THE RELATIONSHIP BETWEEN INVESTMENT AND FINANCIAL PERFORMANCE OF INSURANCE COMPANIES IN KENYA

BY

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D61/68114/2013

A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE AWARD OF MASTER OF BUSINESS ADMINISTRATION DEGREE, SCHOOL OF BUSINESS

UNIVERSITY OF NAIROBI

2015
DECLARATION
This research project is my original work and has not been submitted to any other university for award of a degree.

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This research project was submitted for examination with my authority as the university supervisor

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DEDICATION

Specially dedicated to my brother Wahome Njiiri, I couldn’t have done it without you.
Thank you for urging me on.
ACKNOWLEDGEMENT

My sincere gratitude to Professor Josiah Aduda, he has been the ideal project supervisor. His sage advice, insightful criticisms, and patient encouragement aided the writing of this project in innumerable ways.

I would also like to extend my deepest gratitude to Mr. Julius Irungu, whose steadfast support of this project was greatly needed and deeply appreciated.
# LIST OF ABBREVIATIONS

<table>
<thead>
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<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>AKI</td>
<td>Association of Kenya Insurers</td>
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<tr>
<td>IRA</td>
<td>Insurance Regulatory Authority</td>
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<tr>
<td>OECD</td>
<td>Organization for Economic Cooperation and Development</td>
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<tr>
<td>ROA</td>
<td>Return on Assets</td>
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<td>ROE</td>
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ABSTRACT

The purpose of this study was to establish the relationship between investment and financial performance of insurance companies in Kenya. The study took the form of a descriptive study with a target population of 45 insurance companies in Kenya. All the 45 insurance companies were involved in the study. Secondary data was successfully collected from 32 insurance firms. Multivariate regression analysis and correlation analysis were carried out to establish the nature of the relationship between investment and financial performance. The study established insurance companies in Kenya invest their funds in three popular areas. These include investments in real estate that holds the largest funds in terms of investments; investments in deposits with other financial institutions where the firms hold certificates of deposits and investment in Government securities. These investments in real estate, certificates of deposit, Government securities, corporate bonds and stocks have a significant impact on the financial performance of the insurance companies since they explain more than 50% of the variance in financial performance. There however other factors those are outside this study that account for the remaining 47.6% of the remaining variance on the financial performance of the insurance companies.
CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Most institutional investors around the globe such as insurance companies invest the money they receive in various sectors in order to receive returns. The most common investment opportunities that are pursued by most of these institutions world over include investment in real estate, equities, treasury bills and bonds, deposits with banks, and certificates of deposits. For instance in the year 2012 alone, most institutional investors invested more than 80% of their portfolio in bonds and equities. However, there seems to be a trend where most organizations are now moving away from bills and bonds and investing in other assets such as real estate. The income earned by the institutions from these investments is largely positive in many countries despite the economic pressures that lead to economic instability in some countries (OECD, 2013).

The global insurance industry has suffered a number of incidents since the year 2010 that have led to its dismal performance. Some insurers in specific countries have been affected by natural catastrophes that have forced them to make huge payments in terms of compensation. There is also evidence of sluggish demand for insurance products due to several factors such as the low yields that are provided by insurers to those who invest in insurance products; stiff competition from commercial banks in search of sources of funding as well as the desire among individuals to maintain some level of liquidity to cushion them from adverse economic conditions. Insurers’ investment portfolios are also characterized by high levels of debt thus making it difficult for them to earn any reasonable income (Barsuto, Romero& Idris, 2012).
GI TAU (2013) also asserts that the uptake of insurance products has been very low both in the international and Kenyan aspects. This is an indication that few people seek for insurance products and this trend seems to worsen as time goes by. For instance life insurance premiums have been on the decrease globally with non-life insurance premiums registering slight improvement. These developments are associated with difficult economic times that have hit most countries around the globe since the global financial meltdown of the year 2008. The general trend in the global insurance sector indicates that the growth is not very promising and that uptake of insurance products is very poor.

1.1.1 Investments

In the financial sense investment is the commitment of a person’s fund to derive future income in the form of income, dividend premium, pension benefit, or appreciation, in the value of their capital. Examples include purchasing of shares, debentures, post office saving certificates, insurance policies are all investments in the financial sense such investment generates financial assets. Investment in the economic sense means the net addition to the economy’s capital stock which consists of goods and services, that are used in the production of other goods and services. Examples include new constructions of plants and machines and inventories (Weebly, 2013).

Insurance companies depend on insurance premiums to raise money for their investments. However, it can be noted that most insurers across the globe have been faced with decreasing insurance premiums and this largely affects the level of income they earn since the investments are limited to the amount of money available.
Some of the factors that have contributed to the worsening of this situation include high rate of unemployment; slow economic growth; lower income as a result of the financial crisis and increased competition for non-life business are recurring explanations. Slow growth and high unemployment, constrained demand for workers’ compensation insurance, which can represent a substantial part of the non-life market. Strong competition in motor insurance put downward pressure on premium growth in some countries (OECD, 2013).

According Harvey (2012) there are different types of investments that can be made by firms. Both individuals and companies can have investments. This may include stocks, mutual fund distributions, investment in Government securities, interest-bearing bank accounts, bonds, and other debt instruments. A firm may also opt to invest in rental property or real estate or other assets owned for investment purposes.

