

**EFFECT OF SOCIAL RISKS ON THE FINANCIAL PERFORMANCE OF
INSURANCE COMPANIES IN KENYA**

BY

DAVINE CHEPCHUMBA TALAM

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DECLARATION

I, the undersigned, declare that this research project is my original work and has not been submitted for a degree in any other university

Signed

Date

Davine Chepchumba Talam

D61/84300/2015

This research project has been submitted with my approval as University Supervisor

Signed 

Date 27th November, 2020

Dr. Caren Angima (PhD)

Senior Lecturer

Department of Business Administration

School of Business

University of Nairobi

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DEDICATION

To my loving family, thank you all for your prayers, constant support and encouragement

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LIST OF ACRONYMS/ABBREVIATIONS

CP	-	Contingency Planning
ERM	-	Enterprise Risk Management (ERM)
GDP	-	Gross Domestic Product
IRA	-	Insurance Regulatory Authority
KNBS	-	Kenya National Bureau of Statistics
KRA	-	Kenya Revenue Authority
NSE	-	Nairobi Securities Exchange
SPSS	-	Statistical Package for Social Science
WHO	-	World Health Organization

ABSTRACT

The threat posed by the prevalence of risks facing insurance firms around the world has been a major challenge experienced in the insurance industry. To a large extent, such risks have accounted for huge insurance claims facing insurance firms and have consequently affected their profitability. The aim of this study was to establish the relationship between social risks and financial performance of insurance companies in Kenya. Social risks arise largely from changes in the social processes, inter-personal behaviors, environmental and political structures surrounding the insurance sector. Descriptive research design was adopted, and all fifty-four (54) insurance firms as at the end of 2018 were targeted for study. The study used both primary and secondary data. The former was collected using a structured questionnaire that was filled by a senior management staff in each company. The latter comprised data on financial performance for each company obtained from IRA publications for the period 2014-2018. Data was analyzed using descriptive statistics, correlation and linear regression. The study found out that insurance fraud and intermediaries were the main social risks that have had a negative and statistically significant effect financial performance of insurance firms in Kenya. Further, whereas terrorism and political unrest were found to have an insignificant effect, the influence of social risks arising from substance abuse, lifestyle changes and moral hazard were perceived to be moderate. Correlation results showed that there was a significant positive relationship between each pair of social risks considered in the study, suggesting that they have the potential to interact with each other, to adversely impact on profitability. The study recommends insurance firms to carefully consider, assess and evaluate their various social risk mitigation measures so as to lessen the adverse effects on profitability.

CHAPTER ONE:

INTRODUCTION

1.1 Background of the Study

The risky nature of the business world is unsustainable without insurance and businesses might be unable to cope with all risks within the dynamic and uncertainty of the world economy (Ahmed et al., 2010). Insurance is a risk transfer mechanism with the capacity and experience to handle risks. Risk transfer is done at a fee called premium (Marshall, 2001). Insurance companies handle risks by creating a pool. Mehr and Cammack (1961) state that pooling of risks involves grouping of homogeneous risks to produce a correct prediction of the longer term, the pooled premiums are then used to settle claims of insureds who suffer losses. One of the biggest challenges in the insurance industry worldwide arises from social risks. Social risks are factors largely arising from changes in social processes, inter-personal exchanges and behavior, health, environment, as well as administrative and political structures (Holzmann, R., & Jorgensen, S., 2000). If an appropriate risk management strategy is not in place, risks arising from these factors could affect the financial position for insurance firms.

This study was anchored on three theories. First, is the Enterprise Risk Management (ERM) Theory, which asserts that insurance companies handle many inter-linked risks that range from financial to social risks, and that if not properly managed, overall performance will be greatly hampered. Babbel and Klock (1994) point out that there is nothing worse than when clients discover that their insurer may be unable to honor their claims. This will lead to losses which cause a decrease in their financial performance (Magezi, 2003). Second, is the Dynamic Theory of Profit which suggests that firms' financial performance is dependent on the dynamic changes

experienced in the economy and/or environment in which they operate. This calls for dynamism and proactivity in their responses to market disturbances (Rasmussen & Svedung, 2000). Third, is the Contingency planning theory, which provides that the environment in which an organization operates will determine how the company will be managed. The implication of the theory is that insurance companies need to be mindful of the risks that can potentially cause damage, loss or significantly hinder the company's ability to achieve other goals. The choice of risk mitigating instruments to use is directly linked with the calculative culture of the company (Mikes & Kaplan, 2014).

