THE EFFECT OF WORKING CAPITAL AND CAPITAL STRUCTURE ON THE FINANCIAL PERFORMANCE OF INSURANCE COMPANIES LISTED AT NAIROBI SECURITIES EXCHANGE.

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DECLARATION

I declare that this research project is my original work and has not been submitted to any other university for award of a degree.

Signature---------- **Date----------**

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The project was submitted for examination with my approval as the university supervisor.

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LIST OF ABBREVIATIONS

AKI	Association of Kenya Insurers
IRA	Insurance Regulatory Authority
NSE	Nairobi Securities Exchange
LKH	Liberty Kenya Holdings
PAI	Pan Africa Insurance
Kenya Re	Kenya Re-Insurance
Kshs	Kenya Shillings
ROA	Return on Assets
ROCE	Return on Capital Employed

ABSTRACT

The impact of working capital and capital structure on financial performance is a topic that has attracted a great deal of scholarly attention. Nonetheless, much of the research has concentrated on large multinationals, with little attention being paid to the insurance industry. This is particularly true for insurance companies in Kenya, which are still facing the challenge of low penetration. There is, therefore, limited understanding of how Kenyan insurance companies can enhance their financial performance using their working capital and capital structure despite their instrumental position in the Kenyan economy. Focusing on six publicly listed companies, this descriptive study sought to fill this gap in literature. The study particularly sought to examine the impact of capital structure (debt to equity or gearing ratio) and working capital management (current ratio) on the financial performance of Kenyan insurance companies as measured by return on assets (ROA) as well as return on capital employed (ROCE). Following correlation and regression analyses, it was found that 50% and 33% of publicly listed insurances in Kenya companies depicted a strong positive correlation between gearing ratio and ROA, and between gearing ratio and ROCE, respectively. It was further found that 33% and 83% of the companies portrayed a strong positive correlation between working capital ratio and ROA, and between working capital ratio and ROCE, respectively. While it was found that both gearing ratio and working capital ratio may have a positive impact on ROA and ROCE, gearing ratio was found to have a greater impact. Generally, the study established that insurance companies in Kenya can capitalise on their debt-equity mix and working capital management policy to enhance their financial performance, especially with respect to ROA and ROCE. The study has important implications for both practice and policy in the Kenyan insurance industry.

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

The effect of working capital and capital structure on financial performance is a topic that has attracted immense scholarly attention. A business's financial environment plays an instrumental role in its success. In essence, efficiency in the allocation of financial resources is crucial for survival and profitability. The significance of decisions relating to financial management in business is apparent as most of the factors attributable to failure can be effectively managed through sound financial decisions. The recent financial crisis provides a practical example of the significant implications financial strategy can have on financial performance (Peterson & Fabozzi, 2012).

A number of research studies have indicated that the major causes of business failure are poor financial planning, funding and capital inadequacy, capital mismanagement, unplanned growth, as well as unnecessary fixed-asset investment (Ibarra, 1995; Van Auken & Howard, 1993). These challenges can be effectively addressed via sound capital structure and working capital management strategies. Nonetheless, industry players have been concentrating on financing operating expenses, with little emphasis on specialized personnel with expertise in financial planning. The primary objective of a profit-oriented organization is to maximize shareholder wealth. To achieve this, the organization must build a competitive advantage to exploit opportunities in the markets in which it operates – in both its trading and financial environment. Working capital management and capital structure decisions can be crucial sources of competitive advantage (Bender & Ward, 2009).

The main focus of working capital and capital structure is on the financial element of strategic goals and objectives. This certainly means a closer connection with shareholder interests and capital markets. Nonetheless, similar to corporate and business strategies, an effective financial management strategy must consider all external and internal stakeholders of the organization. Financial management strategies are often specific and customized to the individual needs of the individual organization and, in some instances, even to units and departments within the organization. Therefore, the definition of financial management strategy with respect to capital structure and working capital takes into account the need to pay attention to these micro-level these inter-relationships.

Bender & Ward (2009) described capital structure and working capital as having two elements: 1) appropriate acquisition of funds; and 2) proper management and deployment of the funds. The element of acquiring funds considers the organization's overall strategy as well as the interests and requirements of its key stakeholders. It must be noted that appropriate acquisition of funds does not necessarily mean acquiring them at the least cost. The primary aim of financial strategy is to add value, which may not always be attained via cost minimization attempts. The element of proper management and deployment of funds is concerned with distributing or reinvesting the profits an organization generates. In essence, the significance of working capital and capital structure cannot be overemphasised.

1.1.1 Working Capital and Capital Structure

Working capital management and capital structure constitute important elements when it comes to financial management strategy. Working capital management essentially entails the management of liquidity, which essentially denotes the capacity of an organization to finance its short term

liabilities. It is generally measured by the current ratio, which is calculated by dividing current assets and current liabilities (Porter & Norton, 2011). A high ratio (high liquidity) generally indicates that a company will be in a position to fund its liabilities in the short term, often in the next one financial year. It implies that the firm has huge deposits of cash or assets it can quickly convert to cash. This places the firm in a low risk position, though it may decrease profitability as the firm may focus more on retaining current assets rather than investing them. The vice versa is true. The management of working capital needs careful attention since it significantly affects financial performance.

Capital structure, which is measured by the gearing ratio, is also a significant factor in corporate financial management and can directly affect a firm's financial performance (Gallagher & Andrew, 2007). It basically denotes the various sources from which a firm acquires funds to finance its operations. Capital structure specifically relates to decisions such as the proportion of capital that should be debt or equity, whether or not to issue new equity, whether to retain more profits and pay lesser dividends, and so forth. For instance, rather than issuing more equity or taking debt, a company may decide to retain profits so as to take advantage of investment opportunities. In addition, rather than issuing more equity, a firm may resort to debt financing in form on bank loans, corporate bonds, and so forth.

Modigiliani's and Miller's capital structure theory, which is one of the most popular capital structure theories, argues that a firm must find the optimal balance of equity and debt if it is to maximise shareholder wealth, which is the primary objective of any firm (Porter & Norton, 2011). However, this is often a difficult balance to achieve. On one hand, it is argued that a higher ratio of debt to equity results in greater shareholder wealth, while on the other hand some commentators advocate for a higher ratio of equity to debt (Gallagher & Andrew, 2007). All the same, capital

structure decisions have a significant impact on firm financial performance. Managers must, therefore, choose a capital structure that provides the most optimal cost of capital and one that maximises shareholder wealth while minimizing financial and business risk.

1.1.2 Financial Performance

Financial performance depicts an organization's revenues, profitability, as well as value as evidenced by its share price (Mwangi & Murigu, 2015). It measures the degree to which an organization is effective in converting its assets or capital to revenues and profitability. The term is also used to describe the overall financial health of an organization in a given period of time, and can be utilized for comparing firms in the same industry or sector.

Common measures of financial performance include annual turnover, gross profit margin, net income, profit (loss) after taxation, return on assets (ROA), return on capital employed (ROCE), returns on investment (ROI), and return on equity (ROE), and so forth (Gallagher & Andrew, 2007). Nonetheless, some financial performance measures may vary from industry to industry. In the insurance context, for instance, measures such as net premiums earned and profitability from underwriting activities are often used. ROA, ROE, and ROCE are particularly important indicators when it comes to measuring the profitability of a company. These measures basically indicate the extent to which a firm generates profit from its factors of production. They are intended to assess the efficiency and effectiveness with which a firm utilises its available resources to create wealth for shareholders (Porter & Norton, 2011)

The significance of financial performance in the growth, survival, and competitiveness of firms cannot be overemphasised (Gallagher & Andrew, 2007). This is particularly true for insurance companies. Without impressive financial performance, insurers may not lure outside capital to

accomplish their goals and objectives in the constantly evolving competitive environment. Financial performance plays an essential role in attracting the attention of various stakeholders, including policyholders, shareholders, business partners, and financiers. Therefore, the ultimate objective of insurance companies is to generate the highest returns possible.