1.1.2 Financial Performance

Financial performance is one of the oldest measures of organizational performance that have been used for several centuries around the globe. This traditional approach to organizational performance is however being replaced with other performance measurement tools such as the balanced scorecard. Financial performance refers to the processes of using various financial instruments to measure the performance or profitability of the organization. Financial performance is therefore, more interested in the profitability of the firm than any other aspect (CAPI, 2009). In order to effectively measure the financial performance of an organization, proper bookkeeping is important since it determines the quality of financial statements that can be obtained.
Measuring financial performance of an organization is very important since it determines whether the organization has been able to achieve its financial objectives or not. There are a variety of measures that organizations can use or adopt in measuring their financial performance. One such category of measures is the liquidity measures that determine the ability of the business to meet its financial obligations without disrupting any of its activities. These measures usually rely on the relationship between assets and liabilities of the organization. The other type of measures are solvency measures which determine the amount of borrowed capital used by the business relative the amount of owner’s equity capital invested in the business (Ismailia, 2011). Solvency measures provide an indication of the business’ ability to repay all indebtedness if all of the assets were sold. Financial performance can also be measured using profitability measures such as Return on Assets (ROA) and Return on Equity (ROE). The profitability measures are important in measuring the extent to which a business can be able to generate profits from the factors of production (Crane, n.d).

1.1.3 Investment and Financial Performance

Investment plays a very significant role in the financial performance of an organization. Organizations invest their resources in order to earn returns that will enable them enhance their financial performance. The is a position that has been confirmed by Loof and Heshmat (2008) who assert that there is a positive relationship between investment and the level of financial performance achieved by an organization. However, they argue that the effect of investment on the financial performance of a firm may not be long-lasting but a temporary position that may last for some short time.
Young and Rice (2003) also reveal that investment both interest and non interest investment compliments each other in improving the financial performance of an organization. Lantz and Sahut (2005) however, indicate that investments should also be viewed from the perspective of research and development. They argue that any many that a firm spends on research and development has the potential of improving the investments as well as the financial performance of the firm. They argue that expenditure on research and development increases the future earnings of a firm.

1.1.4 Insurance Companies in Kenya

The Insurance industry in Kenya has 45 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; 11 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. In addition to the above there exists also 161 licensed insurance brokers, 24 Medical Insurance Providers (MIPs), 3931 insurance agents, 2 locally incorporated re-insurers. There are also 21 loss adjusters, 2 claims settling agents, 193 loss assessors/investigators, 26 insurance surveyors, and 8 risk managers (Kiragu, 2014).

According to the Association of Kenya Insurers (2011) the number of insurance companies in Kenya has rapidly grown from 15 in the year 1978 to 45 currently. This was made possible due to springing up of a number of companies in the 1980s and 1990s due to liberalization of the economy. The collapse of the giant state owned Kenya
National Assurance in 1996 also served to intensify competition in the industry. In the year 2003 and 2005 leading medical insurers Mediplus and were wound up and the industry suffered a setback as a result. In Kenya, it is evident that insurance customers are concentrated in the major towns and the products have remained very traditional over time. This implies that the increase in the number of companies, forty five (45) in number as at the end of 2011, offering Insurance services has increased at a greater pace than the number of customers seeking the service leading to severe competition (AKI report 2011).

The report on the financial position of the insurance industry reveals that gross written premium from non-life insurance was ksh. 60.67 billion, while that from life insurance business was ksh.30.93 billion representing 15.86% growth compared to 2010. Following the opening up of the Uganda and Tanzania Insurance markets and increased emphasis on globalization and regionalization, the industry now faces greater competition from its neighbors. With the growth on the number of providers, it would be expected that the Insurance penetration would have been enhanced. Insurance penetration is calculated as the ratio of percentage of total insurance premiums to the gross domestic product. Unfortunately, this has not been the case with Insurance penetration at 3.02% (AKI report, 2011).

1.2 Research Problem

There seems to be a number of challenges facing the global insurance industry such as increasing levels of unemployment and sluggish economic growth and they negatively impact on the growth of the industry. These challenges impact negatively on the
investments made by insurance companies and this also has effects on the financial performance of the insurers. People are also reducing the amount of money saved and invested in insurance products due to worsening economic times that force them to retain money for transactionary motives (Barsuto, Romero and Idris, 2012). This situation therefore raises issues on the relationship that exists between investment and the financial performance of insurance firms in Kenya.

In Kenya, there is evidence that the number of insurance companies has grown from 15 in 1978 to the current 45 despite the low rate of insurance uptake in the country. A number of insurance companies have either been wound up in the past or placed under statutory management. A research conducted by Gitau (2013) on the strategies adopted by Insurance companies in Kenya to alleviate slow penetration of insurance reveals that lack of knowledge and awareness by the general public about Insurance products and the benefits, negative perception, cultural and religious beliefs like merry go rounds and harambee mentality, inappropriate products, limited distribution channels are some of the factors behind low penetration of insurance in Kenya. Kiragu (2014) also carried out a study on the challenges facing insurance companies in Kenya in building competitive advantage. The findings revealed that Government regulation is the greatest challenge faced by the companies. Mose and Kuloba (2013) carried out a survey of the insurance industry in Kenya. The study reveals that there is high optimism that the insurance industry in Kenya is growing.

Kanyi (2013) carried out a study on the relationship between performance of insurance companies and unclaimed benefits regulation in Kenya. The study established that there
was a direct relationship between the two. It however did not dwell on investment income.

There is evidence of research on the insurance industry in Kenya but none focuses on the relationship that exists between investment and the financial performance of the insurance companies.

It is also clear that there is slow penetration of insurance in Kenya and this begs the question on whether the relationship between investment and the financial performance of insurance companies is of causality or correlation. This reveals that a research gap existed that enabled the researcher to seek answers to the question; what is the relationship between investment and financial performance of insurance companies in Kenya?

1.3 Research Objective

To determine the relationship between investment and financial performance of insurance companies in Kenya.

1.4 Value of the Study

The findings from this study will assist in providing more knowledge on the theoretical relationship that exists between investment and the financial performance of insurance companies. This is an area that does not have adequate research activity and the findings will be significant in providing knowledge on a topic that has scanty literature especially in the Kenyan context.
The policy makers both in the Government and the insurance industry will also be able to understand the relationship between investment and the financial performance of the insurance companies. This will enable them to develop appropriate investment policies that will assist in improving earnings from investment and also in enhancing the financial performance of the companies.

The findings from the study will also be beneficial to the management of insurance companies in Kenya. It will assist them to have a clear understanding on the relationship between investment and the financial performance of their firms. This will motivate them to make prudent investment decisions and decisions to help in improving their financial performance.