The insurance industry in Kenya has had its fair share of challenges arising out of social risks. High rate of motor claims arising from drunk-driving and fraud caused by insureds and service providers have contributed to decline in profits (IRA, 2018). Congenital diseases like cancer, high blood pressure resulting from unhealthy lifestyles have made medical insurance less profitable. Insurance intermediaries have increased operation costs in the sector. Terrorism and political unrest have also affected profitability of most insurance companies (Larobina & Pate, 2009). In this context, this study analyzes the effect of social risks on the financial performance of insurance companies in Kenya.

1.1.1 Social Risks

Social risks can be described as those risks that arise out of moral hazards, that is, human behavior, culture, lifestyle, perception and belief towards insurance services. Moral hazard arises when the insured persons do not take into account the consequences of their behavior on the expenditures anticipated for the insurer (Spinnewijn, 2009). The insured will exercise less precautionary efforts

the more they are insured. The literature in this field has focused more on standard quantifiable risks, such as market and liquidity risks. Little attention is paid on the role of non-quantifiable risks that may be associated with socio-political issues branding (HM Treasury, 2004). Social risks, according to Navicke (2014), is linked with rising cases of unemployment, health inequalities, financial instability, loneliness, breakdown of both formal and informal support networks as well as reduced educational attainment.

Fraud is a form of deception with an intention of personal or financial gain. It has been the leading social risk affecting profitability of most insurance companies worldwide. According to Mutua (2014), there are several forms of insurance fraud that occur in insurance companies including, falsification of products; misuse of premiums; and double billing that insurance companies pay and which ultimately affect their profitability. The 2018 report of the Insurance Regulatory Authority (IRA) has indicated that fraud has affected the use of insurance products and shows that most insurance companies suffered losses due to fraud (IRA, 2018).

According to the 2012 report of the World Health Organization (WHO), alcohol and substance abuse is identified as among the leading road safety risks around the world. This is likely to affect premiums paid on car insurance. Firms that insure against injury ensuing from a road crash have witnessed rising part of their costs as a result of insurance claims payments for compensation and injury rehabilitation. The financial cost of litigation and compensation affect profitability of insurance companies.

Pressure from insurance intermediaries (Agents and brokers) is another social risk facing insurance companies. Intermediaries assist insurance companies in acquiring and distributing insurance services and they are paid commission for business acquired. Insurance intermediaries make false representation of the products and services according to (Churchill, 2006), while others collect and misappropriate premiums from clients (Njuguna & Arunga, 2013). Thus, the operating expenses and administrative costs of managing intermediaries is high and in the absence of economies of scale, it is unprofitable (Weiss, 2006).

Moral hazard is another social risk. This involves a change in the behavior of policyholders, after they have entered into an insurance contract, so that the risk event under which they are insured against becomes likely to occur. Weiss (2006) argues that moral hazard is common in the micro-insurance sector. It is expected that a policyholder will pay due attention in their transactions to reduce the occurrence of losses and claims, the ideology of risk sharing requires that a smaller percentage of policyholders suffer losses (Brown and Churchill, 2000).

Changes in the lifestyle of policyholders have led to enormous medical expenses for insurance companies. Singh and Singh (2008) indicate that diseases seem to increase in number and become complex over time. While in past centuries, infectious diseases and malnutrition were prevalent, lifestyle diseases, chronic diseases and neoplastic disorders are more common today. Increased consumption of fast-foods among the population coupled with the lack of body exercises exposes the body to lifestyle diseases such as high-blood pressure, obesity, back problems, eye problems and cancer. Ding et al. (2015) in their study, identify lifestyle changes as the main cause of

mortality among the middle-aged and older adults. Further, Kokkinos et al. (2008) suggest that exercising and body fitness reduces mortality by between 50 to 70 percent.

Terrorism and political unrest have continued to pose a threat to insurance companies across the world and have contributed immensely to these losses. Research has shown that terrorism has negatively impacted on financial markets and business environment of the affected countries (Larobina & Pate, 2009). According to IRA (2013), following terrorist attacks in Kenya, insurance claims rose significantly in 2013, to an amount comparable to a third of the industry's payments in 2012. Whereas no bankruptcies were reported during that period, insurers and reinsurers incurred huge cash outflows and recorded low profits.

1.1.2 Financial Performance

The success of a company in the industry depends on the extent to which it achieves its financial and market objectives. The company's overall performance is the result of the various strategies it uses to achieve those objectives. Cameron, Whetton and Kim (2007) argue that every aspect of the firm's organizational performance is unique, because performance is intrinsically situational. Wani and Dar (2015) describe financial performance as a subjective indicator that determines how companies utilize resources at their disposal to generate income. Performance varies across firms depending on internal variables as influenced by management decisions, and external factors as influenced by the market.