1.1.3 Working Capital, Capital Structure, and Financial Performance

Financial performance is a factor of several elements, both in the internal and external environment of a business. Whereas internal factors entail characteristics specific to a firm, external factors relate to both the characteristics of the industry of operation as well as macroeconomic variables (Mwangi & Murigu, 2015). Firm-specific factors that predict financial performance include financial management strategy, organisational culture, management competency, industry experience, and so forth. External factors include factors such as political stability, the regulatory environment, social and demographic variables, industry competition, and so forth.

In the internal environment, financial management strategy can be a major predictor of financial performance. This is particularly true with reference to capital structure and liquidity management strategies (Gallagher & Andrew, 2007). As argued by the Modigiliani & Miller proposition, the mix of debt and equity ultimately determines the level of wealth an organisation creates for shareholders. Numerous studies demonstrate the positive relationship between debt-equity structure and financial performance (Shiu, 2004; Mwangi, 2013; Charumathi, 2012; Chen & Wong, 2004).

In addition, liquidity management strategies affect financial performance in the sense that holding extreme levels of current assets may imply forgoing investment opportunities, thereby affecting profitability (Gallagher & Andrew, 2007). In other words, if a firm focuses more on working

capital, profitability may be reduced as resources that may be invested in fixed or long term assets to generate profit are minimized. On the other hand, low liquidity levels may constrain the ability of the firm to meet its short term liabilities, which is certainly bad for business as it may result in financial distress. In other words, if a firm focuses too much on fixed assets and neglects its short term capital needs, it may face illiquidity or bankruptcy due to insufficient funds. Working capital management, therefore, encompasses controlling the level of current assets in a manner that achieves a balance between the firm's profitability and the risks related to that profitability. Several studies demonstrate the relationship between liquidity levels and financial performance (Nyabuti & Ondiek, 2014; Bawa & Chattha, 2013; Cheluget et al., 2014; Kithii, 2008; Mathuva, 2009; Nyakundi, 2003).

In the Kenyan insurance industry, poor financial management strategies have been associated with poor financial performance on the part of some companies. A study carried out by Cheluget et al. (2014), whose aim was to examine financial distress amongst insurance firms in Kenya, particularly demonstrates that poor liquidity management was a significant factor in the recent collapse and/or placement under statutory management of 9 insurance firms in Kenya. The 9 companies include: Invesco Assurance Company, Stallion Insurance, Standard Assurance, Lake Star Assurance Company, Blue Shield Insurance, Access Insurance Company, Kenya National Assurance Company, United Insurance Company, and Concord Insurance Company. Some of these companies were put under receivership between 2008 and 2011. The crisis points to widespread inattention to financial management strategies on the part of both the regulator (IRA) and players in the industry. As the regulator, IRA bears the responsibility of monitoring insurance firms in Kenya, especially with respect to capital adequacy and liquidity, with a view to ensuring stability of the industry.

1.1.4 Insurance Companies in Kenya

The practice of insurance dates back to several hundreds of years ago. Early practice was reported in Europe for over one thousand years ago with the earliest being marine insurance. The core objective of insurance practice is to eliminate or minimise risk for individuals and organizations by transferring responsibility for the risk another party – an insurance company in this case. To bear this responsibility, the insurance company requires the insured to pay premiums under defined terms and conditions. Whenever a loss occurs, the insurance company uses these premiums to compensate the victim. Besides covering individuals and organizations for losses, insurance firms serve as financial intermediaries, investment channels, as well as vehicles for employee and retirement benefits. Insurance companies, therefore, play a key role in the financial sector and the economy as a whole. Thus, they must be properly managed and monitored.

Insurance is a relatively new concept in Kenya compared to the developed world. It was originally introduced during the early part of the 20th century. Since then, the industry has grown tremendously. Most insurance companies emerged in the 1980s, and others in the 1990s following reforms aimed at liberalizing the economy. Currently, there are 49 registered insurance companies in Kenya (IRA, 2015). Out of these, 25 are involved in non-life insurance products only, 13 are involved in life insurance products only, and 11 sell both life and non-life insurance products (IRA, 2015). Dissimilar to developed countries, the Kenyan insurance market is largely dominated by non-life insurance products, which account for 65% of the total premiums. Even so, the industry has registered tremendous growth in the last five years, with gross premium income growing from Kshs 63.5 billion in 2010 to Kshs 173.3 billion in 2015, which represents a growth of approximately 174% (AKI, 2015). Over the same period, total assets have grown by more than 100% from Kshs 209.5 billion to Kshs 478.5 billion in 2015. The growth of the industry is expected

to be even more impressive in the near future given that more and more Kenyans are embracing insurance products (IRA, 2015). The industry accounts for approximately 2.08% of the country's total GDP (Mwangi & Murigu, 2015).

1.2 Research Problem

Though the interaction between working capital and capital structure and financial performance has received fairly significant scholarly attention, much of the research has concentrated on large multinationals, particularly in the banking industry. In essence, little attention has been paid to the insurance industry, thereby leaving a significant gap in literature. This is despite the significance of financial management strategy to the performance of business organisations. Lack of scholarly attention to the insurance context is particularly true for the Kenyan insurance industry, which is still facing the challenge of low penetration. The insurance industry in Kenya constitutes an important element of the financial system. Like commercial banks, insurance firms play a role in financial intermediation. Failure of the insurance industry can, therefore, be detrimental to the economy at large (Agiobenebo & Ezirim, 2002; Ansah-Adu, Andoh & Abor, 2012). Therefore, identifying working capital and capital structure as key performance indicators in the insurance industry can be valuable in designing financial management policies that may enhance the profitability of players in the industry.

A few studies have been carried out in the Kenyan insurance context to examine the factors that influence the performance of firms. In his study, for instance, Mwangi (2013) found that the performance of insurance companies is mainly affected by liquidity, competition, as well as interest rate fluctuations. However, the study did not explain their relationship. Wabita (2013) conducted a similar and established that financial performance is affected by industry growth,

leverage, and asset base. In another study, which focused on life assurance companies, Mutugi (2012) found that financial performance was driven by innovation as well as ownership and capital structure. Though these studies provide valuable insights, they provide little understanding of the relationship between financial management strategy and financial performance in the Kenyan insurance sector.

The largely under-researched correlation between working capital management and capital structure and financial performance in the Kenyan insurance industry motivated further inquiry into this topic. It is particularly important to understand how particular elements of financial management strategy such as capital structure and liquidity management strategy relate with particular elements of financial performance, notably ROA and ROCE. In fact, most studies on this topic focus on financial performance in general and do not isolate the various components of financial performance. To this end, this study sought to examine how the working capital management strategies and capital structure of insurance companies in Kenya affect their financial performance. The study particularly narrowed down to the relationship between working capital management strategy and capital structure, and financial performance as measured by ROA and ROCE.

1.3 Research Objective

The objective of the study was to establish the effect of working capital and capital structure on the financial performance of insurance companies listed at Nairobi Securities Exchange.