Scholars will be able to use this study as a basis for further research.
CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter presents a review of past studies that have been conducted on investment and financial performance of insurance companies. The main areas of focus in this chapter includes the theories that are related to investment and financial performance; a review of empirical studies that have been carried out; a detailed review of literature on investment; determinants of financial performance in insurance companies; review of literature on financial performance and a summary of the entire chapter.

2.2 Review of Theories

This section presents a review of the guiding theories on the relationship between investment and the financial performance of insurance companies. The study focuses on three theories that have relevance. These theories include the resource dependency theory, the agency theory and the accelerator theory of investment.

2.2.1 Resource Dependency Theory

This theory was developed by Pfeffer and Salancik (1978). The theory is based on the assumption that environments are the source of scarce resources and organizations are dependent on these finite resources for survival. A lack of control over these resources thus acts to create uncertainty for firms operating in that environment. Organizations must develop ways to exploit these resources, which are also being sought by other firms, in order to ensure their own survival. Pfeffer and Salancik (1978) established factors that have significant influence on the level of dependence an organization has on particular
resources. The first factor relates to overall importance of the resource to the firm; second is the scarcity of the resource. The scarcer a resource is the more dependent the firm becomes. Finally, another factor influencing resource dependence is the competition between organizations for control of that resource. Together, all three of these factors act to influence the level of dependence that an organization has for a particular resource. Resource dependence theory also infers that a firm’s strategic options are determined to a great extent by the environment. Since firms are dependent on the environment for resources, they need to enact strategies that would allow them to acquire these resources. Therefore, the external environment has already been determined for these firms, and they experience little strategic choice (Pfeffer and Salancik, 1978).

The proponents of the resource dependency theory believe that the environment is the source of scarce resources that are critical to a firm’s survival. It is the lack of control over these critical resources, rather than a lack of information, that gives rise to environmental uncertainty. Environments that contain high levels of resources are perceived as less hostile to the stability of organizations, whereas those with low levels of resources act to increase the intensity of competition among firms. Consequently, the proponents of this theory further argue that in order to reduce the impact of this environmental uncertainty on organizational performance, it is necessary for organizations to develop and sustain effective relationships with their external environment (El-Nadi, 2013). The implication of the resource dependency theory on financial performance of insurance companies is that investments are equated to resources which the companies depend on. The investment opportunities are available in the business environment within which insurance companies operate. Investments are
therefore considered resources that the companies depend on as far as their financial performance is concerned.

2.2.2 The Agency Theory

Jensen and Meckling (1976) were the first people to suggest the agency theory in a theory of the firm based upon conflicts of interest between various parties such as shareholders, corporate managers and debtors. However since then, the finance theory has developed both theoretically and empirically to allow a fuller investigation of the problems caused by divergences of interest between shareholders and corporate managers. The Agency theory indicates that agency problems arise because of the impossibility of perfectly contracting for every possible action of an agent whose decisions affect both his own welfare and the welfare of the principal, Brennan (1995b). The main challenge that arises from the agency conflict is how to induce the agent to act in the best interests of the principal.

Jensen and Meckling (1976) further argue that in the modern corporation, in which share ownership is widely held, managerial actions depart from those required to maximize shareholder returns. In agency theory terms, the owners are principals and the managers are agents and there is an agency loss which is the extent to which returns to the residual claimants, the owners, and fall below what they would be if the principals, the owners, exercised direct control of the corporation. The theory specifies mechanisms which reduce agency loss. These include incentive schemes for managers which reward them financially for maximizing shareholder interests. Such schemes typically include plans whereby senior executives obtain shares, perhaps at a reduced price, thus aligning financial interests of executives with those of shareholders (Jensen and Meckling 1976).
According to McColgan (2001) the scope of each type of agency conflict will differ from one firm to another, as will the effectiveness of governance mechanisms in reducing them.

Each type of governance mechanism can be important in reducing the agency costs of the separation of ownership and control. What is required is a more detailed understanding of what makes these mechanisms important for some firms and ineffective for others. Managerial awareness of the threat of takeover perhaps leads to entrenchment at lower levels, as does the potentially ineffective market for corporate control in disciplining management. McColgan (2001) further argues that despite its faults, with respect to agency conflicts, the modern corporation appears to be the most popular form of corporate organization. Perhaps this can largely be attributable to the evolution of governance mechanisms designed to limit the scope of these problems. Pension schemes may be considered as agents of the members. They are entrusted with money that belongs to the members for them to manage on their behalf. This theory implies that the pension schemes are only agents who need to act for the benefit of the owners who are the contributors to the pension schemes. The pension schemes may have other divergent interests to pursue but the main purpose of their existence is to create value for the contributors. The contributors have a right to decide how their savings into pension schemes are invested and accessed including early access.

2.2.3 Slack Resources Theory

The Slack Resources theory was first published by March and Simon (1958). This theory equates an organization to a living organism that struggles to survive amid turbulence
from the environment within which it operates. According to Bourgeois (1981), slack is a cushion of actual or potential resources which allow an organization to adapt successfully to internal pressures for adjustment or to external pressures for change in policy, as well as to initiate changes in strategy with respect to the external environment. The theory suggests that slack performs four main functions in an organization. The first function of slack is acts as an inducement to members. The second function of slack is to act as a resource for conflict resolution. The third is function of slack is to act as an insulation to protect the organization from environmental turbulence. Finally, slack can be a facilitator of strategic behavior, which allows the firm to experiment with new strategies such as introducing new products and entering new markets (Tan and Peng, 2003).