For the typical insurance company, financial performance can be determined by assessing profitability, liquidity and solvency. According to Zenios et al. (1999) and Green and Inman (2007)

the assessment of profitability focuses on the connection between the costs incurred and the income received. The authors propose the use of financial indicators such as the Return on Assets (ROA), Net profit/income, sales growth, Return on Equity (ROE), Return on Investment (ROI) and market share as measures of firm performance. ROA is a widely used measure because it considers the returns generated from the company's assets.

1.1.3 Insurance Companies in Kenya

The Insurance Regulatory Authority (IRA) regulates the insurance sector as per the Insurance Act (Amendment) 2006, CAP 487 of the Kenyan Laws. The IRA is also responsible for overseeing the regulation and promotion of the sector's growth. It also controls Re-insurance companies, insurance dealers, automobile valuers, risk managers, among others.

According to IRA(2017) Kenya's insurance industry has grown tremendously in recent years, witnessing nominal growth of 6.3% in 2017, with long term insurance business growing by 12.6% while general insurance growing by 2.5%. The sector's general performance is driven mainly by premium, which averaged 60%. This notwithstanding, the sector's penetration (as measured by Gross Domestic Insurance Premiums to GDP ratio) remained at 2.7% in 2017, and expected to stabilize at 2.8 in 2018. These penetration levels were way below the global average of 6.1% and Africa's average of 3.0% (IRA, 2017). The insurance industry has suffered from social risks, poor governance, poor economic growth, and industry saturation. About nine (9) insurance companies have gone bankrupt within the past decade of 2008 to 2018 because of the above-mentioned challenges. This compelled the IRA in 2013 to launch an inclusive risk management scheme for the industry.

1.2 Research Problem

The role of Insurance companies is to manage risks belonging to individuals, firms or the government. In its efforts to manage risks, insurance companies incur financial losses because of the nature of their business. Changes in the social environment will affect amounts that insurance companies pay in form of claims that could arise out of social risks (Boobier, 2016). Social risks affect the insurance firms' overall performance by increasing possibilities of losses occurring through increased claims, hence financial stability of the insurance company is compromised (Navicke, 2014). It is in line with this that this study seeks to identify social risks faced by insurance companies in Kenya, how they affect their financial performance, in order to suggest ways to manage those social risks. It also attempts to assess various social risks in the insurance sector in Kenya and their relations with the financial performance of the sector.

Empirical work on the link between risks and firm financial performance has been conducted. Maaka (2013) studied this relationship among Kenya's insurance firms, by focusing on the influence traditional forms of risks such as financial and liquidity risks, while Njeru & Kamau (2016) examined operational, market and credit risks faced by listed insurance companies in the Nairobi Securities Exchange (NSE)'s listed insurance firms and how these risks affect their financial performance. Mwangi (2013) explored the factors influencing financial performance of insurance firms in Kenya and considered how underwriting risks relate with financial performance. These studies did not address social risks in their analysis. The study therefore contributes to this literature by answering the question, how do social risks affect financial performance of Kenya's insurance companies?

1.3 Study Objectives

The objectives of the study were to:

- i) Determine the social risks associated with insurance business in Kenya.
- ii) Establish the relationship between social risks and financial performance of insurance companies in Kenya.

1.4 Value of the Study

To the underwriting and claims managers and other policymakers, the study's findings will enlighten them on the nature of social risks facing them, sources, and how to handle them. It may enable underwriters to identify potential sources of social risks so that they apply proper rating and conditions on policies likely to be affected by social risks. In the process, the insurance sector in Kenya may be profitable, and thus may be able to maintain a higher competitive advantage.

The study will be importance for interested parties such as government. This is because the study will provide necessary influences from both a practical and theoretical view on the effects of social risks. The governing body IRA will use the information to formulate policies useful in better management of social risks and thus help in protecting the industry resources and ensuring stability of the sector. Additionally, policymakers in the insurance sector would be able to improve on social risk management systems and thus reduce losses which then will improve financial performance. Finally, for academics, the study will contribute to the literature on social risks, by identifying the social risks related to insurance companies and how they affect the overall financial situation of their organizations. The study findings will also be useful for further research.

CHAPTER TWO:

LITERATURE REVIEW

2.1 Introduction

This part describes and evaluates the theories relevant to the study. It reviews, summarizes and evaluates existing empirical evidence, while bringing out the knowledge gap.

2.2 Theoretical Foundations

Many theories on risk and financial performance have been proposed and discussed at length. Related to this study, the most relevant ones are: the Enterprise Risk Management Theory, The Dynamic Theory of Profit and the Contingency Planning (CP) Theory.

2.2.1 Enterprise Risk Management (ERM) Theory

The Enterprise Risk Management (ERM) theory as propounded by Gordon, Loeb and Teng (2009) provides a holistic approach to managing an organization's risks by linking firms' performance to five key factors, namely: environmental unpredictability, industry rivalry, firm footage, firm twist and Board of Directors' monitoring. The empirical evidence of Hoyt and Liebenberg (2011) showed that companies using the ERM concept improve their performance, thus supporting the theory. According to the theory, by adopting an all-round approach to managing firms' risks, ERM is presumed to reduce the overall risk of bankruptcy, thus improving its overall performance.