1.4 Value of the Study

The findings of this study have significant implications for the Kenyan insurance industry. The study contributes to the general understanding of financial management strategies (capital structure and working capital management) and their effect on the financial performance of insurance companies in Kenya. The study, therefore, serves as a wakeup call for insurance companies in Kenya to adopt efficient working capital polices and capital structures so as to enhance their financial performance. Optimising their financial management strategies will enable insurance companies to grow their businesses and maintain a competitive advantage, which will eventually maximise the wealth of shareholders. In addition, the study adds knowledge to the existing body of knowledge on working capital management strategies and capital structure and their effect financial performance. The study also serves as a reference for other scholars who desire to study the interaction between working capital and capital structure and financial performance in not only the insurance industry but also other industries. Most importantly, the study provides valuable insights for regulators in the insurance industry especially the Insurance Regulatory Authority (IRA).

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter critically reviews the available literature on working capital and capital structure and financial performance. It begins by reviewing financial theories related to financial strategy, then an overview of empirical studies and literature relating to working capital management, capital structure and financial performance. The chapter also focuses on the information collected from various researchers, scholars, analysts and authors who have conducted research in the same field.

2.2 Theoretical Review

The study of capital structure and working capital management is not a new practice. Scholars have for the last several decades paid attention to these concepts in an attempt to suggest or recommend the most optimal strategies for acquiring and managing the finances of a company. Four important theories that particularly underpin scholarly work in the area of capital structure include the Modigliani-Miller theorem, the net income approach, the pecking order theory, and the trade-off theory. As for working capital management, firms may choose from the aggressive approach and the conservative approach.

2.2.1 Modigliani-Miller Theorem

The Modigliani-Miller Theorem asserts that a firm's market value is a factor of its earning power as well as the risk associated with its underlying assets (Modigliani & Miller, 1958). The theory further states that the value is not dependent on how it elects to fund its operations or distribute dividends. As is normally the case, a firm can select from three financing methods: issuing equity,

debt or reinvesting profits instead of distributing them to shareholders. The fundamental argument is that under certain assumptions, it does not matter whether a firm chooses debt or equity.

2.2.2 The Net Income Approach

Durand (1959) identified two extreme views. The first is the net income approach (NI) in which the cost of equity and/or debt are presumably independent of capital structure. WACC decreases and the firm's value rises, and the use of average increases. The second view is the net operating income (NOI) approach. Under this approach, the cost of equity presumably rises linearly with average. Therefore, WACC and the value of the firm remain constant and average changes. If the NI approach is valid, then financing decisions have a significant impact on firm value. Equally, if the NOI view is true, then financing decisions may not affect the value of the firm, hence should not be of much concern to the firm.

2.2.3 Pecking Order Theory

According to the pecking order theory, which was postulated by Myer (1984), firms tend to prefer internal financing. The theory also argues that dividend policy is often inclined to investment opportunities available to the firms. In addition, unanticipated variations in investment opportunities and profitability imply that internally generated funds can be more expensive. Therefore, profitable and cash flow sufficient firms will tend to use less debt. Ghosh (2012) and Gachoki (2005) tested this theory and found that no relationship exists between debt and internal funds deficit. Other studies showed a positive relationship on capital structure choice that finance managers follows a hierarchal order when making capital structure decision and supporting the pecking order theory (Baskin' 1989; Hewledge & Liang, 1996; Frank & Goyal, 2003; and Kahugu, 2009).

2.2.4 The Trade-Off Theory

The trade-off theory argues that managers seek to trade off tax savings on debt against cost of debt. Many studies show a strong significant relationship that the level of adjustment is relative to the cost of debt and many managers revise their capital structure to maintain an optimal balance of cost and debt (Graham & Harvey, 2001; De Jong *et al.*, 2011; Hovakimian, Opler & Titman, 2011; Dang, 2013).

2.2.5 Other Theories of Capital Structure

Other capital structure theories include the agency cost theory (Jensen & Meckling, 1976), the free cash-flow theory (Jensen, 1986), the theory of information asymmetries and signalling (Ross (1977), as well as Leland's & Pyle's (1977) model. These theories also demonstrate that the mix of debt and equity significantly affects financial performance. It is important to note that so far there is no universal theory or explanation reached that could intensely explain the optimum debt/equity mix or the inherent relationship between capital structure and the firm performance. The existing empirical studies in overall suggest that firms decisions on capital choice and its relationship to performance thereof is dependent on size, industry and even the operating environment.

2.2.6 The Aggressive and Conservative Approaches

Working capital management essentially entails the management of liquidity, which is measured as a ratio of current assets to current liabilities (Porter & Norton, 2011). The two major approaches for the management of working capital are the aggressive approach and the conservative approach. The aggressive approach entails high levels of long term assets and low levels of current assets

(Porter & Norton, 2011). Though this may increase profitability firm, it may increase the risk of illiquidity in the short term. The conservative approach on the other hand entails low investment in fixed assets, but high investment in current assets. A major advantage with this is that investment in long-term investment is forgone, which may affect profitability in the long run.

In essence, achieving optimal working capital ratios is often a difficult task for most organizations since organizations often face the dilemma of choosing between keeping current assets to meet short-term financial obligations and investing current assets to generate earnings. This is referred to as the liquidity-profitability trade-off. In fact, managing working capital entails a trade-off between risk and profitability. Focus on profitability tends to increase risk, and focus on risk reduction tends to reduce profitability. Without a sound working capital management policy, a firm may experience poor financial performance (Gallagher & Andrew, 2007). It is, therefore, important to choose a working capital management approach that ensures a balance between idle current assets and long-term investments.

2.3 Determinants of Financial Performance of Insurance Companies

The performance of insurance companies is determined by internal (firm-specific) and external (macroeconomic) factors. Detailed discussion of external factors is beyond the scope of this paper. Some of the internal factors that may affect financial performance include leadership and management, organisational culture, risk management, investment decisions, working capital management, and capital structure (Rejda, 2008). In this review, further attention is paid to the last two.

2.3.1 Working Capital Management

One of the major decisions that organizations face in their day to day operations relates to liquidity management. According to Gupta (2002), working capital management ensures the liquidity needed to operate efficiently is available. Gitman (2000) defines working capital management as the control and regulation current assets and current liabilities with a view to enabling the organization fulfil its short term financial obligations. Also high levels of short liabilities increase chances of bankruptcy. The focus of the firm in this regard is to ensure there are available funds to settle liabilities in the next 12 months. This is essentially referred to as liquidity. Proper liquidity management is important as it may determine a firms' financial performance and value as well as exposure to liquidity risk (Smith, 1980). From an insurance perspective, liquidity encompasses the insurer's capacity to meet their immediate obligations to policyholders without liquidating financial assets or increasing underwriting and investment activities. The insurer must always have current assets to pay claims from policyholders (Chaharbaghi & Lynch, 1999).

2.3.2 Capital Structure

The financial manager must also make decisions relating to financing. They must carefully decide where, how and when to acquire funds for financing the organization's activities. Generally, the financial manager must maintain a proper balance of debt to equity, which denotes the capital structure (Ghosh, 2012). Reliance on equity can make the firm's value to increase, which would be an indication of growth as well as greater shareholder wealth (Gachoki, 2005). On the other hand, reliance on debt may affect shareholder risk and return. Though it may be more risky, it may increase ROE. In essence, a good capital structure is one that maximizes shareholder wealth while minimizing risk. Such a structure maximizes the firm's market value.

