AN ASSESSMENT OF THE EFFECT OF MICRO-INSURANCE ON THE FINANCIAL PERFORMANCE OF INSURANCE COMPANIES IN KENYA

BY

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DECLARATION

Student's Declaration

This research project is my original work and has not been submitted to any other University or institution of higher learning for any academic award.

Signed…… Date ……..

TruphosaAlando

Supervisor's Declaration

This research project proposal has been submitted for examination with my approval as the University Supervisor.

Signed…… Date ……

Dr. Josiah Aduda

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DEDICATION

I would like to dedicate this work to my supportive and inspirational family that has always stood by me and whose strength, determination and faith makes everything look effortless. Special dedication also goes out to my friends in the industry for the key role they played in furnishing me with the resources I so much required.

ABSTRACT

The principles of Micro insurance are not new. Risk pooling and risk transfer can be traced back to some of the precursors of insurance, such as the Roman burial guilds. The products are not new as small policies, such as industrial life, and mutual protection schemes were offered in the 19th and early 20th century. Micro insurance is the protection of low-income people against specific perils in exchange for regular premium payment proportionate to the likelihood and cost of the risks involved. The need for enhanced access to insurance at affordable rates to the poor and low end market has been a major topic of discussion in our continent Africa. The study sought to establish the effect of micro insurance on financial performance of insurance companies in Kenya. This study research design was an analytical survey as well as correlation study which helped in establishing the associations between variables. The targeted population comprised the 10 firms underwriting micro medical and property businesses. The study used published secondary data on net profits which are readily available from the insurance industry annual reports, insurer's annual financial statements and journals from the Chartered Insurance Institute .Primary data on premiums, claims and reinsurance costs for the period 2009 to 2013 was obtained by the use of the data forms administered to the head of underwriting and finance departments. The study used both descriptive and inferential statistics in analyzing the data. Analysis was done with the help of Statistical package for social sciences (SPSS version 21). The multiple linear regression equation used took into consideration three independent variables for the 10 companies from 2009 to 2013 period. From the regression model, the study found out that there were micro insurance variables influencing the financial performance of insurance companies in Kenya, namely; micro-insurance premiums, micro-insurance claims and micro -insurance cost. They either influenced it positively or negatively. The study found out that the intercept was 0.903 for all years. The three independent variables that were studied (micro-insurance premiums, micro-insurance claims and micro re-insurance cost) explain a substantial 70.6% of financial performance of insurance companies in Kenya as represented by adjusted R^2 (0.706). The study recommends that all insurers should find an area they excel and capitalize on it to get a competitive edge while trying to upgrade on the areas in which they are weak. The study also recommends that Insurers should invest in financial analysts to help them gauge when re-insurance costs work in or against their favour to increase their income. The study concludes that micro insurance has a significant effect on the financial performance of insurance companies in Kenya.

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LIST OF ABBREVIATIONS

AIG	-	American international group insurance
AKI	-	Association of Kenya Insurers
APA	-	Apollo and Pan African insurance company
BRITAM	-	British American Company
CIC	-	Co -operative Insurance Company
FDI	-	Foreign Direct Investment
GMM	-	Generalized Method of moments
(IAIS)	-	International Association of Insurance Supervisors
ICEA	-	Insurance Company of East Africa
(ICP's)	-	Insurance Core Principles
IRA	-	Insurance Regulatory Authority
KTDA	-	Kenya Tea Development Authority
MFI	-	Micro Finance Institution
MI	-	Micro-insurance
NHIF	-	National Hospital Insurance Fund
OECD	-	Organization for Economic Cooperation Development
Shs	-	Kenya Shillings
SMART	-	Simple, Measurable, Attainable, Reliable & Timely
TCHP	-	The community healthcare plan
UAP	-	Union and provincial insurance

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The principles of Micro insurance are not new. Risk pooling and risk transfer can be traced back to some of the precursors of insurance, such as the Roman burial guilds. The products are not new as small policies, such as industrial life, and mutual protection schemes were offered in the 19th and early 20th century. The mechanisms of Micro insurance were preceded by cooperatives and credit unions, some of which created their own insurance companies (Richard, 2011)

However, the term Micro insurance is new. It was developed as part of Microfinance in the 90's when MFIs started offering insurance products, primarily credit life .The Micro-insurance was initially constrained to providing credit life products that paid off the outstanding loan in the event of the death of the borrower. Credit life rapidly became commoditized with insurers and specialists intermediaries fighting for market share based on price. Premiums fell below sensitive levels and providers started to innovate the coverage to protect the price (Gerrit, 2014)

In the year 2004, work began to develop a new form of crop insurance product called Weather index. This was prompted by the struggles of the small hold farmers in accessing microfinance loans to purchase inputs such as improved seed and fertilizers. The theory was that if an insurance product was developed that covered the risk of drought and other climatic events, then the microfinance community would be willing to lend to those farmers who in turn bought better inputs and experienced higher yields (McKinsey, 2010)

Livestock insurance also emerged as an area of continued product innovation given the role of cattle as an informal savings mechanism for many rural communities. The innovation around these livestock products mostly focused on ways to reduce fraudulent claims with the invention of radio frequency identification chips which were inserted into the cow to make it harder for the farmer to remove the tag and make a claim if the animal is still actually alive. However, the cost of more secure tags has overweighed the reduction in premiums (Richard, 2011).

Coverage for the poor's dwelling microenterprise and belongings against damage from fire, theft and natural disaster was an add-on to enhanced credit life product. However the penetration has been low as most people do not own their dwelling places or land they are built on and even if they do, they lack formal documentation to prove their ownership.