However some critics of the slack resources theory argue that slack resources are an additional cost to an organization hence an excessive level of slack cannot be tenable by any organization. According to Shaffman et al, (1988) organizational slack can be split into absorbed and unabsorbed slack. The latter refers to resources that are currently not committed to any activity hence can easily be redeployed to another activity depending on the environmental requirements. This gives the management greater discretion on how to commit the resources and it can impact on the performance of an organization. The absorbed slack refers to excess costs in the organization and these are usually very difficult to redeploy (Tan and Peng, 2003).
2.3 Determinants of Financial Performance in Insurance Companies

There are several factors that determine the financial performance of insurance companies. These factors largely fall into two main categories. The first category of determinants relates to internal factors whereas the second category relates to factors that originate from outside the organization (Mwangi and Murigu, 2015). One of the internal determinants of financial performance of insurance companies is the leverage of the firm. This is normally a ratio that reveals how an insurance company is able to manage borrowed funds in the generation of its own wealth. It also reveals how the insurance firm manages its economic exposure in order to overcome losses that are unexpected (Adams and Buckle, 2000).

The performance of an insurance company can also be determined by the size of the firm itself. The size of the insurance firm has a very significant relationship with the efficiency of its operations. A large insurance firm has enough resources that can enable it to exploit the economies of scale and scope thus providing it with the ability to significantly reduce its operating costs and enhance its performance. However, this may not be the case with small firms that must struggle to gather enough resources. For insurance firms, the size can be equated to the net premium that is earned after deductions such as reinsurance. The amount of premium earned by an insurance company largely determines the fraction of policy liabilities the firm can be able to handle (Teece, 2009).

Shiu (2004) argues that the age of an insurance company is also a very important determinant of its financial performance. Older firms, by the fact that they have been in operation for a longer time have learnt various business tricks and have enormous
experience that can enable them to overcome business challenges that are presented by the dynamic environment. However, on the other hand the age of a firm may also work to its detriment especially in cases where older firms are rigid to change. When it comes to adoption of changes in the market there is evidence of an inverse relationship between the age of a firm and its financial performance (Shiu, 2004).

There are other factors that also determine the financial performance of insurance companies. They include the underwriting risk (Adams and Buckle, 2000); the equity that is controlled by the firm which is actually the amount of funds raised by the owners of the insurance company (Mwangi and Murigu, 2015); the level liquidity of the insurance company which reflects the firm’s ability to meet its short term credit repayments (Mwangi and Murigu, 2015) as well as the ownership structure of the insurance firm. The ownership structure determines the type of decisions to be made in the running of the insurance firm which in turn determine its financial performance (Agiobenebo and Ezirim, 2002).

2.4 Review of Empirical Literature

Loof and Heshmat (2008) conducted a study on investment and performance of firms. Their main objective was to establish whether the relationship that exists between the two variables is that of correlation or causality. The performance variables for the study included sales, value added, profit, cash flow, capital structure and employment. The investment variables were research and development and physical capital. The researchers adopted a multivariate vector autoregressive approach to a panel of Swedish firms observed between 1992 and 2000. The study findings revealed that there exists a
two-way causal relationship mainly temporary in nature. It was further established from the study that some heterogeneity in the firms’ investment and performance behavior by their size existed.

Havemann and Webster (1999) also carried out a study on whether ethical investment pays. The study sought to establish the relationship that exists between ethical investment and financial performance of an organization. The study was based on the premise that there are wide ranges of ways in which ethical or unethical behavior could influence a company's commercial success and its share price, and the use of ethical criteria in the selection of a portfolio of shares could also have a variety of positive or negative effects upon investment performance. The findings from the study reveal that in practice ethical news of one sort or another can influence a company's share price for good or ill. Effects between 0.5% and 3% of share price have been identified in a variety of studies. Such effects are obviously significant for the managers of the company concerned, although it should be noted that from the perspective of portfolio managers such individual stock price movements would not move many portfolios significantly up or down the performance ranking tables on their own.

The USSIF (2013) also conducted a study on the impact of sustainable and responsible investment. The main objective of the study was to determine the role of sustainable investment in enhancing the financial performance of an organization. The study was based on the argument that Sustainable and responsible investors have been, and continue to be, a force for positive change. They have helped to improve the environmental, social and governance (ESG) practices of companies in the United States and around the world,
indirectly benefiting countless individuals and communities. They have pursued investment strategies that foster economic development and expand financial services in lower-income communities. To advance their principles and priorities on a larger scale, sustainable investors have advocated for national and global policies and created national and international standard-setting organizations. The study concluded that responsible investment has contributed to the creation of intermediaries to finance community initiatives and has helped build wealth in underserved communities worldwide.

A study was also carried out by Taiana (2012) on extra-financial performance in socially responsible investment. The study focused on 76 large global equity funds in Switzerland. The results from the study confirm that demonstrate the importance of accurate sector and company analysis during the construction and management of the fund. The analysis of the fund’s holdings shows a big overlap between securities listed in SRI and non-SRI funds. This is evidence of the wide-scale application of the best-in-class approach to company selection in fund construction practice. As a result, the comparison of SRI versus non-SRI funds is difficult and mostly inconclusive.

Lareefi and Gretha (2008) carried out a study on the financial performance of solidarity funds. The study involved solidarity finance which covers the 90/10 funds, where 10% of resources are invested in Government -recognized solidarity companies, and revenue sharing funds, where holders accept that all or part of their remuneration is given to an organization with a social or humanitarian purpose. The results from the study reveal that while solidarity investment funds offer financial performance that is lower than market indices, there is no econometric evidence of these solidarity funds under-performing,
particularly with shared revenue funds, compared with traditional ethical funds. While the holders of shared revenue fund titles accept a lower rate of return individually, the managers of these funds can hope for the same performance objectives as conventional fund managers.

Another study was conducted by Ismail (2013) on the determinants of financial performance of Takaful and Insurance Companies in Malaysia. The study utilized the economics paradigm in analyzing performance and not behavioural paradigm. The study of the financial performance of the Takaful and insurance companies was particularly significant in view of the financial landscape that is becoming increasingly challenging. The growing number of insurance companies’ failures in recent years has caused further concerns on the financial stability of the takaful and insurance industries to stakeholders. The findings indicate that company’s size, takaful dependence and solvency margin are statistically significant determinants of the financial performance of the general takaful companies in Malaysia. For Malaysian general insurers, all factors are statistically significant determinants of financial performance, except for equity returns. As these factors are important in determining the Malaysian general takaful and insurance companies’ financial performance, it should be capitalized to further improve and sustain the financial performance.