2.4 Empirical Review

The subject of financial management strategy has been explored in the discipline of finance. However, very few studies have been conducted in Kenya to address whether working capital and capital structure have an effect on financial performance. Most of the studies that have been done are basically on specific financial decision without comprehensively looking and overall financial decisions. Other studies basically covered general strategy or strategy implementation without emphasising on capital structure and working capital. This section will review the empirical studies in view of the study.

Nyabuti & Ondiek (2008) studied the link between working capital management strategy and financial performance of publicly quoted companies in Kenya. The study found working capital management to be positively related with financial performance. Wabita (2013), Mutugi (2012), and Mwangi (2012) sought to examine the factors that determine the financial performance of insurance firms in Kenya. Similar studies have also been conducted in other countries. For instance, Charumathi (2012) carried out empirical study to establish the determinants of profitability in Indian life insurance companies. Other studies have focused on strategic planning in general. For instance, Arasa & K'obonyo (2012) conducted a study to examine the impact of strategic planning on both financial and non-financial performance. The study found that effective strategic planning improved both financial and non-financial performance. Other studies have also demonstrated the positive correlation between effective strategic planning and implementation and performance (Aosa et al., 2012; Kiarie, 2013).

Other studies have specifically focused on the implications of financial management practices on firm performance. In a study of Mexican firms, Valencia et al. (2006) found that most firms

maintain an optimal leverage ratio, rely on investment analysis techniques, utilize financial ratios in analyzing profitability, and do not rely on techniques such as economic valued added (EVA). In their study, Jog & Srivastava (1994) sought to explore how Canadian firms made financial decisions relating to aspects such as capital budgeting, financing sources and costs, as well as dividends. The study showed that investment decisions are largely driven by funding opportunities, and that capital budgeting decisions are based on the net present value and the internal rate of return. The study further established that the firms sought to maintain an optimal debt-equity ratio, and that dividend payout was determined by the firm's present and future earnings.

Other studies have examined the use of certain financial analysis techniques by firms. In their studies, Pohlman et al. (1988) and Lazaridis (2002) found that most companies rely on subjective techniques to forecast cash flows, with only a few utilizing sophisticated methods. Kamath (1997) examined long term financing decisions in large companies and found that most firms did not have a specific objective in their capital structure – they preferred a financial hierarchy. Kamath (1997) further established that the major concern for most firms in terms of financing is to ensure financial flexibility and long term survival. In their study, Zopounidis & Doumpos (2002) focused on a method referred to as the Multi-Criteria Decision Aid (MCDA). The method assists financial decision-making processes by taking into account aspects such as debt, financial distress, investment, and corporate performance.

Scholarly attention has also been paid to the impact of financial decisions on shareholder value. In their study of Mexican firms, which aimed to examine the relationship between financial decisions and economic value creation, Escalera & Herrera (2006) found that firms that rely on supplier financing are better placed to generate economic value so long as there are no collection difficulties, and that inventory must be considered when making investment decisions. The study,

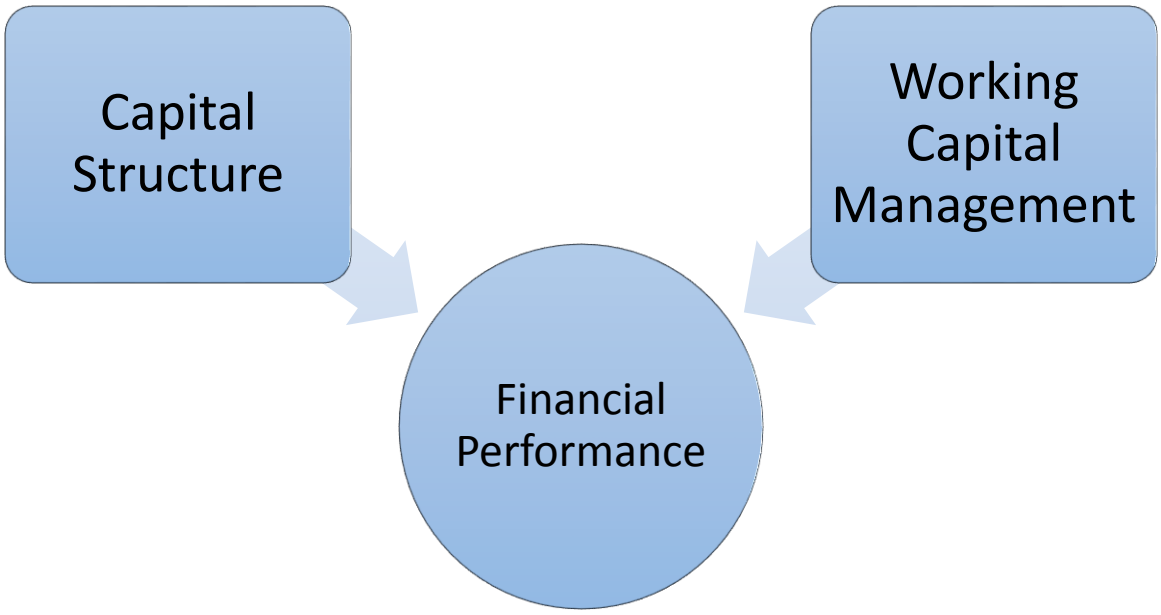
however, focused on business owners' perceptions of the significance of financial decisions, ignoring somewhat more important factors such as competitiveness and business performance.

Evidently, much of the research has focused on the utilization of analysis techniques in financial decision processes as opposed to the decisions themselves and their effect on financial performance. As such, more inquiry is needed in this area. This is particularly true for insurances, in which financial strategies remain largely under-researched.

2.5 Conceptual Framework

Based on the preceding theoretical and empirical review, the relationship between capital structure, working capital management, and financial performance can be conceptually described as shown in figure 1 below:

Figure 1: Conceptual Framework



2.6 Summary of Literature Review

Capital structure and working capital management can be an important source of competitive advantage for an organization in an increasingly competitive business environment. Processes relating to these two aspects can be designed to optimize financial management and hence improve performance (Lopez, 2006). While financial performance is a factor of several factors, empirical evidence demonstrates that capital structure and working capital management can be important performance drivers. Effective management of working capital and capital structure is the primary constant upon which a firm can identify its source of profitability. This requires the designing and implementation of strategies which exploits to maximum effect each firm's unique characteristics (Michael, 1999).

Capital structure and working capital management encompasses two strongly interrelated decisions: source of financing funding and working capital (Ross, Westerfield & Jordan, 2000). Financing decisions relate to the combination of debt and equity with a view to achieving an optimal capital structure, while working capital decisions are concerned with managing short term liquidity. Since every firm primarily seeks to maximize profitability, it is imperative to make the right decisions with respect to capital structure and working capital management. Mallette (2006) asserts that a firm's financial management strategy is so important that it ought to be evaluated and adjusted as often as the operational strategy. The author further argues that financial management strategies must be aligned with the operations of the business as well as its needs.

It is evident that the decisions made by managers affect the financial performance of an insurance company. This then emphasizes the need for proper financial management strategies to be adopted to direct the goals and interests of management to the interests of the organization. A firm's

stakeholders also require an assurance that their interests are safeguarded by firm's management and strategies. From the literature, it is discovered that the desire to improve financial performance should be balanced with the financial management strategies associated with the operations of the firm. This then leads to the development of financial management strategies with emphasis on working capital and capital structure to meet the financial success of an organization.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter describes the methods, techniques and procedures that were used to conduct the study. The chapter particularly describes the research design used, the target population and sample, as well as data collection and analysis procedures.