Finally health insurance has received significant attention from the micro insurance industry .The poor demand health insurance because they know they will need to seek medical help on a regular basis. The volume of claims and potential fraud is significantly high due to the outpatient services that occur more frequently. The cost of administering out-patient treatments as a percentage of the cost of the treatment itself also makes insurance a flawed mechanism for outpatient care. A step to cab high claims ratio was realized by the establishment of Fund Management Policies. Corporate clients pay lump sums to the insurer to be utilized for a certain period of time by its individual members. The utilization is closely monitored to prevent its depletion and to keep member subscription running and valid (Anja, Doubell, Herman & Grieve, 2010).

1.1.1 Micro Insurance

Micro insurance is the protection of low-income people against specific perils in exchange for regular premium payment proportionate to the likelihood and cost of the risks involved. This definition is exactly the same as one might use for regular insurance except for the clearly prescribed target market: low-income people. The target population typically consists of persons ignored by mainstream commercial and social insurance schemes, as well as persons who have not previously had access to appropriate insurance products (Richard, 2011).

Micro insurance can also be said to be insurance with low premiums and low caps or coverage but run in accordance with generally accepted insurance practices which should include the ICP. Importantly this means that the risk insured under a micro insurance policy is managed based on insurance principles and funded by premiums. The micro insurance activity itself should therefore fall within the purview of the relevant domestic insurance regulator or supervisor or any other competent body under the national laws of any jurisdiction. This insurance operates by risk-pooling, is financed through regular premiums and is tailored to the poor who would otherwise not be able to take out insurance. Micro insurance, like regular insurance, may be offered for a wide variety of risks .Its production or contribution is measured by the amount of premium versus claims, reinsurance and administrative cost experiences (Gerrit, 2014).

1.1.3 Financial Performance of Insurance Firms

Financial performance is important to investors and management in determining the future success of a business. Jim (2007) mentioned that performance of financial institutions is measurable in several categories which include profit growth, employee

growth, asset growth or any other type of variable an investor or management thinks is an important indicator of future success to the company. However ,insurance firms measure performance according to the gross income, net premium written, claims incurred, net commissions, management expenses, underwriting results, investment income, operating profit or loss after taxation, asset investments and shareholders fund results.

According to the Kenya micro insurance policy frame paper (2012) ,the top five issues likely to have high impact on the micro-insurance business are; high transaction and administrative costs, moral hazard and adverse selection. Besides, lack of necessary capacity to develop MI products and lack of reliable IT solutions are a huge barrier to MI development.

1.1.3 Micro Insurance and Financial Performance of Insurance Companies

Peter (2014) asserted that micro insurance was directly related to the performance of insurance companies in terms of production and premium reporting. The separation of this class from the other businesses when reporting as required by the Kenya regulator was a mileage towards its recognition in the insurance books. This relationship is widely affected by the size of the firm, reinsurance dependence, availability of resources and supportive company policy structures .He observed that the larger the company, the stronger the polices fine-tuned towards MI development and the more the underwriting profits.

In the study done by Lucas (2014), he observed that good public relationship and intercompany relationship got a long way towards realizing high profits for the micro

insurance underwriters. This was because, the target population involved was very sensitive and required fast services during policy preparation and resolving of crisis .The good intercompany relationship was as important as many businesses trickled from the banking sector to the underwriter and this meant more profits for the underwriter in terms of premium intake from the banking sector.

A further analysis by Laura (2014) in her paper "Micro-insurance learning" observed that micro insurance production was largely affected by the human resource capacity. She asserted that the success of the product measured from the premiums and claims analysis was not conclusive enough in measuring the overall performance of the firm with lack of knowledgeable human capacity. It was evident that an investment in human resources boosted the overall premium of the product upgrading the overall net premiums of the company's cash flow statement.

Andrew (2012) viewed the claims and premiums relationship on the insurance company with regard to micro insurance and concluded that they had different roles. Customers would rather pay smaller monthly bills for the premiums while the insurer compensated the entire claim amount at once. This meant that few premiums received, were fully disbursed to claims regardless of full premium payment or not resulting to less profit for the firm in the long run. Under these conditions, the company had to get more resources from other activities to run the micro claim department successfully.

1.1.4 Insurance Companies in Kenya

According to the Association of insurance report (2012), insurance industry in Kenya consists of a number of players namely; insurance and reinsurance companies, intermediaries and other service providers.There were 47 licensed insurance

companies at the end of 2013. Twenty three companies wrote non- life insurance business only, nine wrote life insurance only while fifteen were composite. There were 169 licensed insurance brokers, 24 medical insurance providers and 4,803 insurance agents. Other licensed players include 3 reinsurance companies, 140 investigators, 91 motor assessors, 21 loss adjusters, 3 claims settling agents, 5 risk managers, 27 insurance surveyors and the regulatory bodies.The top ten general insurance providers were APA with a market share of 8.3 %, Jubilee at 7.9%, Kenindia at 7.7%, UAP at 6.8 %, AIG at 5.7%, Heritage at 4.8% and ICEA Lion group at 3.8 %.The micro insurance underwriters in the market are about ten with the likes of APA, Kenya orient, AAR, Jubilee, CIC, UAP and Britam just to mention a few. The market is also characterized by International health insurance providers namely;Bupa International,Aetna Global and Allianz**.**

The Insurance Act, Chapter (487) of the Laws of Kenya, has been an effective tool for regulating the insurance industry since its enactment in 1984.Recently the regulator introduced a draft bill that adopted the principles of corporate governance, in order to achieve separation of ownership and management for good corporate governance and development of the market .It stipulated that Life and general insurance businesses were not to be undertaken by the same company and Medical insurance providers were required to be registered as insurance companies or carry out business purely as intermediaries within the provisions of the law. Finally, all licensees were required to be members of the industry association AKI.