Schich (2009) also carried out a study on insurance companies and the financial crisis. The study sought to establish how the 2008 banking crisis that originated from the United States of America affected the financial performance of the insurance companies. The results from the study confirmed that insurance companies were affected, and in mostly
adverse ways. For many insurers, direct exposure to the centre of the crisis, the US mortgage market, and to related securities appears to have been limited. But the financial crisis has nonetheless had an increasingly visible impact on the insurance industry, primarily through their investment portfolios, as the crisis spread and financial market valuations and the outlook for real activity deteriorated significantly. The results further indicated that a number of concentrated exposures to credit and market risks exist, including in US mortgage and financial guarantee insurance companies, as well as in parts of certain other insurance-dominated financial groups. Thus, while insurers as a group may have cushioned rather than amplified the downward pressures during the financial crisis, some clearly have added to downward pressures. Financial instruments that were at the core of difficulties served an insurance function and, thus, it is not so surprising that some institutions from that sector have been affected by the crisis on one or the other side of their balance sheets.

Murungi (2013) also carried out a study on the relationship between macroeconomic variables and financial performance of insurance companies in Kenya. The financial performance of insurance companies was measured by Return on Assets computed from the financial statements of the firms. The other macroeconomic variables were obtained from the figures available from the Central Bank of Kenya. The study took the form of a descriptive research design with a target population of 46 insurance companies that were registered by the Association of Kenya Insurers in the year 2013. The findings reveal that interest rate, gross domestic product, claim ratio and expense ratio were statistically significant in influencing financial performance of insurance companies.
Maina (2003) carried out a study on the risk and Return of investments held by insurance companies in Kenya. The study aimed to achieve two objectives: to establish whether there were differences in returns among companies from investment in similar assets and to establish whether there existed a correlation between risk and return. The study took a sample of 10 insurance companies and their secondary data between 1997 and 2001 was collected and analyzed. The findings revealed that insurance companies in Kenya invested in five main assets: Government securities, secured loans, ordinary share, bank deposits and real estate. The relationship between risk and return was only found in secured loans.

2.5 Chapter Summary and Research Gaps

This chapter has focused on literature review related to investment and the financial performance of insurance companies. The study identifies three theories namely the Resource dependency theory; the Agency theory and Slack resources theory as guiding theories. Literatures on empirical studies that have been carried out previously have also been reviewed. The chapter has also reviewed literature on investment and financial performance. The literature reveals that there are a number of studies that have been conducted on insurance companies in Kenya. Most of the studies have focused on a number of issues such as macroeconomic variables and financial performance Murungi (2013) and risk and return Maina (2003). However, these studies have not focused on investment and financial performance of the insurance companies. This therefore leaves a research gap that needs to be filled.
CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter discusses the methodology that was adopted by the researcher studying the relationship between investment and the financial performance of insurance companies in Kenya. The methodology includes the research design, data collection methods which include the data collection instruments used and the way they were structured, and data analysis techniques that were employed in analyzing the quantitative data that was collected. It also provides information on how the findings were presented.

3.2 Research Design

The study adopted a descriptive research design. Rick (2014) asserts that descriptive research gathers quantifiable information that can be used for statistical inference on the target audience through data analysis. As a consequence this type of research takes the form of closed-ended questions, which limits its ability to provide unique insights. This research design was appropriate for this study since it focused on the financial performance of insurance companies in relation to investment over a duration of time.

3.3 Target Population

According to OECD (2013) target population refers to the set of elements about which information is wanted and estimates are required. Practical considerations may dictate that some units are excluded such as institutionalized individuals, the homeless, or those that are not possible to access without incurring excessive cost. The target population of this study included all the insurance companies in Kenya. According to the Association
of Kenya Insurers (AKI) there are a total of 45 insurance companies in Kenya. The 45 insurance companies formed the target population of the study.

3.4 Sample Size and Sampling Techniques

The study involved a causality relationship where several independent variables associated with investment are perceived to have an effect financial performance of insurance firms in Kenya. In this case therefore the study involved corporate insurance companies from both life and general insurance sectors. According to Association of Kenya Insurers (AKI) there were 23 life insurance companies that were operating in Kenya and 22 General Insurance companies. Since the study made use of secondary data, the sample involved all the 45 insurance companies. The main reason of involving all the 45 insurance companies was because the number was not huge and the data required could easily be obtained from audited financial statements.

3.5 Data Collection

This researcher made use of secondary data that was in quantitative form. The data was in form of figures. The secondary data was obtained from published annual financial statements of insurance companies. The data collected was for five years from 2010 to 2014. The data collected related to five variables: investments on real estate, investments in Government securities, investments in certificates of deposits, investments in stocks and investments in corporate bonds. An appropriate data collection schedule was developed to assist in data collection.
3.6 Data Analysis

The data collected was subjected to multivariate regression analysis to establish the relationship between investments and the financial performance of the life insurance companies in Kenya. A regression model in the form of $Y = a + b_1x_1 + b_2x_2 + b_3x_3 + b_4x_4 + b_5x_5 + e$ was used to depict the relationship between financial performance and investments. Where: $Y =$ the financial performance that was measured using ROA; $a =$ the value of $Y$ when $x = 0$; $x_1 =$ the real estate investments; $x_2 =$ Investments in Government securities such as treasury bills and bonds; $x_3 =$ Investments in certificate of deposits $x_4 =$ Investments in stocks; $x_5 =$ investment in corporate bonds; $b_1$ to $b_4$ were regression weights whereas $e$ is the error term. Correlation analysis was also done and a correlation matrix was obtained to show the relationship between the variables in this study. The findings were presented in tables and graphs. A T-test was also conducted to determine the significance of the relationship between financial performance and investments. A p-value less than 0.05 implied greater significance while that greater than implied little significance.
CHAPTER FOUR: DATA ANALYSIS AND DISCUSSION

4.1 Introduction
The purpose of this study was to establish the relationship between investment and financial performance of insurance companies in Kenya. Secondary data was collected from 32 insurance firms out of a sample of 45. This implies that the study managed to obtain a response rate of 71%. This is sufficient enough to enable the findings of the study to be generalized on all the insurance companies in Kenya.