An aspect of the theory that is relevant to this study is environmental uncertainty, which is characteristic of the dynamic external environment in which a firm operates. Uncertainty often

causes problems for organizations because of growing unpredictability of the future (Gordon et al., 2009). A firm's response to various risks it faces with depending on the environment uncertainty confronting it.

2.2.2 The Dynamic Theory of Profit

The Dynamic Theory of Profit was propounded by Clark (1907) and it proposes that firm profit is attributed to dynamic changes taking place in the economy and all its organizations. Institutions in a static economy cannot realize real profits. According to this theory, firm's profit can be as a result of six (6) dynamic changes, namely: changes in population; changes in consumers' tastes and preferences; multiplication of consumer needs; increased capital formation; advancement in technological; and changes in the nature, structure and systems within business organizations. On account of these changes, entrepreneurs will continuously be confronted with unpredictable changes in demand for their product, and consequently some businesses may be at advantageous positions against others and may reap more profits.

Rasmussen & Svedung (2000) note that it is important for firms to carefully consider take cognizance of their dynamic environment, sources of disturbances (risks) and control requirements. Their risk management approach must be increasingly proactive if they have to be successful in the long run. This theory is applicable to this study for reasons that social risks are highly dynamic, insurance companies which fail to respond appropriately to these changes may not realize any profit and may even incur losses. Pearce and Robinson (2005) identify the dynamic social factors that will influence the demand for firm's product to include beliefs, opinions and

lifestyles of consumers which emanate from their cultural, ecological, educational and ethnic conditioning.

2.2.3 Contingency Planning Theory

The Contingency Planning Theory developed by Scott (1981) states that organizations do have a prescribed way of coping with risks, because everything is shaped by the environment in which the organizations operate in and relate. According to this theory, different risk situations call for different approaches in handling, managing and solving the situation. In support of the theory, Hinson and Kowalski (2008) argue that business organizations need to plan ahead for those risks or losses that are likely to occur. This is due to the fact that not all risks can be prevented from occurring. Despite the organizations efforts to avoid or prevent risks, losses will still occur.

The theory is applicable to this study, in that management of social risks take a whole process which involves assessing the risk, rating the risk, proving insurance of the risk, providing loss reducing measures on the risk and finally settling the claim when it occurs. Contingency requires that there are resources in place in the event that any loss occurs. Organizations pursue contingency planning in order to lower the negative consequences of unpredictable events that could occur.

2.3 Management of Social Risks

The main goal of social risk management should be to prevent the risk from occurring, but since this may not be achieved, mitigation can be encouraged. According to Bandara & Weerakoon (2012) managing risks is vital for the success of insurance companies. Individual and organizational efforts can prevent social risks from occurring but in many cases require support

from the government. These strategies are set based on the background of different degrees of information; the information held by partners like intermediaries and service providers, clients and the government will influence the effectiveness of social risk management. Below are various ways of social risk management that are relevant to this study.

Training of stakeholders is process whereby insurance companies engage and equip its stakeholders with information and skills regarding social risks. It is the oldest form of risk management applicable to almost all elements of risk (Holzmann, R., & Jorgensen, S., 2000). These trainings target groups with information regarding social risks management hence reducing the chances of social risks causing losses and creating claims (Maleika & Kuriakose, 2008). Cases of lifestyle diseases such as cancer and high-blood pressure have been on the rise causing high claims to the insurance companies. Insurance companies need to liaise with medical practitioners to train insureds on importance of healthy lifestyle.

Proper rating of policies that are affected by social risks is another tool of managing social risks by insurance companies. Most insurers lack the data that is required to improve on their pricing decisions, and hence they may charge less or more than the cost. The situation could be avoided if they allowed an error margin and make adjustments whenever a claim occurs (Patel, 2002). Churchill (2006) advises Insurance companies to constantly utilize the services of actuaries when making these price adjustments.

Re-insurance is the other technique of market-based arrangement helpful in management of social risks like terrorism. Re-insurance enable insurance companies to increase their capacity of

underwriting risks, it also enables insurance companies to spread their risks so that in case of a huge claim, the loss is shared at agreed portions, and this point was emphasized by Prahalad (2005). The regulators and policy makers of insurance industry have a role to ensure that insurance companies have made adequate and proper Re-insurance arrangements.