1.2 Research Problem

Study by Smith (2011) showed that two thirds of the population living in extreme poverty is classified as women often living on less than a dollar per day. This category is quite vulnerable to risks and without adequate mitigation measures the probability of lapsing into a vicious cycle of poverty is high. Micro-insurance as an area, is thought to make a profound impact on most of the population, an example being the Jamii Bora, a CIC product that enables a microcredit group with focus to offer health insurance for its members. Out of 300,000 members, at least 160,000 have bought the product and this means a general growth in the industry in terms of premium and insurance penetration level.

The need for enhanced access to insurance at affordable rates to the poor and low end market has been a major topic of discussion in our continent Africa. We know that the foundation of growth lies in the saving and spending by the common man, an opportunity that can be created by low prices on goods and a characteristic of MI products. Additionally, underwriting skills, regulation and reasonable pricings are foreseen to improve the penetration and profitability of insurance from its current rate considering the target market is extremely price and service sensitive.

It is also increasingly being recognized that the micro insurance agenda is inevitable as a form of financial inclusion and avenue for increasing insurance penetration. Majority of the insured Kenyans are drawn from the formal sector which accounts for about 5% of the total population. This means that most of the Kenyan population is in the informal sector that is not adequately provided for by the conventional insurance. The Insurance penetration in the market is specifically low with about 3% but with very high growth prospects expected in the long run.

Research has demonstrated a positive impact of insurance on the lives of the poor and, more broadly, in our communities. For instance, health insurance can reduce out-of-pocket expenditure and increase use of health services. Property insurance, on the other hand, allows entrepreneurs to take more risk and invest more in their businesses. Furthermore, various studies have demonstrated a causal link between the development of the insurance industry and national economic development by putting a price on risk and supporting entrepreneurship. Indeed, it is not possible to have meaningful social and economic development without micro-insurance.

This then leaves us with the questions of what future the product holds in the market with the already laid down polices. What happens when a poor family's breadwinner dies and a child in such a disadvantaged household is hospitalized? What happens to the home of a vulnerable family when destroyed by fire or natural disaster? Every serious illness, accident and natural disaster threatens the very existence of such a home leading them to deeper poverty. Besides, the more we patch up the loose ends in our company structures, the more we experience industrial growth. That is how MI adds value in our society.

1.3 Research Objective

The objective of this study was to establish the effect of micro insurance on the financial performance of insurance companies in Kenya.

1.4 Value of the Study

This study will give an insight on the market trends and micro insurance performance indicators. This will be an eye opener to the insurance players in the market as they will look out for proper innovations that steer them towards good performance.

Besides companies will be able to have a benchmark for measuring individual achievements.

To the government, it will provide proof on whether laws and guidelines are worth formulating for this class of business plus the hurdles it needs to scrap off for proper MI underwriting and growth. Finally, it will be a source of reference and reservoir of knowledge to scholars and other researchers when conducting their future research on the same topic.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter summarizes substantive findings which constitute the collection of interrelated concepts that guide this research, determining what measures to look out for and the statistical relationships of other authors works.

2.2Theoretical framework

2.2.1 Team Production Theory

Alchian, Armen, Demsetz andHarold (1972) in their analysis of the team production theory , argued that the firm emerged because extra output was provided by team production, but that the success of that depended on being able to manage the team so that metering problems and attendant shirking could be overcome, by estimating marginal productivity and observing or specifying input behavior. Such monitoring could only be encouraged effectively if the monitor was the recipient of the activity's residual income. They, argued that the firm was an entity which brought together a team which was more productive working together than at arm's length through the market, because of informational problems associated with monitoring of effort.

2.2.2 Organization Development Theory

An organization developmental theory developed by Larry (1994) was helpful when examining the problems associated with growth on organizations and the impact of change on employees. It argued that growing organizations moved through five

relatively calm periods of evolution, each of which ends with a period of crisis and revolution. Each evolutionary period was characterized by the dominant management style used to achieve growth, while each revolutionary period was characterized by the dominant management problem that must be solved before growth continues. They argued that growth involved five steps namely growth through direction, delegation, co-ordination and collaboration.

Greiner was not certain what the next revolution would be, but he anticipated that it would center on the 'psychological saturation' of employees who grew emotionally and physically exhausted by the intensity of teamwork and the heavy pressure for innovative solutions. He felt that to overcome and even avoid the various crises ,managers could attempt to move through the evolutionary periods more consistently with the sequencing-direction to coordination to collaboration to delegation-rather than the ordering depicted by Greiner.

2.2.3 The Knowledge-Based Theory

This theory of the firm considered knowledge as the most strategically significant resource of a firm. Its proponents argued that because knowledge-based resources were usually difficult to imitate and socially complex, heterogeneous knowledge bases and capabilities among firms were the major determinants of sustained competitive advantage and superior corporate performance. This knowledge is embedded and carried through multiple entities including organizational culture and identity, policies, routines, documents, systems, and employees. Originating from the strategic management literature, this perspective built upon and extended the resource-based view of the firm

2.3 Determinants of Performance of Insurance Companies

One of the determinants of performance of insurers is a rise in profit or interest rates .It produces greater returns on investment assets thus increasing the total company's returns, provided the returns are not counteracted by lower underwriting gains. According to D'Arcy (1979), high interest rates give rise to high investment earnings and consequently this enhances the investment performance of insurance companies. Bonds and fixed deposits are examples of investment portfolios which depend mostly on the levels of interest rates for returns on investment. According to Browne and Hoyt (1995), as interest earnings are a significant source of revenue for insurers, companies are more likely to perform well and remain solvent when interest earnings are high. Therefore, it is expected that performance is positively related to profit/interest rate levels

Investment in equity portfolio also provides insurance companies with a stream of dividend income. According to Browne, Carson &Hoyt (1999), as equity returns increase, returns on insurer's investment portfolio may also increase and this will improve the performance of the insurer. Booth, Cooper, Haberman &James (1999) are of the view that equities have the benefit of providing inflation hedge and over the long term, the investment would be expected to give higher real returns than fixed interest investments. However, a higher proportion of investment in equities may lead to a higher risk of insolvency if the values of the assets dropped. Thus, a positive relationship between performance and equity returns is expected.