3.2 Research Design

There major designs from which the researcher can choose when conducting research include the exploratory design, the descriptive design, and the explanatory design (Saunders, Lewis & Thornhill, 2009). Exploratory research refers to initial research in a given topic or area. The research lays a foundation for further inquiry in the area. Descriptive research is concerned with clarifying or providing more information on a certain subject or topic. The researcher focuses on filing gaps in extant literature. Explanatory research involves examining cause-and-effect relationships. The researcher focuses on discovering and explaining relationships between variables (Marinova, Plantenga & Remery, 2010). As this study aimed to fill a gap in literature by examining the link between capital structure, working capital management strategy and financial performance in the Kenyan insurance industry, it mainly fell within the descriptive category.

The quantitative approach was deemed the most appropriate route for conducting the study. The major advantage of this approach is that it involves less time, effort and cost as far as data collection and analysis are concerned. This is unlike the qualitative approach, which usually consumes more time as the researcher has to arrange interviews with respondents, make observations, as well as transcribe and analyze the taped responses (Gill & Johnson, 2010).

Nonetheless, the quantitative approach may sometimes be limited by the fact that some variables may not be readily measurable or quantifiable (Easternby-Smith, Thorpe & Lowe, 2008). This challenge was, however, not encountered in this case.

3.3 Target Population and Sampling

The target population for this study was insurance companies in Kenya. The choice of Kenya as a focus for this study was informed by the fact that modest research has been conducted to examine the relationship between working capital management strategy, capital structure and financial performance in the Kenyan insurance industry. As of 2015, there were 49 registered insurance companies in Kenya (IRA, 2015). Nonetheless, the study only included publicly listed companies. This was specifically informed by the likely challenges of data availability. Data for publicly listed companies tends be more readily accessible compared to privately held companies. As of 2015, there were six publicly listed insurance companies in Kenya: Liberty Kenya Holdings (LKH), Jubilee Insurance, Britam, Kenya Re-Insurance (Kenya Re), CIC Insurance, and Pan Africa Insurance (PAI). This was deemed to be a fairly representative sample of the population.

3.4 Data Collection

The aim of this study was to examine the impact of working capital and capital structure on financial performance. Therefore, the two major variables for the study included working capital and capital structure (independent variable) and financial performance (dependent variable). As seen in the literature review section, financial management strategy entails several components including investment strategy, risk management strategy, capital structure (ratio of equity to debt), and working capital management strategy. Due to the challenge of data availability, it was not

possible to include all these elements in the study. The study therefore concentrated on capital structure and working capital management strategy.

Previous studies have demonstrated that capital structure and working capital are significant predictors of financial performance. Financial performance basically measures how well a firm utilises its assets to make money (Peterson & Fabozzi, 2012). There are several indicators of financial performance: return on investment (ROI), return on assets (ROA), return on equity (ROE), return on capital employed (ROCE), asset turnover, gross and net profit margin, market value, and so forth. Since it may be difficult to include all these measures in a single study particularly due to data availability the study focused only on ROA and ROCE. ROA indicates the extent to which an organisation is efficient in terms of utilising its assets to generate earnings, while ROCE indicates the efficiency with which an organisation employs its capital (Peterson & Fabozzi, 2012).

The data required for this study was quantitative in nature and was collected predominantly from secondary sources. The data was particularly extracted from individual company annual reports, specifically focusing on the period 2011-2015. A major advantage of secondary data is that lesser time, effort and cost are involved in data collection. Nonetheless, the possibility of bias in the underlying primary data is often a major problem (Saunders, Lewis & Thornhill, 2009).

3.5 Data Analysis

The collected data was analysed on the basis of descriptive statistics. Descriptive statistics essentially entails a quantitative description of the main features of collected information (Mugenda and Mugenda, 2003). In this regard, Microsoft Excel 2010 was used to facilitate the data analysis process. The software was particularly used to generate tables and carry out

correlation and regression analyses. Table 1 below summarises the variables included in the analysis.

Table 1: Study variables

Variable	**Definition**
Return on Assets (ROA)	Ratio of net income to total assets
Return on Capital Employed (ROCE)	Earnings before interest and tax / Capital Employed (Total Assets – Current Liabilities)
Capital structure (gearing ratio)	Ratio of debt to equity
Working capital ratio	Ratio of current assets to current liabilities.

3.5.1 Analytical Model

As for the regression analysis, the relationship between financial performance and capital structure and working capital was depicted using the following model:

$Y_1 + Y_2 = \beta_1 X_1 + \beta_2 X_2 + \varepsilon$

Where: Y_1 and Y_2 are the two dependent variables representing financial performance, which was measured using ROA and ROCE

X represents the independent variables as shown in table 1 above (X_1 represents gearing ratio while and X_2 represents working capital ratio)

β represents the regression coefficients; and ε represents the error term

CHAPTER FOUR: DATA ANALYSIS, FINDINGS AND DISCUSSION

4.1 Introduction

This chapter presents the findings of the study. First, a description of the findings is provided in terms of capital structure (gearing ratio), working capital management (working capital ratio), and financial performance (ROA and ROCE) from 2011-2015. Results of the correlation and regression analyses are then provided. Finally, a discussion of the findings is provided, clearly demonstrating the relationship between gearing ratio and working capital ratio and financial performance as measured by ROA and ROCE.

4.2 Descriptive Statistics

The data used to analyse the study has been summarised in the appendix while the descriptive statistics summary on the variables have been summarised in Table 2 and Table 3.

4.2.1 Capital Structure

Capital structure is generally measured using the gearing ratio. The ratio basically measures the combination of debt and equity in a firm. It quantifies financial leverage, indicating the extent to which a firm finances its operations by owner's funds versus creditors or lenders. Simply, the gearing ratio is used to assess the financial position of a company in the long run. A higher leverage implies that a company is more risky, and vice versa. On the whole, there is no recommended gearing ratio – companies often weigh their ratios against their competitors in the industry (Stickney, 2010).

As shown in table 2 below, all of the six companies included in the study rely on both debt and equity to finance their activities. Nonetheless, some companies have a significantly high proportion of debt compared to the rest. CIC Insurance, for instance, had the highest average ratio (35.6%) compared to the other five companies, whose average ratio range from 1.6% to 20.4%. The company's proportion of debt particularly jumped from 12% in 2013 to 70% and 75% in 2014 and 2015, respectively, indicating a substantially increased reliance on debt. Kenya Re-Insurance on the other hand depicted the lowest proportion of debt, with its gearing ratio being 1.6% on average. In fact, the company has in the last two years (2014 and 2015) completely eliminated debt from its books, a reduced dependence on debt.

Table 2: Gearing ratio (%), 2011-2015

Company/Year	2011	2012	2013	2014	2015	Mean	STD
Liberty Kenya Holdings	12	9	13	15	14	12.6	2.06
Pan Africa Insurance	20	20	22	20	20	20.4	0.80
Kenya Re-Insurance	2	3	3	0	0	1.6	1.36
Britam	9	0	1	1	3	2.8	3.25
Jubilee	19	15	11	8	0	10.6	6.47
CIC Insurance	13	8	12	70	75	35.6	30.22

4.2.2 Working Capital Management

Measured as a proportion of current assets to current liabilities, the working capital ratio is used to indicate a firm's ability to meet its short term financial obligations (Fridson & Alvarez, 2011). As explained by Stickney (2010), working capital ratios tend to vary from one industry to the other, though they generally range between 1.5 and 3.0. This range is often indicative of a healthy financial position. A very high current ratio usually indicates inefficiencies in the utilization of current assets, while a very low current ratio (normally below 1.0) often points to difficulties in fulfilling short term financial obligations (Fridson & Alvarez, 2011).. Even so, it is important to

note that low current ratios do not always signal a critical problem. If a firm's long term prospects are good, they can be used to borrow in order to meet current obligations.