Screening applications is another method that reduces adverse selection. This technique ensures that high risk clients are not accepted on standard terms of insurance (Patel, 2002). This will reduce the possibility of claims arising out of high-risk clients and if it arises the terms of the policy were favorable to the insurer especially for medical insurance, insurance companies should subject prospective clients through medical tests to ascertain the position of their health conditions. On fraud, Radu (2003) argues that organizations need to formulate strategies that suppress all the motivations for committing fraud, focusing on those that will reduce opportunity, pressure and rationalization of the activities that are being sought by an individual.

Lastly, intermediaries help insurance companies to distribute insurance services and products. On Misrepresentation on products, insurance intermediaries should focus on offering adequate training so that they have the full knowledge of the products (Njuguna & Arunga, 2013). With regard to misappropriation of premiums; insurance companies need to formulate policies that encourage premium payment directly to insurers (Radu, 2003).

2.4 Empirical Review and Knowledge Gaps

The studies conducted on the insurance sector in Kenya are not exhaustive. Most of them focus on financial risks, operational risks, liquidity risk and risk management. Empirical literature on social risks, particularly in Kenya is minimal.

Mwangi (2013) examined the factors influencing insurance firms' performance, and found that variability in interest rates, competition and liquidity effects were the main drivers of the company's performance. Other studies (for instance, Mikes, 2009; Jordan, Jorgensen, & Mitterhofer, 2013) examined threats to firms involving non-financial and qualitative factors. According to these studies, the various risk management programs undertaken by the organization require employee involvement and managers. While some companies are guided by a value-system with a managerial approach towards measurable result-oriented goals (Mikes, 2009), other firms question the significance of risk management; they lay emphasis on learning by interrogating their achievements (Mikes, 2011). The types of risks faced by different organizations allow them to emphasize risk management. These studies however did not consider the role of social risks in driving firm performance. They considered a number of insurable, financial and measurable factors that threaten the company's strategic goals, ignoring social risks.

The key risk management practices of the AAR Insurance Kenya Limited has been studied by Njoroge (2013). The study established that reputational risk was the most notable risk suffered by most companies, caused by poor claims payment practices, low profitability and poor customer service. The study recommended the need for companies to drive the risk agenda across the organization, and that attention could focus on other emerging types of risks including information

technology and operational risks among others, at the same time, not lose focus on the traditional risks, for instance credit risks. The study focused on only one insurance firm in Kenya, and further, did not consider social risks in the analysis.

Kinyua (2010) studied risk assessment within the corporate strategy applied by selected life insurance companies in Kenya. Key findings showed these companies to have faced risks arising from competition, regulation and deregulation, and overall risk of the industry. The study recommend that insurance companies ought to improve strategic planning, and propose tools that offer the company an external perspective of the whole strategic planning process. This study does not cover the effect of social risks in insurance companies.

Wanjugu (2014) analyzed the components that impacted solvency of Kenya's insurance firms. Factors such as debt leverage (measured by debt-to-equity ratio) were considered. This measure gives an indication of the companies' ability to manage unanticipated losses. According to Adams and Buckle (2000), the total debt-equity ratio signifies the firm's potential impact on company's capital and shortfalls in reserves resulting from huge financial claims. The study recognized huge claims as a factor affecting profitability, but did not relate it directly to social risk or focus on social risks in the industry.

Other studies have identified unethical insurance practices (see for example, Ngethe, 2012; Kathanga, Awino Kabiru, 2016; and Chepkoech & Rotich, 2017) as a cause of huge insurance claims. Ngethe (2012) found that most insurance companies in Tanzania struggled to eradicate unethical practices, and led to huge loses in the industry. The study singled out collusion between

different stakeholders such as investigators, assessors, police force, loss adjusters and internal staff, with the insured, as the main source of fraud. Chepkoech and Rotich (2017) reported that the number of fraudulent claims reported to Kenya's insurance regulatory authority (IRA) had declined over time, while Kathanga, Awino Kabiru (2016) pointed out that the frequency of occurrence of fraud in the industry in Kenya had been high. These studies however, did not consider the channels through which fraud was associated with financial loss. Further, they ignored the role of other social risks.

CHAPTER THREE:

RESEARCH METHODOLOGY

3.1 Introduction

This section covers the approach used in answering the research questions. It describes and justifies the design chosen, population, sampling strategy and analysis plan.

3.2 Research Design

The research design concerns itself with how the research question of the study will be answered. Mugenda and Mugenda (2003) refer to it as the structure of the research used to get answers to research questions. Cross-sectional descriptive design was adopted in this study. The design enables a researcher to establish the linkage between variables examined or conditions in a given situation. The reason for descriptive research is to determine and provide feedback on how things are and to help show the current status of the population studied. The approach used in this study aimed at establishing the relationship between social insurance risks and financial performance.

