Risk Manager. The process for identifying strategic risk should focus on its three core components: wrong decisions, poor implementation of decisions and failure to adapt to changes in market conditions. The risk strategy should have clear objectives aligned with the needs of a company's key stakeholders. This is

important for both the business model and the company's reputation. The strategic risks form the basis of a company's risk strategy. It should be effectively integrated into the business strategy and it follows that the two strategies must be correlated. An integrated view of the risk and business strategies enables an insurer to organise, adapt and enhance its structures and processes accordingly. Dealing with the interdependencies between insurance, the market environment and regulation will gain in importance. It is the researcher's view that techniques such as reverse stress-testing have the potential to generate business- model innovation. The quality of strategic risk assessment will be enhanced if the impact of decisions on the safety, growth and profit objectives is analysed before the decisions are made.

5.4 Recommendations

The study recommends that the Board should continue taking ownership and driving the risk agenda across the business. While senior management with support from the CRO/Head of audit are involved in managing risks, the oversight by the board cannot be delegated. Risk management should be infused throughout the organization; not only at enterprise and business unit level; but also in strategic and operational decisions. The risk appetite sets the limits and delineates acceptable versus unacceptable risks. This should continue being formulated and constantly monitored for compliance.

The study further recommends that distinction between risk management and internal audit should be emphasized within the organization to ensure clarity of roles, responsibilities and accountabilities. Consolidate the various risk functions (e.g. IT risk, Credit Risk, Operational Risk) to facilitate better oversight and reporting.

In line with the findings, internal audit plans should be aligned to the results of the risk assessment arising from the strategic risk management. The Internal Audit department should provide assurance on the effectiveness of the Risk Management framework and program implementation. It is important to define and monitor compliance to the organization's risk appetite statement. This may call for integrating various risk efforts while seeking a coordinated implementation approach across the organization.

It was also recommended that the organization should focus on new emerging risk types such as reputation, operational risks and IT security while not losing focus on the traditional risks such as credit and market risks. AAR should also define Risk Management framework and program which enables effective reporting and consolidation of data. The company should have regular trainings on board and senior management on Strategic Risk Management concepts and implementation so as to build internal capacity. In addition it was recommended that the company should undertake a continuous culture change program to embed a risk-aware culture across the organization

To derive value and facilitate integration of risk information across different units of the organization, it is recommended that the company should consider implementing a robust dedicated risk technology solution. The risk technology solution is only an enabler; the key determinant on its efficacy will be the quality of the risk registers and framework in use within the organization.

5.5 Limitations of the study

The study was limited to AAR which is a Life insurance company in Kenya thereby limiting the findings to this category of the insurance Industry. The results may have been different had all players in the Industry been considered. The Limitation of time for this

research project did not allow for consideration of a wider exploration for reliability of the research.

5.6 Recommended areas of Further Research

The findings of this study, it is hoped, will contribute to the existing body of knowledge and form basis for future researchers. The following areas of further researcher are thus suggested: - (1) Whereas the current study focused on responses from the management and other senior staff of the AAR insurance company, future studies should focus on the regulators and the customers of the insurance companies; (2) The current study should be replicated to other sectors of the economy in Kenya.

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APPENDIX 1- INTERVIEW GUIDE

1 a) From your viewpoint, does the insurance sector consider risk management control among its strategic objectives?

b) If yes, which type of risks are risks are considered important?

2. Which are the main objectives pursued by the companies of the sector for risk control?

3. Is there a specific reserve for risk control allocated in the 2013 budget? (elaborate further):

4. As regards the set of initiatives related to risk control performed by your company, is there a master plan to support their launch?

5. Within the company's strategy, when undertaking or concluding an initiative, the following is analyzed (tick one or more options):

[ ] Profitability

[ ] Risk/Profitability

[ ] Others:

6. Which are the main functions of the personnel assigned to risk control?

7. How does the organization govern risk?

8. Where does the risk management department sit within the organization? (i.e. Finance and

Administration, Legal, etc)

9. What kind of resources does the risk management function have?

10. Are their specific risks (such as financial or operations) they are not responsible for?

11. Does risk management have access to the Board? Do they report directly into the board?

12. What is the title of the senior risk person within the organization?

13. How does the organization clarify its strategic risk and business objectives?

How do they identify risks?

14. Do they identify risks by function/product/process? (or it is a combination?)
15. Does the organization use a specific list of risks or system of classification? (such as a taxonomy)
16. Do they use environmental scanning tools (such as PESTEL, Value Chain, SWOT, etc) to identify risks?
17. How does the identification of risks influence strategy development?
18. Does the risk management function review or have access to the organization's strategy?
19. How does the review of strategy affect the identification of risks?
20. How does the organization report on risk?
21. List the risk management practices employed by AAR Kenya Ltd