There is a positive relationship between performance and the company size due to operating cost efficiencies through increasing output and economizing on unit of cost.

Large corporate size also enables insurers to effectively diversify their assumed risks and respond more quickly to changes in market conditions. Industrial organization economists such as Bain (1968) and Scherer (1980) argued that large firms possess monopoly power which allows them to set prices above the economic costs involved in the production of the products resulting in additional profit for the larger firms. In terms of investment performance, Adams (1996) believed that large companies were able to diversify their investment portfolios and this could reduce their business risks. Large companies generally out-perform smaller ones because they manage to utilize economies of scale and have the resources to attract and retain managerial talent. It is therefore expected that performance is positively related with size of company.

Another determinant is the Solvency margin .This is the amount of capital which acts as a cushion to absorb the risk of conducting insurance .The capital or surplus is measured as the excess of assets over obligations. Consequently, insurance companies with higher solvency margin are considered to be more financially sound as they have more surpluses to cater for any unexpected losses. In theory, prospective policyholders would prefer to buy policies from financially sound insurance companies. According to Butsic (1994), many policyholders especially business customers would normally research for the information on the financial soundness of their insurers. Shiu (2004) believed that insurance performance would improve through a higher solvency margin as better risks were attracted to the more stable insurers and this contributed towards higher premium revenues. Therefore, we expect that the relationship between performance and reinsurance dependence to be positive.

The stability of underwriting operation is another determinant. An increase in premium growth improves the financial performance of insurance companies as it provides inflows of income to the company. However, a remarkable increase in premium volume could indicate favorable business expansion and thus improve earnings, provided it is accompanied by adequate reserves, profitable operation and stable product mix. According to Shiu (2004), a dramatic change in underwriting performance could signal that the insurance company is facing financial difficulty as general insurers sometimes engage in cash-flow underwriting as a means to survive financial difficulties. Through this arrangement, the price of the insurance product will be discounted below its true value and the premiums generated from the sales will be invested in financial instruments that earn higher investment returns. Shiu (2004) is also of the view that an underwriting cycle can have impact on the stability of the underwriting operation of insurance companies. Accordingly, there is no prior expectation on the direction of the relationship between performance and stability of the underwriting operation

According to Shiu (2004), companies with more liquid assets are likely to perform better as they are able to realize cash at any point of time to meet its obligation and are less exposed to liquidity risks. Lack of sufficient cash or liquid assets may force insurance companies to sell investment securities at a substantial loss in order to settle claims promptly. However, there are contrasting views with regard to performance and liquidity in relation to the agency theory. According to Pottier (1998), high liquidity could increase agency costs for owners by providing managers with incentives to misuse excess cash-flows by investing in projects with negative net present values and engaging in excessive perquisite consumption. According to Adam

and Buckle (2003), liquidity measures the ability of managers in insurance and reinsurance companies to fulfill their immediate commitments to policyholders and other creditors without having to increase profit from underwriting and investment activities or liquidate financial assets. Therefore, having high liquidity obviates the need for the management of the insurance companies to improve their financial performance.

General insurance companies usually take out reinsurance cover to stabilize earnings, increase underwriting capacity and provide protection against catastrophic losses. This is called reinsurance dependence. Nevertheless, there is a cost for reinsurance. As a result, determining an appropriate retention level is important for insurance companies, and they have to strike a balance between decreasing insolvency risk and reducing potential profitability. Although it increases operational stability, increasing reinsurance dependence that is lowering the retention level, reduces the potential profitability. Therefore, it is expected that the relationship between performance and reinsurance dependence would be negative.

2.4 Empirical Studies

Liyan, Donghui, Farborz and Anhui (2010), attempted to study the relationship between insurance development and economic growth by employing GMM models on a dynamic panel data set of seventy seven economies**.** Insurance density was used to measure the development of insurance. Controlled by a simple conditioning information set and policy information set, they drew a conclusion that insurance development was positively correlated with economic growth**.** The sample was then divided into developed and developing economies. For the developing economies, the

overall insurance development, life and non-life insurance development played a much more important role than they did for the developed economies.

Donghui, Fariborz, Pascal and Timothy (2007) examined the determinants of life insurance consumption in OECD countries. Consistent with previous results, the study found a significant positive income elasticity of life insurance demand. Demand increased with the number of dependents and level of education, and decreased with life expectancy and social security expenditure. The country's level of financial development and its insurance market's degree of competition appeared to stimulate life insurance sales, whereas high inflation and real interest rates tended to decrease consumption. Conclusively, life insurance demand was better explained when the product market and socioeconomic factors were jointly considered depicting an income to those insurers.

Anja, Doubell & Herman (2012) spelt out the significance of micro insurance in the Kenyan market by stating the development and penetration rate of micro insurance to be 3% of the GDP while life insurance accounted for 1% .Out of 16 million insurable Kenyans 12 million were stated to be in the micro insurance sector. This signified the potential impact of the micro products in the development of insurance and its penetration within Kenya.

In the study "the theory of optimal life insurance", Peter (1972) discussed that rate discount, wages and the amount of wealth were determinants of the quantity of insurance life policies demanded. He mentioned that demand for life products was of special interest in the transmission of monetary policy especially the life insurance

policy on loans. A life insurance sale on the other hand was a link in the transmission of monetary policy to capital markets.