As illustrated in table 3 below, the six companies have depicted fairly high working capital ratios in the last five years. Kenya Re-Insurance had the least working capital ratio on average (3.51) while CIC Insurance had the highest (7.86). Generally, each company's gearing ratio was above the recommended range of 1.5-3.0, which could be an indication of inefficient utilisation of current assets, though not necessarily.

Table 3: Working capital ratio, 2011-2015

Company/Year	2011	2012	2013	2014	2015	Mean	STD
Liberty Kenya Holdings	3.27	4.63	6.43	4.32	4.33	4.60	1.03
Pan Africa Insurance	4.89	6.10	4.59	3.70	3.61	4.58	0.91
Kenya Re-Insurance	3.48	2.51	3.89	4.03	3.65	3.51	0.54
Britam	1.7	6.15	5.39	2.44	3.29	3.79	1.71
Jubilee	4.26	3.63	5.19	5.31	5.68	4.81	0.75
CIC Insurance	10.33	14.42	10.73	2.41	1.43	7.86	5.07

4.2.3 Financial Performance

Two common indicators of financial performance include ROA and ROCE. ROA basically measures the degree to which a firm is efficient in converting its total assets into profit (Peterson & Fabozzi, 2012). It is a particularly important measure of profitability as it shows the firm's capacity to generate profits before leverage. Dissimilar to other measures of profitability such as ROE, ROA includes all of the company's assets – including those arising from creditor liabilities and investor contributions. Nonetheless, a major disadvantage of ROA is that it is often of less interest to firm owners compared to other financial ratios such as ROE.

In general, there is no recommended level of ROA – it usually varies from industry to industry (Peterson & Fabozzi, 2012). For instance, industries that are heavily dependent on capital (such as thermal power plants) will usually depict a relatively low ROA as they must have a large asset base to remain in business. Conversely, firms in industries that are not capital-intensive (such as service firms) will often yield a high ROA as they require minimal assets. Accordingly, when utilizing ROA as a measure of profitability, it is more appropriate to compare it against the firm's previous ROA figures or its competitors.

As shown in the appendix, the six firms have generally depicted impressive financial performance in the last five years, especially in terms of growth in revenue, net income, and assets. Nonetheless, ROA would give a clearer picture of financial performance.

Table 4: ROA (%), 2011-2015

Company/Year	2011	2012	2013	2014	2015	Mean	STD
Liberty Kenya Holdings	4	3	4	3	3	3.4	0.49
Pan Africa Insurance	4	4	6	4	0	3.6	1.96
Kenya Re-Insurance	10	12	11	10	10	10.6	0.80
Britam	-8	7	6	3	-1	1.4	5.46
Jubilee	5	5	4	4	4	4.4	0.49
CIC Insurance	5	10	8	6	5	6.8	1.94

In the five years, Kenya Re-Insurance recorded the highest ROA, averaging 10.6%, while Britam recorded the lowest, averaging 1.4% (see table 4). For virtually all the companies, the movement of ROA depicted a rather stable trend, though CIC Insurance's was quite volatile, moving from 5% in 2011 to 10% in 2012, and back to 8%, 6% and 5% in 2013, 2014 and 2015, respectively

The other important measure of profitability used in this study was ROCE. The ratio basically measures the ability of a company to generate returns from all its capital, which includes equity

and long term liabilities (Sinha, 2009). It depicts a firm's profitability and efficiency in terms of its capital investments. ROCE, therefore, provides a better measure of profitability compared to ROA. A major drawback of ROCE, however, is that capital depreciation and amortization are not taken into account (Sinha, 2009). In addition, since capital employed is placed in the denominator, ROCE may increase without an actual rise in profit if a firm has depreciated assets.

As shown in table 5 below, the movement of ROCE for all the six companies, with the exception of CIC Insurance, has been relatively stable in the last five years. Kenya Re-Insurance had the highest ROCE on average (14.2%), while Britam had the lowest (2.2%). This would be expected as both companies had the highest and lowest ROA over the same period, respectively.

Table 5: ROCE (%), 2011-2015

Company/Year	2011	2012	2013	2014	2015	Mean	STD
Liberty Kenya Holdings	5	5	4	4	3	4.2	0.75
Pan Africa Insurance	5	5	8	5	0	4.6	2.58
Kenya Re-Insurance	13	15	14	14	15	14.2	0.75
Britam	-7	8	7	5	-2	2.2	5.78
Jubilee	3	4	4	4	4	3.8	0.40
CIC Insurance	8	12	10	13	7	10	2.28

Essentially, ROCE should always exceed the company's cost of capital otherwise additional borrowing may lead to decline in shareholder earnings. Given that the cost of capital in Kenya is significantly dependent on interest rates, the six insurance companies can be said to have not performed impressively in terms of ROCE in the last 5 years. Since 2010, interest rates have averaged 15-20%, implying that the cost of capital has been higher than ROCE. Nonetheless, with regulatory adjustments have been made recently to cap interest rates at not more than 4 percentage points above the Central Bank Rate, the future may be much brighter for the companies. Overall, the six companies have depicted a fairly impressive performance in terms of ROA and ROCE. Can

this impressive performance be attributed to changes in gearing and working capital ratios? The next sub-section of this chapter answers this question.

4.3 Correlation Analysis

The primary aim of this research was to examine the relationship between capital structure and working capital management, and financial performance. As shown in table 6 below, which depicts the correlation coefficients, the relationship varied from company to company.

Table 6: Correlation coefficients

	LKH	PAI	Kenya Re	Britam	Jubilee	CIC
ROA & Gearing Ratio	-0.06	0.69	0.78	-0.97	0.92	-0.59
ROA & Working Capital Ratio	-0.16	0.52	-0.85	0.82	-0.94	0.75
ROCE & Gearing Ratio	-0.44	0.66	-0.36	-0.96	-0.80	0.03
ROCE & Working Capital Ratio	0.09	0.48	-0.29	0.80	0.59	0.18

In particular, gearing ratio was found to be positively correlated with ROA in three companies, with the correlation coefficient exceeding 0.6 in the three cases. This indicates strong relationship between the two variables. Nonetheless, gearing ratio was found to be positively correlated with ROCE in only two companies (33%), with the correlation coefficient for one of the cases being 0.03, which indicates a rather weak correlation. A positive correlation was also found between working capital ratio and ROA, though for only two companies. Nonetheless, only one company depicted a negative correlation between ROCE and working capital ratio. Overall, 50% of the companies depicted a strong positive correlation between gearing ratio and ROA and 33% depicted a strong positive correlation between gearing ratio and ROCE. In addition, 33% of the companies portrayed a strong positive correlation between working capital ratio and ROA, and 83% portrayed a strong positive correlation between working capital ratio and ROCE.

4.4 Regression Analysis

As mentioned earlier, financial performance was measured using both ROA and ROCE. Beyond correlation analysis, it was important to determine the extent to which the movement of the dependent variable is influenced by the movement of the independent variable. This is the essence of regression analysis. The regression results are as shown in table 7 below.