3.3 Population of the Study

Population is a complete set of entities from which an investigation will be conducted prior to selecting a sample Mugenda and Mugenda (2003). Kothari (2004) notes that the elements contained in the population should have common observable characteristic. For this study, the population comprised of all fifty-four (54) insurance firms in Kenya as at the end of December 2018, according to the IRA (2018). Census was conducted since the population under study was relatively small.

3.4 Data Collection

The target population included all fifty-four (54) insurance companies as at the end of December 2018, and targeted the head offices of each insurance company. A senior management staff of the company, preferably the claims manager in each company was the target respondent owing to the fact that they were better placed to provide the most reliable information about the company, and that which was relevant for the study. The researcher obtained primary data using a structured questionnaire which were dropped at every insurance company to be filled by the claims manager and later be picked. As a data collection tool, a questionnaire enables a researcher to gather structured information from the respondents.

3.5 Data Analysis

In analyzing the data collected, descriptive statistics and linear regression were employed, with the help of the Statistical Package for Social Science (SPSS) software. The results were summarized and presented using tables and then interpreted. To investigate the relationship between social risks and financial performance, correlation and regression analysis were used.

Various elements of social risks were the independent variables. Financial Performance (FP) was the dependent variable and was measured by the return on assets (ROA), computed as a ratio between net income of a company during a given period and the value of its total asset. This was sourced from firms' existing records, and an average for the last five years (2014-2018) was considered. A data collection form (in appendix II) was used to obtain the information.

The independent variables were represented by Insurance Fraud (IF), Substance Abuse (SA),

Insurance Intermediaries (INI), Moral Hazard (MOR), Lifestyle Changes (LIF) and Terrorism and Political Unrest (TER). The measures of these variables were derived from a Likert type questions which were administered to the respondents. Specifically, they were measured on a 5-point Likert scale where the respondents were required to rate the extent to which each of the variables are either: “not significant”, “least significant”, “moderately”, “significant” or “highly significant” in influencing financial performance. The responses for which respondents rated as “highly significant” were given 5 points, followed by 4 points, 3 points, 2 points and 1 point for responses with “not significant” variable. The mean score of the Likert scale scores for each question asked for the independent variables were used as measures of the respective independent variable.

The simple regression model estimated was specified as follows.

$$FP = \beta_0 + \beta_1 IFR + \beta_2 INI + \beta_3 SA + \beta_4 TER + \beta_5 MOR + \beta_6 LIF + \varepsilon \quad (3.1)$$

Where; β_0 is the constant term, and $\beta_1, \beta_2, \dots, \beta_6$ are the coefficients in the model; FP is Financial Performance, measured by an average of a company’s annual Return on Assets (ROA) over a five-year period (2014-18). IFR is the mean score for Insurance Fraud; INI is the mean score for Insurance Intermediaries; SA is the mean score for Substance Abuse; TER is the mean score for Terrorism and Political Unrest; MOR is the mean score for Moral Hazard; LIF is the mean score for Lifestyle Changes; and ε is the error term that denotes the effect of other independent variables that could not be included in the model.

CHAPTER FOUR:
DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This study sought to assess the effect of social risk on financial performance of insurance companies in Kenya. This chapter presents, interprets and discusses the research findings.

4.2 Profiles of the Respondents

A total of fifty-four (54) questionnaires were issued, one for each insurance company. Out of these, fifty-two (52) were completed and returned, implying a response rate of 96%. The response rate was deemed acceptable for further analysis and inference. Table 4.1 depicts the classification of the 52 respondents by work experience.

Table 4. 1: Work Experience

Work experience(years)	Respondents	Percentage (%)
1 – 5 years	2	3.8
6 – 10 years	8	15.4
11 – 15 years	3	5.8
16 – 20	9	17.3
Over 20 years	30	57.7
Total	52	100

Source: Research data

From table 4.1 above, 3.8% of the respondents have between 1 and 5 years of work experience, 15.4% of them have worked between 6 and 10 years, 5.8% of them have more than 10 years of experience but less than 15 years, 17.3% of them have between 16 years and 20 years of work experience, while the rest 57.7% have worked in their companies for more than 20 years. From the findings, a significant proportion (80.8%) of the respondents worked for more than 10 years in the insurance industry. This implies that a significant proportion of the responses are experienced,

and this informs the quality and reliability of the information on social risks and financial performance of insurance companies in Kenya.

4.3 Effects of Social Risks on Insurance Financial Performance

In this section, the effect of social risks on financial performance is presented and analyzed. First, the main social risks facing the insurance sector in Kenya are identified. Second, their effect on financial performance is analyzed.

4.3.1 Social Risks in the Insurance Industry

Respondents we asked to identify the main social risks facing the industry based on their knowledge and experience. The results are depicted in table 4.2 below. It was found that 40.1% of the respondents identified insurance fraud as the main risk, followed by pressure from intermediaries (20.3%) and disease and lifestyle changes (16.2%). The others social risks received responses of less than 10%.