Olalekan and Taiwo (2013) analyzed the long and short run relationship between insurance development and economic growth in Nigeria over the period 1986 to 2010. Using error correction model, the study found that insurance development integrated with economic growth in Nigeria. That is, there was a long run relationship between insurance development and economic growth in Nigeria. The results also showed that physical capital and interest rate both at contemporary and one lagged value had significant positive effect on economic growth in Nigeria while physical capital and inflation had negative long run relationship with economic growth. The results of this study generally indicated the statistical significance contribution of insurance to economic growth in Nigeria.

Li, Moshirian and Sim (2003) studied the determinants of intra-industry trade in insurance services. They analyzed and measured the magnitude of intra industry trade in insurance services for the United States. The empirical results of the determinants indicated that foreign direct investment in insurance services was a significant contributor to the volume of trade in insurance services. Unlike the traditional trade theory that considered trade and foreign direct investment in insurance services as substitutes, trade and FDI complemented each other hence multinational insurance companies contribute to an increase in the volume of trade in insurance services. Furthermore, that study showed that trade intensity between the US and its trading partners led to product differentiation in insurance services and hence an increase in consumer welfare.

Grace and Lin (2007) examined the life cycle demand for different types of life insurance using the survey of consumer finances. The authors strived to test whether consumers' aversion to income volatility resulting from the death of a household's wage-earner affected their purchase of life insurance. They developed a financial vulnerability index to control the risk of the household, and examined the life cycle demand for several categories of life insurance. In contrast to previous researches, the authors found a relationship between financial vulnerability and the amount of term life or total life insurance purchased. In addition, they found that older consumers used less life insurance to protect a certain level of financial vulnerability than younger consumers.Besides,life insurance demand was a perfect contributor to the success of the insurance and the banking industry.

Cummins and Danzon (1997) developed a model of price determination in insurance markets. Insurance was provided by firms that were subject to default risk. Demand for insurance was inversely related to insurer default risk and was imperfectly price elastic because of information asymmetries and private information in insurance markets. The model predicted that the price of insurance, measured by the ratio of premiums to discounted losses, was inversely related to insurer default risk and that insurers had optimal capital structures. Price would increase or decrease following a loss shock that depleted the insurer's capital, depending on factors such as the effect of the shock on the price elasticity of demand. Empirical tests using firm-level data supported the hypothesis that the price of insurance was inversely related to insurer default risk and provided evidence that prices declined in response to the loss shocks of the mid-1980s. Prior research suggests that the occurrence of a catastrophe would

lead to increases in risk perception, risk mitigation, and insurance purchasing behavior.

The Kenya Micro-insurance policy framework paper (2012) also highlighted the emerging trends in Kenyan market in terms of product innovation and pricing. It spelt out the potential role, opportunities and challenges for the micro insurance development. The paper concluded that the Kenyan market has mainly focused on corporate and property markets despite majority of the working population being in the informal sector. However, with the premium collection adopting the use the likes of M-PESA, this is bound to change as it will contribute towards economic growth and overall industrial growth in the long run.

Nancy and Jose (2013) cited that micro insurance providers continued to struggle to stimulate and sustain demand for their products. This was due to the long-established and significant audience barriers to purchase including use of informal risk management mechanisms embedded in local cultures, lack of trust in providers, low financial and insurance literacy, concerns about the intangibility of benefits compared with costs of premiums, and a tendency not to appreciate the value of future benefits. The paper was intended to provide examples of good practice for developing promotional campaigns that would help overcome some of those barriers. It provided micro insurance providers and their distribution partners with a ten-step promotional planning model, outlined as follows; Providing background information ,Describing the current offer, establishing SMART goals for this promotional effort ,Selecting and describing the target audience for that promotional effort among others

2.5 Summary of Literature Review

It is evident that performance is pegged on various variables from the different works of the authors mentioned above. The purpose of this thesis was to look at the impact of micro insurance on the financial performance of insurance companies and determine if any correlation exist between the level of micro insurance production and the company's growth besides analyzing the products production rates in the individualized companies sampled. Additionally, this chapter appreciates the citations and efforts of different authors on aspects that affect performance figures amongst them are; the long term serving employees, skilled workers, team work and the surrounding environment in terms of rural or urban set-up.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

We noted in chapter one that this study sought to determine the effect of micro insurance on the financial performance of the insurance companies in Kenya. The objective of this chapter was therefore to adopt an appropriate analytical framework that helped address the above objective of the study. This chapter introduces the research methods, design, population, sampling and data collection methods to be used and finally the data analysis approach taken.

3.2 Research Design

This study research design was an analytical survey as well as correlation study which helped in establishing the associations between variables. These designs are preferred because they combine the use of qualitative and quantitative techniques on data and seek the opinion of a population about a specific subject matter which helps in crystallizing problems and identifying information needs for future research (Churchill and Iacobucci, 2002). The method is chosen since it is more precise and accurate since it involves description of events in a carefully planned way (Babbie, 2004).

3.3 Population

Population is defined as the entire group of individuals, events or objects having common characteristics that conform to a given specification (Mugenda & Mugenda, 2003).The targeted population comprised the 10 firms underwriting micro medical

and property businesses namely; AIG,APA,Britam,CIC,Heritage,ICEA,Jubilee,Kenya Orient,Kenindia and UAP since 2009. Since the population was not large, the study took a census approach.

3.4Data Collection

According to Flick (2009), data collection is the gathering of empirical evidence with the objective of gaining new insights about the situation and to answer the questions that initiated the research. The study used published secondary data on net profits of the target population for the period 2009 to 2013 that were readily available from the insurance industry annual reports and insurer's annual financial statements .Data collection forms were administered specifically to the Head of Department of either Underwriting or Finance Department in the insurance companies chosen to obtain the premiums, claims and reinsurance scores for the years 2009 to 2013 .