Table 7: Regression coefficients

	LKH	PAI	Kenya Re	Britam	Jubilee	CIC	Mean
ROA & Gearing Ratio	-0.01	1.58	0.46	-1.57	0.06	-0.04	0.08
Error Term	0.00485	0.017677	0.006059	0.017169	0.002199	0.020196	0.01
ROA & Working Capital Ratio	0.00	0.01	-0.01	0.03	-0.01	0.00	0.00
Error Term	0.004792	0.20904	0.005125	0.039159	0.001903	0.01664	0.05
ROCE & Gearing Ratio	-0.13	1.91	-0.26	-1.70	-0.05	0.00	-0.04
Error Term	0.006942	0.023334	0.011047	0.021976	0.002806	0.030677	0.02
ROCE & Working Capital Ratio	0.00	0.01	-0.01	0.03	0.00	0.00	0.01
Error Term	0.007718	0.027198	0.011316	0.045349	0.003791	0.030185	0.02

Given the above coefficients, the overall regression model was as follows:

$$ROA + ROCE = 0.04X_1 + 0.01X_2 + 0.03$$

Where X_1 represents gearing ratio and X_2 represents working capital ratio.

In essence, a one percentage increase in gearing ratio would result in a four percentage increase in ROA and ROCE, and a one percentage increase in working capital ratio would result in a one percentage increase in ROA and ROCE. On the whole, the regression results indicate that gearing ratio has a greater impact on ROA and ROCE compared to working capital ratio.

Table 8 below provides the model summary.

Table 8: Model summary

Model	R	R Squared	Standard error
1	0.86	0.74	0.03

As shown in table 8, the value of R^2 was 0.74. This means that the model accounted for 74% of the variance in ROA and ROCE. R^2 shows that the model predicts 74% of variance in financial performance. The standard error was 0.03.

Table 9 below depicts the results of ANOVA analysis

Table 9: ANOVA

Sum of squares	Mean square	df	F-test	p-value
0.012675	0.001496	6	2.3412	0.03

The above ANOVA analysis indicated that the results were significant at a 5% level of confidence as the p-value ($p = 0.008$) was less than 5%. This implies that the findings are ideally representative of the population. In other words, the findings can be used to infer to the populations. The F-test at a 5% level of confidence was 2.3412. This further demonstrates the significance of the model. In other words, gearing ratio and working capital ratio influence the performance of insurance companies, especially with respect to ROA and ROCE.

4.5 Discussion of Findings

This study aimed to examine the relationship between capital structure and working capital management in publicly listed insurance companies in Kenya. The correlation and regression analyses showed that a strong positive relationship exists between gearing ratio and ROA and

ROCE in more than 33% of the companies included in the sample. This confirms a broadly held view that the mix of debt and equity may have significant implications for the financial performance of a company (Gallagher & Andrew, 2007). Essentially, as the ratio of debt to equity increases, the firm's efficiency in terms of converting assets into profits increases. The vice versa is true. In other words, more debt and less equity generally generate greater shareholder wealth compared to less debt and more equity. A number of studies support the positive relationship between a debt-oriented capital structure and profitability. For instance, Bawa's & Chattha's (2013) study, which was carried out within the Indian insurance context, shows that profitability is negatively related with equity capital. This implies that the greater the level of equity, the lesser the profitability.

However, other studies provide contradictory findings. In their study, which aimed to examine the determinants of the financial performance of general insurance companies in Kenya, Mwangi & Murigu (2015) found that capital structure is a significant determinant of the financial performance of general insurance companies in Kenya. The study particularly found that the more the equity capital the better the financial performance in terms of ROA. The positive influence of equity capital on financial performance has also been demonstrated in other studies, including studies carried out in non-Kenyan contexts (Shiu, 2004; Mwangi, 2013; Charumathi, 2012; Chen and Wong, 2004). This suggests that firms should pay greater attention to equity financing as opposed to debt financing. All the same, it is important to note that very few studies have been carried out to examine the relationship between capital structure and financial performance (ROA and ROCE), particularly within the Kenyan insurance context. Further inquiry is, therefore, needed to reach a more convincing conclusion.

The correlation and regression analysis further indicated that 33% of the companies had a strong positive correlation between working capital ratio and ROA, and that 83% had a strong positive correlation between working capital ratio and ROCE. This suggests that financial performance may also be a factor of working capital management. This finding somehow suggests that firms should be more oriented to a conservative working capital management policy, where more focus is on current assets as opposed to fixed assets.

The positive relationship between working capital management strategy and ROA is indeed supported by several other studies. For instance, Nyabuti's & Ondiek's (2014) study, which sought to examine the relationship between working capital management strategy and the financial performance of 10 firms listed in the Nairobi Securities Exchange (NSE), found that liquidity management policy is positively related with financial performance as measured by ROA. A study carried out by Bawa & Chattha (2013) in the Indian context shows that the profitability of life insurers (particularly in terms of ROA) is positively influenced by liquidity. In a similar vein, Cheluget et al.'s (2014) study found that poor liquidity management was a significant factor in the recent collapse and/or placement under statutory management of 9 insurance firms in Kenya. This adds weight to the argument that working capital management policy can significantly impact on a firm's financial performance.

Other studies, though not carried out within the insurance context, have also found a positive relationship between working capital management and ROA (Kithii, 2008; Mathuva, 2009; Nyakundi, 2003). Some studies, however, suggest otherwise. In their study, for instance, Mwangi & Murigu (2015) found that no relationship exists between liquidity and financial performance as measured by ROA. All the same, evidence for a positive relationship between working capital management and financial performance appears overwhelming. Nonetheless, more research is

needed to validate this argument as little or no research has been carried in this area. This is particularly true for the relationship between working capital management and ROCE.

CHAPTER FIVE: SUMMARY, CONCLUSION, AND RECOMMENDATIONS

5.1 Introduction

This chapter provides a summary of study findings and implications for future research as well as policy and practice. In particular, the chapter presents a concise summary of the study, describes what should be done in future studies to reinforce the findings of the study and literature on this topic, and highlights the relevance of the findings to policy practice in the area of financial management in insurance companies in Kenya.

5.2 Summary of Findings

This study sought to examine the impact of capital structure and working capital management on the financial performance of publicly quoted insurance companies in Kenya in the period 2011-2015. The study was motivated by inadequate scholarly attention in this area and, more particularly, the recent trend of insurance companies being placed under statutory management due to poor performance emanating from poor financial management. The study particularly narrowed down to the relationship been financial management strategy (specifically in terms of capital structure and working capital ratio) and financial performance as measured by ROA and ROCE.

Following correlation and regression analyses of the variables, it was established that a strong positive relationship exists between gearing ratio and ROA and ROCE; as well as between working capital ratio and ROA and ROCE. In essence, it was found that 50% and 33% of publicly listed insurances in Kenya companies showed a strong positive correlation between gearing ratio and

ROA, as well as gearing ratio and ROCE, respectively. It was further found that 33% and 83% of the companies showed a strong positive correlation between working capital ratio and ROA, as well as working capital ratio and ROCE, respectively. In other words, the greater the proportion of current assets to current liabilities, the greater is the ROA and ROCE, and vice versa. While it was found that both gearing ratio and working capital ratio may have a positive impact on ROA and ROCE, gearing ratio was found to have a greater impact on ROA and ROCE compared to working capital ratio.