Table 4. 2: Social Risks in Kenya’s Insurance Industry

Social risk	Response (%)
Fraud	40.1
Substance abuse	9.5
Strikes and political unrest	4.7
Pressure from intermediaries	20.3
Moral hazard	7.7
Disease and lifestyle changes	16.2
Others	1.5
Total	100.0

Source: Research data

The results above were supported by the results in the subsequent sections, which partly showed the extent to which the social risks have affected the financial performance of insurance firms.

4.3.2 Effects on Financial Performance

The study aimed at examining the extent to which social risks affected financial performance of insurance firms. The respondents' feedback is summarized in table 4.3 below.

Table 4. 3: Extent of Effect of Social Risks on Financial Performance

Social risk	Mean	Standard Deviation
Fraud	4.17	0.834
Pressure from intermediaries	4.00	0.95
Substance abuse	3.06	1.162
Terrorism and political unrest	2.77	1.148
Disease and lifestyle changes	3.76	1.014
Moral hazard	3.22	1.18
Overall Mean Score	3.496	1.048

Source: Research data

The findings indicate that the leading social risks affecting insurance firms in Kenya are insurance fraud and pressure from intermediaries. Their mean scores of 4.17 and 4.00 respectively suggest that the two social risks have affected financial performance of insurance firms significantly. Further, their standard deviations (0.834 and 0.95, respectively) were below one, reflect lower variability in the responses, implying that the manner in which these social risks affected insurance firms in the country did not vary from one firm to the other.

The results also showed that disease and lifestyle changes, moral hazard and substance abuse affected insurance financial performance moderately (as reflected by mean scores of 3.76, 3.22 and 3.06 respectively). Their standard deviations were above one, suggesting that their effect on

performance varied from one company to another. Terrorism and political unrest had the least effect on performance, as reflected by the lowest mean score of 2.77.

In summary, the findings in table 4.3 identify insurance fraud, role of intermediaries as well as disease and lifestyle changes as the main three social risks that affect financial performance of insurance firms in Kenya, while terrorism and political unrest were the least important social risks in explaining financial performance. The overall mean score of 3.496 implies that all social risks have had a moderate effect on financial performance of insurance firms in Kenya, while the overall standard deviation of 1.048 points to a relatively wide variation in the effect from one firm to another, implying that the effects do not uniformly affect all insurers.

4.4 Relating Individual Social Risk with Financial Performance

Turning to the individual social risks and their connection to financial performance, the respondents were asked to indicate how individual social risks have affected the financial performance of their companies. The results are displayed in tables 4.4 to 4.9.

Table 4. 4: Fraud and financial performance

	Mean	Standard Deviation
Increased Claims	3.81	1.14
Increased premium rates	3.40	1.16
Reduced profits	3.87	1.21
Increased operational costs	4.04	1.08
Overall Mean Score	3.78	1.147

Source: Research data

The above results indicated that insurance fraud manifested itself through a number of channels. The most significant channel was through increased operational costs such as claims adjustments and higher costs of investigating fraudulent activities. With a mean score of 4.04, the result suggests a significant link through which fraud reduced financial performance. The standard deviation of 1.08 (which is slightly above one) reflect a relatively high disparity from one firm to another, in the degree to which higher operational costs affected financial performance.

The results also point to a significant association between insurance fraud and reduced profitability (with a mean of 3.87) and between fraud and high insurance claims (with a mean of 3.81). The standard deviations of 1.21 and 1.14 indicates that the extent of their association differs from one firm to another. The link between fraud and increased premium rates was found to be moderate (with a mean of 3.4). In summary, the overall mean score and standard deviation of the four factors associated with fraud were, respectively, 3.78 and 1.147, implying a significant relationship. However, the degree of association varies for each firm.

On the question of how the risk associated with intermediaries manifested in the insurance business, the results are displayed in table 4.5. The most significant means through which intermediaries influence financial performance is by them taking business to rival companies at lower rates (with a mean score of 4.17) and their failure to remit collected premium promptly (where the mean score is 4.13). The standard deviations (0.86 and 0.91) were below one, suggesting that the respondents' feedback did not vary much. Thus, the degree to which intermediaries take businesses to rivals at favorable rates and their delay in remitting premiums does not change from one insurance company to the other.