4.2 Descriptive Statistics

Table 4.1: Descriptive statistics

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>Std. Deviation</th>
<th>N</th>
</tr>
</thead>
<tbody>
<tr>
<td>Return on assets</td>
<td>.0560</td>
<td>.10206</td>
<td>32</td>
</tr>
<tr>
<td>Real estate</td>
<td>127,1600</td>
<td>250.69336</td>
<td>32</td>
</tr>
<tr>
<td>Government securities</td>
<td>41.8807</td>
<td>79.82265</td>
<td>32</td>
</tr>
<tr>
<td>Certificate of deposits</td>
<td>70.8076</td>
<td>267.09406</td>
<td>32</td>
</tr>
<tr>
<td>Stocks</td>
<td>6.8947</td>
<td>16.64929</td>
<td>32</td>
</tr>
<tr>
<td>Corporate bonds</td>
<td>5.9902</td>
<td>35.42734</td>
<td>32</td>
</tr>
</tbody>
</table>

The descriptive statistics obtained indicate that the average return on assets (ROA) for the insurance industry for the five years under investigation was 0.056. It was also established that the average investment in real estate was 127.16 which implies that an average of Ksh 127,160,000,000 was invested in real estate each year. The study also established that investment in Government securities had a mean of 41.8807 implying that the insurance companies also invested an average of Ksh 41,880,700,000 every year in Government securities. The findings also reveal that the amount of funds invested by insurance companies in certificate of deposits with other financial institutions was
approximately Ksh70 billion on average for the five years. This is supported by a mean of 70.8076 from the table above. It was further established that investments in stocks and corporate bonds had a mean of 6.8947 and 5.9902 respectively. This implies that the insurance companies spent an average of Ksh 6.9 billion on stocks and another Ksh 6 Billion on corporate bonds for each of the five years.

4.3 Correlation Analysis
The study sought to establish the nature of the relationship that exists between the variables. Partial correlations were carried out and the results are presented in table 4.2 below.

Table 4.2: Partial correlations

<table>
<thead>
<tr>
<th></th>
<th>Return on assets</th>
<th>Real estate</th>
<th>Government securities</th>
<th>Certificate of deposits</th>
<th>Stocks</th>
<th>Corporate bonds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pearson Correlation</td>
<td>1.000</td>
<td>.609</td>
<td>.542</td>
<td>.507</td>
<td>.442</td>
<td>-.059</td>
</tr>
<tr>
<td></td>
<td>.609</td>
<td>1.000</td>
<td>.799</td>
<td>.775</td>
<td>.762</td>
<td>.404</td>
</tr>
<tr>
<td></td>
<td>.542</td>
<td>.799</td>
<td>1.000</td>
<td>.335</td>
<td>.527</td>
<td>-.090</td>
</tr>
<tr>
<td></td>
<td>.507</td>
<td>.775</td>
<td>.335</td>
<td>1.000</td>
<td>.622</td>
<td>.701</td>
</tr>
<tr>
<td></td>
<td>.442</td>
<td>.762</td>
<td>.527</td>
<td>.622</td>
<td>1.000</td>
<td>.145</td>
</tr>
<tr>
<td></td>
<td>-.059</td>
<td>.404</td>
<td>-.090</td>
<td>.701</td>
<td>.145</td>
<td>1.000</td>
</tr>
<tr>
<td>Sig. (1-tailed) Return on assets</td>
<td>.003</td>
<td>.011</td>
<td>.020</td>
<td>.001</td>
<td>.351</td>
<td></td>
</tr>
<tr>
<td></td>
<td>.003</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.003</td>
</tr>
<tr>
<td></td>
<td>.011</td>
<td>.000</td>
<td>.012</td>
<td>.000</td>
<td>.278</td>
<td></td>
</tr>
<tr>
<td></td>
<td>.020</td>
<td>.012</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
</tr>
<tr>
<td></td>
<td>.001</td>
<td>.000</td>
<td>.000</td>
<td>.000</td>
<td>.170</td>
<td></td>
</tr>
<tr>
<td></td>
<td>.351</td>
<td>.003</td>
<td>.278</td>
<td>.000</td>
<td>.170</td>
<td></td>
</tr>
</tbody>
</table>

| N                  | 32               | 32          | 32                     | 32                      | 32     | 32              |
|                   | 32               | 32          | 32                     | 32                      | 32     | 32              |
|                   | 32               | 32          | 32                     | 32                      | 32     | 32              |
|                   | 32               | 32          | 32                     | 32                      | 32     | 32              |
|                   | 32               | 32          | 32                     | 32                      | 32     | 32              |
|                   | 32               | 32          | 32                     | 32                      | 32     | 32              |
The study findings revealed that there was a moderate positive or direct correlation between return on assets and the investments in real estate made by the insurance companies in Kenya. This is supported by the correlation coefficient of 0.609 as illustrated above. It implies that return on assets increase as investment in real estate also increases. The study findings also reveal that there is a moderate positive correlation of 0.542 between return on assets and investment in Government securities. This implies that as insurance companies increase their investment in Government securities, the return on assets also increases. This is an indication that an increase in the amount invested in Government securities increase the income earned by the insurance firms thus improving their financial performance.