5.3 Conclusion

Overall, it has emerged that financial management strategies, especially with regard to debt-equity mix and working capital management policy, may have significant implications for the financial performance of insurance companies in Kenya. This study particularly suggests that insurance companies in Kenya ought to adopt more debt-oriented capital structures if they are to improve their profitability in terms of ROA and ROCE. The study also suggests that insurance companies should pay greater attention to current assets or rather be more oriented towards a conservative working capital management policy. This, however, raises the question of forgoing long-term investments, which may be detrimental to profitability in the long run. All the same, the study adds weight to the argument that financial management strategy can have substantial implications on the financial performance of a firm. It is, therefore, important for insurance companies to be more mindful of their financial strategies if they are to survive in a rigorously competitive business environment and create maximum value for their shareholders. Nonetheless, more research is needed in this area as it is largely under-researched.

5.4 Study Limitations and Suggestions for Future Research

This study no doubt makes significant contributions to the literature on financial management strategy and financial performance in the insurance context. A major strength of the study compared to most studies on the topic stems from the fact that it focused specifically on ROA and ROCE as opposed to financial performance in general. Nonetheless, it is imperative to note that there are other measures of financial performance including gross profit margin, net profit margin, ROE, asset turnover, and dividend yield. It would, therefore, be important for future research in this research to include as many measures of financial performance as possible. Moreover, the study only used two measures of financial management strategy: capital structure and working capital management strategy. It must be noted that there are other components of financial management strategy such as cash flow management strategy and receivables management strategy. In this regard, including more measurements of financial management strategy in future studies would give a more comprehensive view of financial strategy, thereby, providing a more conclusive picture of the relationship between financial management strategy and financial performance.

Most importantly, the study only involved six insurance companies in Kenya, specifically those listed on the stock exchange. Discretion should, therefore, be exercised when generalising the findings to insurance industries or organisations in other countries, whose macro environmental factors may be different from the Kenyan environment. Despite these limitations, the study provides valuable insights into the relationship between financial strategy and financial performance.

5.5 Recommendations for Policy and Practice

Given that this study adds weight to the argument that financial management strategy may have significant implications for firm performance, it provides relevant implications for policy and practice within the context of insurance in Kenya. In the last few years, a number of insurance companies in the industry have been placed under statutory management, with poor financial management strategies being cited as major causes of poor performance. Against this background, the study serves as a wakeup call for players in the industry to tighten their financial management strategies, particularly in relation to capital structure and working capital management. This would place them in a better position to take advantage of opportunities in the market given that the Kenyan insurance market is growing rapidly as a result of more and more consumers embracing insurance products.

More fundamentally, the study provides valuable policy insights to IRA, which is charged with the responsibility of regulating and stabilising the insurance industry in Kenya. As the regulator, IRA is responsible for monitoring insurance firms, especially with respect to capital structure and liquidity, so as to ensure stability of the industry. With this study, therefore, the regulator is better placed to come up with more effective policies for regulating the industry.

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APPENDIX: SUMMARY OF FINANCIAL PERFORMANCE

Variable/Year	2011	2012	2013	2014	2015	Mean	STD
	Liberty Kenya Holdings (LKH)						
EBIT (Kshs millions)	1010	1179	1306	1336	954	1157	153.33
Net Income (Kshs millions)	950	887	1106	1149	954	1009.2	100.40
Current Assets (Kshs millions)	6373	9269	12198	10804	11993	10127.4	2147.46
Total Assets (Kshs millions)	24294	27390	31452	33194	34534	30172.8	3797.06
Current Liabilities (Kshs millions)	1950	2000	1898	2500	2772	2224	348.71
Debt (Kshs millions)	505	480	722	928	864	699.8	182.09
Equity (Kshs millions)	4175	5422	5465	6157	6233	5490.4	739.11
Capital Employed (Kshs million)	22344	25390	29554	30694	31762	27948.8	3538.77
	Pan Africa Insurance (PAI)						
EBIT (Kshs millions)	552	835	1516	1153	54	822	500.82
Net Income (Kshs millions)	443	698	1250	871	27	657.8	410.32
Current Assets (Kshs millions)	3804	5050	4981	4353	4420	4521.6	456.94
Total Assets (Kshs millions)	11499	16474	21158	24599	27109	20167.8	5614.06
Current Liabilities (Kshs millions)	778	828	1086	1178	1224	1018.8	182.40
Debt (Kshs millions)	435	535	733	738	756	639.4	130.20
Equity (Kshs millions)	2123	2629	3338	3778	3802	3134	660.26
Capital Employed (Kshs millions)	10721	15646	20072	23421	25885	19149	5436.50
	Jubilee						
EBIT (Kshs millions)	1070	1546	2228	2517	3128	2097.8	723.17
Net Income (Kshs millions)	1910	2285	2503	3104	3121	2584.6	470.96
Current Assets (Kshs millions)	12144	16954	19960	25223	24849	19826	4932.29
Total Assets (Kshs millions)	38992	47417	61159	74505	82378	60890.2	16175.41
Current Liabilities (Kshs millions)	2852	4669	3844	4750	4372	4097.4	699.04
Debt (Kshs millions)	1245	1296	1305	1374	0	1044	523.61
Equity (Kshs millions)	6711	8700	11560	16479	20381	12766.2	5028.41
Capital Employed (Kshs millions)	36140	42748	57315	69755	78006	56792.8	15761.25

Variable/Year	2011	2012	2013	2014	2015	Mean	STD
	Kenya Re-Insurance (Kenya Re)						
EBIT (Kshs millions)	2034	2945	3269	3920	4514	3336.4	846.32
Net Income (Kshs millions)	1915	2802	3000	3137	3554	2881.6	542.59
Current Assets (Kshs millions)	10902	10742	17516	20616	22956	16546.4	4982.67
Total Assets (Kshs millions)	19096	23788	28222	32174	35954	27846.8	5960.58
Current Liabilities (Kshs millions)	3129	4274	4503	5116	6295	4663.4	1039.11
Debt (Kshs millions)	241	419	477	0	0	227.4	201.30
Equity (Kshs millions)	11526	14613	17922	19991	21933	17197	3730.93
Capital Employed (Kshs millions)	15967	19514	23719	27058	29659	23183.4	4955.27
	Britam						
EBIT (Kshs millions)	-1724	2849	3196	3212	-1195	1267.6	2236.71
Net Income (Kshs millions)	-1957	2519	2654	2498	-1009	941	2002.48
Current Assets (Kshs millions)	4185	5882	7646	14275	14365	9270.6	4265.73
Total Assets (Kshs millions)	25639	35820	46903	72450	77632	51688.8	20284.93
Current Liabilities (Kshs millions)	2464	956	1418	5847	4364	3009.8	1840.29
Debt (Kshs millions)	785	47	117	200	600	349.8	289.94
Equity (Kshs millions)	8557	12472	16935	21440	17674	15415.6	4458.87
Capital Employed (Kshs millions)	23175	34864	45485	66603	73268	48679	18854.17
	CIC Insurance						
EBIT (Kshs millions)	787	1650	1671	1390	1339	1367.4	319.44
Net Income (Kshs millions)	584	1388	1408	1088	1137	1121	297.78
Current Assets (Kshs millions)	8250	9486	12049	15589	9184	10911.6	2656.04
Total Assets (Kshs millions)	11121	14070	17094	17036	24814	16827	4562.16
Current Liabilities (Kshs millions)	799	658	1123	6458	6431	3093.8	2740.00
Debt (Kshs millions)	538	444	792	5052	5068	2378.8	2192.16
Equity (Kshs millions)	4294	5471	6737	7207	7830	6307.8	1270.08
Capital Employed (Kshs millions)	10322	13412	15971	10578	18383	13733.2	3108.80