3.5 Data Analysis

The study used both descriptive and inferential statistics in analyzing the data. Analysis was done with the help of Statistical package for social sciences (SPSS version 21). First, data collected was cleaned, sorted and collated. Descriptive statistics were used to profile the characteristics of the data. The study used multiple linear regression equation and the method of estimation was Ordinary Least Squares (OLS) so as to establish the relationship between the micro insurance premium, claims, and reinsurance and profit variables. The findings were presented in form of frequency tables and graphs to aid in the analysis and ease with which the inferential statistics were drawn.

3.5.1 Analytical Model

The multiple linear regression equation used took into consideration three independent variables for the 10 companies from 2009 to 2013 period. It was presented as follows;

$$\mathbf{Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon}$$

Where;

Y = The performance of the insurance companies measured by the net profit for the last 5 years

$\boldsymbol{\beta_1, \beta_2, \beta_3}$ =Coefficients of determinations/The slope of the curve

$\boldsymbol{\beta_0}$ = Constant/Y intercept

X_1 = The micro insurance premiums of the 10 companies for the past 5 years

X_2 = The claims figures of the 10 companies for the past 5 years

X_3 = The micro-insurance cost of the 10 companies for the past 5 years

$\boldsymbol{\alpha}$ = The values of an unobserved error term.

3.5.2 Test for Significance

The coefficient of determination (R^2) was used to measure the extent to which the variation in performance is explained by the variations in micro insurance premiums. F-statistic will also be computed at 95% confidence level to test whether there is any significant relationship between micro-insurance and the financial performance.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents the information processed from the data collected during the study to establish the effect of micro insurance on financial performance of insurance companies in Kenya. The sample composed of 10 firms underwriting micro medical and property.

4.2 Descriptive statistics

Table 4.1: Summary of the study variables for the study period

	2009	2010	2011	2012	2013	Mean	Standard Deviation
Financial Performance	173065.5	330503.2	323760.2	527606.5	698695.8	410726.3	204370.3
Micro-insurance premiums	34711.36	60327.18	52810.91	97293	117078.2	72444.13	33785.02
Micro-insurance claims	8239.636	32737.36	11381.55	25124	32196.09	21935.73	11522.69
Micro-reinsurance cost	15345.6	29450.36	33015.5	43498.55	44509.1	33163.82	11904.02

Table 4.1 shows the trend of the various variable of the study for the study period. The findings depict that financial performance improved over the years with a mean score of 410726.3. It was also clear that the micro-insurance premiums steadily increased over the study period although the highest value was recorded in 2013

(117078.2). This is not the case for micro-insurance claims which recorded high values 2010 and had a mean of 21935.73. Micro re-insurance costfigures also rose steadily during the study period and had a mean of 33163.82.

4.3 Regression Results

The study conducted 2009 - 2013 and of financial performance. Coefficient of determination explains the extent to which changes in the dependent variable can be explained by the change in the independent variables or the percentage of variation in the dependent variable (financial performance) that is explained by all the three independent variables (micro-insurance premiums, micro-insurance claims and micro -reinsurance cost).

Table 4.2: Results of multiple regression between financial performance and the combined effect of the selected predictors

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.884	0.781	0.706	0.593

Source: Author (2014)

The three independent variables that were studied, explain 70.6% of the financial performance of insurance companies in Kenya as represented by the adjusted R^2. This therefore means the three variables contribute to 70.6% of financial performance of insurance companies in Kenya, while other factors not studied in this research contributes 29.4% of financial performance of insurance companies in Kenya.

Therefore, further research should be conducted to investigate the other (29.4%) factors influencing financial performance of insurance companies in Kenya.

Table 4.3: Summary of One-Way ANOVA results of the regression analysis between financial performance and predictor variables

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	5.352	3	2.065	8.563	0.0019
	Residual	16.89	6	0.421		
	Total	22.242	9			

Source: Author (2014)

From the ANOVA statistics in table 4.3, the processed data, which are the population parameters, had a significance level of 0.0019 which shows that the data is ideal for making a conclusion on the population's parameter. The F calculated at 5% Level of significance was 8.563. Since F calculated is greater than the F critical (value = 4.76), this shows that the overall model was significant i.e. there is a significant relationship between financial performance and micro insurance.

Table 4.4: Regression coefficients of the relationship between financial performance and the three predictive variables.

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	0.903	0.168		2.021	0.035
	Micro-insurance premiums	0.623	0.115	0.584	3.593	0.024
	Micro-insurance claims	-0.236	0.145	0.304	-1.872	0.031
	Micro-reinsurance cost	0.439	0.126	0.225	3.872	0.016
Dependent variable: Financial performance						

Source: Author (2014)

The coefficient of regression in table 4.4 above was used in coming up with the model below:

FP = 0.903+ 0.623MP - 0.236MC + 0.439 MI

Where FP is financial performance, MP is micro-insurance premiums, MC is micro-insurance claims and MI is micro-insurance cost. From the model, taking all factors (micro-insurance premiums, micro-insurance claims and micro re-insurance cost) constant at zero, financial performance of insurance companies in Kenya was 0.903.

The data findings analyzed also shows that taking all other independent variables at zero, a unit increase in micro-insurance premiums will lead to a 0.623 increase in financial performance of insurance companies in Kenya was 0.903; unit increase in micro-insurance claims will lead to a 0.236 decrease in financial performance of insurance companies in Kenya while a unit increase in micro re-insurance cost will lead to a 0.439 increase in financial performance of insurance companies in Kenya.