Another moderate positive correlation of 0.507 was established between return on assets and the amount of funds invested in certificates of deposits by the insurance companies in Kenya. This implies that an increase in the investment on deposits with other financial institutions improves the return on assets of the firms. This is an indication that when insurance firms increase the amount of funds invested as deposits they earn more income that enhances their financial performance. A near moderate positive correlation of 0.442 was also revealed between investment on stocks and return on assets. This implies that increased investment on stocks both quoted and unquoted improves the financial performance of the insurance firms. However, it was established that there was a very weak correlation between investment in corporate bonds and return on assets.

The study also sought to establish the correlation between the independent variables. It is evident from the findings in table 4.2 above that a strong correlation of 0.799 exists
between investments in real estate and Government securities. This implies that as investments in real estate increase, the investment in Government securities also increased. This is an indication that the most prominent sectors where insurance firms invested in were real estate and Government securities because of the high returns and low risk involved in these investments. Another strong positive correlation was observed between real estate investments and certificate of deposits. This is supported by a correlation coefficient of 0.775 as illustrated in Table 4.2 above. It indicates that an increase in the investments on real estate will also lead to an increase in the certificate of deposits.

Another strong positive correlation of 0.762 was observed between investments in real estate and investment in stocks. Others that had positive correlation include corporate bonds and certificate of deposits (0.701), certificate of deposits and stocks (0.622), stocks and Government securities (0.527) as well as corporate bonds and real estate (0.404). The positive correlations reveal that as investment in one variable increased, investment in the other variables was also increased.

4.4 Regression Analysis
A multivariate regression analysis was also carried out to establish the strength of the relationship between financial performance and investment income of the insurance companies in Kenya. Financial performance was the dependent variable whereas investment in real estate, stocks, Government securities, certificates of deposits as well as corporate bonds was the independent variables. The results are presented in table 4.3 below.
Table 4.3: Model summary

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
<th>R Square Change</th>
<th>F Change</th>
<th>df1</th>
<th>df2</th>
<th>Sig. F Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.724a</td>
<td>.524</td>
<td>.404</td>
<td>.02106</td>
<td>.524</td>
<td>4.254</td>
<td>5</td>
<td>39</td>
<td>.002</td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), Corporate bonds, Government securities, Stocks, Certificate of deposits, Real estate
b. Dependent Variable: Return on assets

The study established that the coefficient of determination (R square) has a value of 0.524. This is an indication that the five independent variables of corporate bonds, Government securities, Stocks, Certificate of deposits and real estate explain 52.4% of the variance on the financial performance of the insurance companies in Kenya. This further implies that there is a variance of 47.6% on the financial performance of the insurance companies that cannot be explained by the five independent variables. It therefore means that there are other variables other than the five that account for the remaining variance of 47.6%.

The P- Value obtained from the study is 0.002 an indication that the relationship is statistically significant to explain the relationship since it was below 0.05.
4.5 Analysis of Variance

Table 4.4: ANOVA table

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>.135</td>
<td>5</td>
<td>.027</td>
<td>4.254</td>
<td>.003</td>
</tr>
<tr>
<td>Residual</td>
<td>.323</td>
<td>39</td>
<td>.008</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>.458</td>
<td>44</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), Corporate bonds, Government securities, Stocks, Certificate of deposits, Real estate
b. Dependent Variable: Return on assets

It can be observed from the findings in Table 4.4 above that F-value is 4.254. This is a large value that implies the existence of a significant relationship between the financial performance of the insurance companies in Kenya and investment. It confirms that investments have a significant effect on the financial performance of the firms. It is also evident that the value of significance is 0.03 which is less than 0.05. This also implies that the relationship is statistically significant and can be relied upon to explain the effect of investment on financial performance of the insurance companies.

4.6 Model Coefficients

Table 4.5: Model coefficients

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
<th>Zero-order</th>
<th>Partial</th>
<th>Part</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 (Constant)</td>
<td>.042</td>
<td>.016</td>
<td>22.604</td>
<td>.003</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Real estate</td>
<td>.032</td>
<td>.010</td>
<td>.975</td>
<td>14.422</td>
<td>.002</td>
<td>.409</td>
<td>.205</td>
</tr>
<tr>
<td>Government</td>
<td>.028</td>
<td>.021</td>
<td>.539</td>
<td>6.346</td>
<td>.003</td>
<td>.342</td>
<td>.175</td>
</tr>
<tr>
<td>securities</td>
<td>deposits</td>
<td>.024</td>
<td>.014</td>
<td>.231</td>
<td>4.118</td>
<td>.004</td>
<td>.307</td>
</tr>
<tr>
<td>Stocks</td>
<td>.016</td>
<td>.002</td>
<td>.067</td>
<td>1.349</td>
<td>.005</td>
<td>.442</td>
<td>.037</td>
</tr>
<tr>
<td>Corp bonds</td>
<td>-.002</td>
<td>.001</td>
<td>-.653</td>
<td>-2.118</td>
<td>.041</td>
<td>-.059</td>
<td>-.321</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Return on assets
The study established that the model coefficients for four independent variables had positive values whereas one had a negative value. Real estate had a value of 0.032, Government securities had a value of 0.028, certificates of deposits had a value of 0.024, stocks had a value of 0.016 and corporate bonds a negative value of -0.002. Based on these values, the study therefore came up with the following multivariate model that can be used to explain the relationship between financial performance and investment among the insurance firms in Kenya: 

\[
Y = 0.042 + 0.032x_1 + 0.028 x_2 + 0.024 x_3 + 0.016 x_4 - 0.002x_5 + 0.016
\]

4.7 Discussion of Findings
The study established that investment has a significant effect on the financial performance of insurance firms in Kenya based on the 52.4% of its variance that was explained by the five independent variables. This implies that the amounts of funds the insurance firms invest are positively correlated to the financial performance of the firms. These findings are in line with those of Loof and Heshmat (2008) who in studying the effect of investment on the financial performance of firms revealed that there exist a causal relationship between these variables.