According to the model, all the variables were significant as their significance value was less than 0.05. However, micro-insurance premiums and micro-insurance cost were positively correlated with financial performance of insurance companies in Kenya. Besides, micro-insurance claims were negatively correlated with financial performance of insurance companies in Kenya.

4.5 Summary and Interpretation of Findings

From the above regression model, the study found out that there were micro insurance variables influencing the financial performance of insurance companies in Kenya, which are micro-insurance premiums, micro-insurance claims and micro -insurance cost. They either influenced it positively or negatively. The study found out that the intercept was 0.903 for all years.

The three independent variables that were studied (micro-insurance premiums, micro-insurance claims and micro re-insurance cost) explain a substantial 70.6% of financial performance of insurance companies in Kenya as represented by adjusted R^2 (0.706). This therefore means that the three independent variables contributes 70.6% of the of financial performance of insurance companies in Kenya while other factors and

random variations not studied in this research contributes a measly 29.4% of financial performance of insurance companies in Kenya.

The study established that the coefficient for micro-insurance premiums was 0.623, meaning that micro-insurance premiums positively and significantly influenced the financial performance of insurance companies in Kenya. This correlates with Laura (2014) who in her paper "Micro-insurance learning" observed that micro insurance production was largely affected by the human resource capacity. She asserted that the success of the product measured from the premiums and claims analysis was not conclusive enough in measuring the overall performance of the firm with lack of knowledgeable human capacity. It was evident that an investment in human resources boosted the overall premium of the product upgrading the overall net premiums of the company's cash flow statement.Gerrit (2014) argues that micro-insurance operates by risk-pooling, is financed through regular premiums and is tailored to the poor who would otherwise not be able to take out insurance. Risk pooling and targeting of the poor has a positive impact on the number of clients to the insurance companies thereby boosting the financial performance.

The study established that the coefficient for micro-insurance claims was -0.236, meaning that micro-insurance claims negatively but significantly influenced the financial performance of insurance companies in Kenya. This is in line with Andrew (2012) who viewed the claims and premiums relationship on the insurance company with regard to micro insurance and concluded that they had different roles. Customers would rather pay smaller monthly bills for the premiums while the insurer compensated the entire claim amount at once. This meant that the few premiums received, were fully disbursed to claims regardless of full premium payment or not resulting to less profit for the firm in the long run. Under these conditions, the

company had to get more resources from other activities to run the micro claim department successfully.Anja, Doubell, Herman & Grieve (2010) argue that the volume of claims and potential fraud is significantly high. As a consequence the insurance companies are forced to pay claims where the insured have not completed the whole amount of the product or service insured which has a significant negative effect on the profits of the companies.

The study further revealed that the coefficient for micro-reinsurance cost was 0.439, meaning that micro-reinsurance cost positively and significantly influenced the financial performance of insurance companies in Kenya. This concur with Shiu (2004) who believed that insurance performance would improve through a higher solvency margin as better risks were attracted to the more stable insurers and this contributed towards higher premium revenues. Therefore, we expect that the relationship between performance and reinsurance dependence to be positive. However this contradicts Buckle (2003) who argues that nevertheless, there is a cost for reinsurance. As a result, determining an appropriate retention level is important for insurance companies, and they have to strike a balance between decreasing insolvency risk and reducing potential profitability. Although it increases operational stability, increasing reinsurance dependence that is lowering the retention level, reduces the potential profitability. Therefore, it is expected that the relationship between performance and reinsurance dependence would be negative.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary of Findings

The principles of Micro insurance are not new. Risk pooling and risk transfer can be traced back to some of the precursors of insurance, such as the Roman burial guilds. The products are not new as small policies, such as industrial life, and mutual protection schemes were offered in the 19th and early 20th century. Micro insurance is the protection of low-income people against specific perils in exchange for regular premium payment proportionate to the likelihood and cost of the risks involved. The need for enhanced access to insurance at affordable rates to the poor and low end market has been a major topic of discussion in our continent Africa. The study sought to establish the effect of micro insurance on financial performance of insurance companies in Kenya. This study research design was an analytical survey as well as correlation study which helped in establishing the associations between variables. The targeted population comprised the 10 firms underwriting micro medical and property. The study used published secondary data on net profits, premiums, claims and reinsurance micro insurance for the period 2009 to 2013, which are readily available from the insurance industry annual reports, insurer's annual financial statements and journals from the Chartered Insurance Institute. The study used both descriptive and inferential statistics in analyzing the data. Analysis was done with the help of Statistical package for social sciences (SPSS version 21). The multiple linear regression equation used took into consideration three independent variables for the 10 companies from 2009 to 2013 period. From the regression model, the study found out that there were micro insurance variables influencing the financial performance of

insurance companies in Kenya, which are micro-insurance premiums, micro-insurance claims and micro -insurance cost. They either influenced it positively or negatively. The study found out that the intercept was 0.903 for all years. The three independent variables that were studied (micro-insurance premiums, micro-insurance claims and micro re-insurance cost) explain a substantial 70.6% of financial performance of insurance companies in Kenya as represented by adjusted R^2 (0.706). The study concludes that micro insurance has a significant effect on the financial performance of insurance companies in Kenya.

5.2 Conclusions

This study examined the relationship between micro insurance and on financial performance of insurance companies in Kenya. The three independent variables that were studied (micro-insurance premiums, micro-insurance claims and micro re-insurance cost) explain a substantial 70.6% of financial performance of insurance companies in Kenya as represented by adjusted R^2 (0.706). Therefore, this study, consistent with previous studies conjectures and concludes that micro-insurance affect the financial performance of insurance companies in Kenya.