The study established that 47.6% of the variance on the financial performance of insurance companies is not explained by the amount of investment in real estate, investment in stocks, investments in certificate of deposits, investment in Government securities as well as investment in corporate bonds. This was an indication that there are other factors that have significant effect on the financial performance of these firms. This confirms the findings by Murungi (2013) who confirmed that interest rate; gross domestic
product, claim ratio and expense ratio were also statistically significant in influencing financial performance of insurance companies.

The study further established that there was a strong positive correlation between investment in real estate and Government securities. It was further evident that the insurance firms invest more funds in real estate, Government securities, certificates of deposits and stocks. These findings are in line with the findings from a study carried out by Maina (2003) on the risk and Return of investments held by insurance companies in Kenya. Maina (2003) found out that insurance companies in Kenya invested in five main assets: Government securities, secured loans, ordinary share, bank deposits and real estate.
CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction
This study was carried out to establish the relationship between investment and the financial performance of insurance companies in Kenya. This chapter presents the summary of findings, the conclusions, recommendations as well as the suggestions for further research.

5.2 Summary of Findings
The study established that among the five independent variables only three constituted the largest share of the investment made by the insurance firms in Kenya. These include investment in real estate which had the single largest invested amount than all the other sectors. It was followed by certificates of deposits which is the area where most insurance firms invested their money in. The other most popular investment was in Government securities. The areas that attracted very minimal investments compared to these three were stocks and corporate bonds. This is an indication that the main areas that insurance firms consider to give them high returns on assets are the real estate, certificate of deposits and Government securities.

The study further established that the five independent variables comprising of real estate, certificate of deposits, Government securities, stocks and corporate bonds explain 52.4% of the variance on the financial performance of insurance companies in Kenya. This was a confirmation that they contribute a significant portion towards the financial performance of the insurance companies hence they cannot be ignored. It was further
evident from the study findings that there is a significant relationship that exists between the investments and the financial performance of the insurance companies since the volume of investments largely determines the level of financial performance the firms are able to achieve.

The study also revealed that other than the investments in the five areas that formed the independent variables to this study, the financial performance of insurance firms also depends on other factors that also explain 47.6% of the variance on financial performance. From other similar studies conducted it is clear that some factors such as the interest rate, gross domestic product, claim ratio and expense ratio of the insurance companies also play a significant role in determining the level of financial performance achieved.

5.3 Conclusions
Insurance companies in Kenya invest their funds in three popular areas. These include investments in real estate that holds the largest funds in terms of investments; investments in deposits with other financial institutions where the firms hold certificates of deposits and investment in Government securities. These investments in real estate, certificates of deposit, Government securities, corporate bonds and stocks have a significant impact on the financial performance of the insurance companies since they explain more than 50% of the variance in financial performance. There however other factors those are outside this study that account for the remaining 47.6% of the remaining variance on the financial performance of the insurance companies.
5.4 Recommendations
The study established that real estate has the highest level of investment among the insurance companies in Kenya. There is need for insurance companies to exercise caution in real estate investments since this may lead to huge losses in case of a global financial crisis that may lead to devaluation of property.

It was also established that the three areas that hold significant funds in investments are real estate, deposits with financial institutions and Government securities. There is need to increase investments into these sectors since they seem to contribute more to the financial performance of the insurance firms.

5.5 Suggestions for Further Research
There is need to carry out a research to establish the factors that explain 47.6% of the variance on the financial performance of insurance companies in Kenya since the studies so far conducted are not comprehensive enough.

It will also be important to carry out a study to establish the reason behind the popularity of investment in real estate, certificates of deposits and investment in Government securities among the insurance companies.
5.6 Limitations of the Study

The study only used one measure of performance ROA. There are other ratios that are used to measure the performance of a company. For example, Return on Investment, Return on Equity and Gross Profit Margin.

This study focused mainly on the relationship between investments and financial performance of insurance companies in Kenya. The study does not however delve much into the specific aspects of investments leading to the said effect

Since this study focuses on the insurance companies, it may be difficult to generalize the findings in other industries. It is therefore important to limit the application of the findings to the Insurance companies in Kenya.
REFERENCES


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www.investopedia.com/terms/i/investmentincome.asp
APPENDIX

APPENDIX I: LIST OF REGISTERED INSURANCE COMPANIES IN KENYA–2013

1. AAR Insurance Kenya Limited
2. A P A Insurance Limited
3. Africa Merchant Assurance Company Limited
4. Apollo Life Assurance Limited
5. AIG Kenya Insurance Company Limited
7. Cannon Assurance Limited
8. Capex Life Assurance Company Limited
9. CFC Life Assurance Limited
10. CIC Group
11. Corporate Insurance Company Limited
12. Directline Assurance Company Limited
13. East Africa Reinsurance Company Limited
14. Fidelity Shield Insurance Company Limited
15. First Assurance Company Limited
16. G A Insurance Limited,
17. Gateway Insurance Company Limited
18. Geminia Insurance Company Limited
19. ICEA LION Group
20. Intra Africa Assurance Company Limited
21. Invesco Assurance Company Limited
22. Kenindia Assurance Company Limited
23. Kenya Orient Insurance Limited
24. Kenya Reinsurance Corporation Limited
25. Madison Insurance Company Kenya Limited
26. Mayfair Insurance Company Limited
27. Mercantile Insurance Company Limited
28. Metropolitan Life Insurance Kenya Limited
29. Occidental Insurance Company Limited
30. Old Mutual Life Assurance Company Limited
31. Pacis Insurance Company Limited
32. Pan Africa Life Assurance Limited
33. Phoenix of East Africa Assurance Company Limited
34. Pioneer Assurance Company Limited
35. Real Insurance Company Limited
36. Resolution Insurance Company Limited
37. Shield Assurance Company Limited
38. Takaful Insurance of Africa Limited
39. Tausi Assurance Company Limited
40. The Heritage Insurance Company Limited
41. The Jubilee Insurance Company of Kenya Limited
42. The Monarch Insurance Company Limited
43. Trident Insurance Company Limited
44. UAP Group
45. Xplico Insurance Company Limited