Based on the findings, the study concludes that micro-insurance premiums positively and significantly influenced the financial performance of insurance companies in Kenya. This is in line with Laura (2014) who in her paper "Micro-insurance learning" observed that micro insurance production was largely affected by the human resource capacity. She asserted that the success of the product measured from the premiums and claims analysis was not conclusive enough in measuring the overall performance of the firm with lack of knowledgeable human capacity. It was evident that an

investment in human resources boosted the overall premium of the product upgrading the overall net premiums of the company's cash flow statement.

In addition the study also concluded that micro-insurance claims negatively but significantly influenced the financial performance of insurance companies in Kenya. This is in line with Andrew (2012) who viewed the claims and premiums relationship on the insurance company with regard to micro insurance and concluded that they had different roles. Customers would rather pay smaller monthly bills for the premiums while the insurer compensated the entire claim amount at once. This meant that the few premiums received, were fully disbursed to claims regardless of full premium payment or not resulting to less profit for the firm in the long run. Under these conditions, the company had to get more resources from other activities to run the micro claim department successfully. Anja, Doubell, Herman & Grieve (2010) argue that the volume of claims and potential fraud is significantly high. As a consequence the insurance companies are forced to pay claims where the insured have not completed the whole amount of the product or service insured which has a significant negative effect on the profits of the companies.

The study also concludes that micro-reinsurance cost positively and significantly influenced the financial performance of insurance companies in Kenya. This concur with Shiu (2004) who believed that insurance performance would improve through a higher solvency margin as better risks were attracted to the more stable insurers and this contributed towards higher premium revenues. Therefore, we expect that the relationship between performance and reinsurance dependence to be positive. However this contradicts Buckle (2003) who argues that nevertheless, there is a cost for reinsurance. As a result, determining an appropriate retention level is important for

insurance companies, and they have to strike a balance between decreasing insolvency risk and reducing potential profitability. Although it increases operational stability, increasing reinsurance dependence that is lowering the retention level, reduces the potential profitability. Therefore, it is expected that the relationship between performance and reinsurance dependence would be negative.

5.3 Recommendations

This study has important policy implications. Insurers should invest in financial analysts to help them gauge when re-insurance costs work in their favour in increasing their income. This would enhance their financial performance hence they would be able to settle all claims irrespective of the amount of risk involved.

The study also recommends that insurers without performance indicators should adopt some. This way, they would know when to invest or not and place them in a better financial position. Besides, appropriate systems should be instituted for policy administration. In the long run, technology is more cost-effective and reliable in tracking client information than manual entries.

The study further recommends that all insurers should find an area they excel and capitalize on to get a competitive edge while trying to upgrade on the areas in which they are weak. This may include maintaining good lines of communication with policyholders. Insight into the preference and concerns of existing policyholders will also help the insurer in designing appropriate products to manage policyholders' expectations besides maintaining the existing portfolio. It has been noted that the micro insurance target group has irregular and unpredictable cash flow. To minimize lapses and maximize renewals payment, timing is important and very crucial. There

should be a short interval for premium collection so the policyholder can pay affordable premiums on a regular basis.

The study finally recommends that insurers should work towards increasing their cash flow to avoid sale of investments when settling huge claims. This would make them financially healthier.

5.4 Recommendation for further studies

The researcher suggests that a similar study to assess the effects of micro-insurance on the financial performance of companies in other sectors should be conducted. A similar research can be undertaken on wider scale, for example covering all the insurance companies in East Africa to see whether there is a similarity in findings. The study targeted firms underwriting micro medical and property businesses, further studies should cover all the firms underwriting any micro services to have a more general conclusion.

5.5 Limitations of the Study

There were challenges which were encountered during the study. Some officers concerned with safe custody of files from the insurance companies were initially reluctant to release them. That reluctance delayed the completion of data collection and analysis of the scores.

There was also limited availability of local literature with respect to the relationship between micro-insurance and financial performance of insurance companies in Kenya which was overcome by consultation of foreign literatures and reference to other relevant locally published materials.

Further, the data was tedious to collect and compute as it was in its very raw form. Due to lack of standardization of financial statements from various insurance companies in Kenya, data computation was made even harder.

In addition, time and resources allocated to this study could not allow the study to be conducted as deeply as possible in terms of other predictor variables for financial performance of insurance companies in Kenya.

Finally, the study had a draw back from most insurance companies which lacked proper reports that showed records of the benefits directly accrued from the micro-insurance variables. This posed a challenge on data collection process especially with the recent introduction of micro insurance business in the industry.

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APPENDICES

Appendix 1: Data Collection Form

Dear Sir/ Madam,

Thank you for accepting to fill this form. The main aim of this study is to establish the effect of micro insurance in the performance of insurance companies in Kenya.

The information given by you will be treated in confidence and will be used for academic purposes only.

COMPANY NAME……..

YEAR	MICRO INSURANCE PREMIUMS	MICRO INSURANCE CLAIMS	REINSURANCE COSTS	PROFITS OFTHE COMPANY
2009				
2010				
2011				
2012				
2013				
AVERAGE RESULTS				

Signedby…….

Date…….. Stamp of company…….

Thank you for your time and cooperation

Appendix II: List of Insurance Companies Underwriting Micro Insurance

1. APA INSURANCE COMPANY LIMITED
2. BRITISH AMERICAN INSURANCE COMPANY (K) LIMITED
3. CIC INSURANCE GROUP LIMITED
4. FIRST ASSURANCE COMPANY LIMITED
5. INSURANCE COMPANY OF EAST AFRICA COMPANY LIMITED
6. KENYA ORIENT INSURANCE LIMITED
7. KENINDIA INSURANCE COMPANY LTD
8. HERITAGE INSURANCE COMPANY LIMITED
9. THE JUBILEE INSURANCE COMPANY LIMITED
10. UAP INSURANCE COMPANY LIMITED