Table 4. 5: Insurance Intermediaries and Financial Performance

	Mean	Standard Deviation
Taking business to rivals at lower rates	4.17	0.86
Sharing company's information with rivals	3.58	1.21
Misrepresentation of product information to client(s)	3.67	1.35
Failure to remit collected premiums promptly	4.13	0.91
Overall Mean Score	3.888	1.083

Source: Research data

The results also point out to the significant role of intermediaries in sharing company information with rivals (mean of 3.58) and in misrepresentation product information to clients (mean of 3.67), in influencing financial performance. The extent to which these have affected performance were found to differ from one firm to another, as indicated by standard deviations of above one. This difference can be attributed to the diverse nature and range of product offered by these companies. To conclude, the overall mean score of 3.888 implies a significant role of insurance intermediaries through the four channels in influencing financial performance, while the standard deviation (1.083) is slightly greater than one, suggesting that their effect varies across insurance. The highest variability (1.35) arises in the misrepresentation of insurance products to clients.

In table 4.6 below, the results relating substance abuse to financial performance are displayed. The findings point out to the moderate effect that increased claims on motor insurance arising from drunk-driving and road carnage (mean of 3.35) has had on financial performance. A similar effect is also reported about the higher third-party claims that insurance firms pay due to road carnage. It is further observed that the standard deviations for both channels (that is, 0.99 and 0.88) was below one, suggesting that the extent of the effect of substance abuse on financial performance was somewhat similar across firms.

Table 4. 6: Substance Abuse and Financial Performance

	Mean	SD
Drunk driving and road carnage have increased claims on motor insurance	3.35	0.99
Road carnage has increased third-party claims	3.17	0.88
Overall Mean Score	3.26	0.935

Source: Research data

Turning to the findings on terrorism and political unrest in table 4.7 below, the results point to the moderate effect of the three channels, namely, increased insurance claims due to damage to property (mean of 3.44), loss of business from foreign clients who had relocated (mean of 3.13) and loss of business from local clients whose businesses could not be re-established (mean of 3.04). Overall, these three factors were observed to have contributed to financial losses in the insurance sector, to a moderate extent (as reflected by an overall mean of 3.203), and that the effect differed from one firm to another (since the standard deviation was 1.10, which is slightly above one).

Table 4. 7: Terrorism and Political Unrest on Financial Performance

	Mean	SD
Huge claims as a result of damage to property	3.44	1.11
Loss of business from foreign clients who have relocated	3.13	0.99
Loss of business from local clients whose businesses could not be reestablished	3.04	1.20
Overall Mean Score	3.203	1.10

Source: Research data

On the question of moral hazard, the results depicted in table 4.8 below indicated that increased policyholders' claims arising from careless was the most significant channel through which moral hazard manifested itself in the insurance sector in Kenya. This is evidenced by a relatively high

mean score of 3.94 and a standard deviation of 0.99. Furthermore, moral hazard was related to a moderate extent, to loss of business (as a result of declined/rejected claims and negative publicity from careless clients) and to higher cost of service provision. Overall, the results in table 4.8 point to the moderate effect that moral hazard have on financial performance (given the overall mean of 3.633).

Table 4. 8: Moral Hazard and Financial Performance

	Mean	Standard Deviation
Increased policyholders' claims due to carelessness	3.94	0.99
Led to loss of business due to declined claims and negative publicity from careless clients	3.52	1.20
Have increased the cost of provision of products to clients	3.44	1.04
Mean Score	3.633	1.076

Source: Research data

Table 4. 9: Disease and Lifestyle Changes on Financial Performance

	Mean	Standard Deviation
Claims on health insurance have soared	3.87	1.09
Premiums on these products have risen	3.71	1.13
Some products have been re-negotiated or cancelled	3.90	1.06
Mean Score	3.83	1.093

Source: Research data

The results on how disease and lifestyle changes have influenced financial performance of insurance companies are presented in table 4.9. Three factors, namely, higher health insurance claims, higher premium rates and product re-negotiation/cancellation, were considered to relate with disease and lifestyle changes. It was found out that, on average, they were significant in influencing financial performance of insurance firms (given the overall mean of 3.83). The

standard deviation of 1.093, is slightly above one, suggesting a somewhat large variation among firms in the extent to which disease and lifestyle changes have affected financial performance.

4.5 Return on Assets (ROA)

In order to have a general understanding of the measurement of the dependent variable, descriptive statistics of the ROA for the insurance firms over the five years is considered. Table 4.10 summarizes the results.

Table 4. 10: ROA Descriptive Statistics

Statistic	Return on Investment (ROA) – in percentage (%)
Minimum	-5.832
Maximum	9.136
Mean	1.952
Standard Deviation	3.28

Source: Research data

From the results, the minimum and maximum ROA for the firms, over the period 2014-2018 were, respectively, -5.832% and 9.136% with an average of 1.952%. The negative value reflects periods in which the insurance firms recorded losses. The mean value indicates that, over the five-year period, 1.952% of every dollar invested in the insurance business in Kenya was returned as profit. This low average level of ROA suggests that over the five-year period, insurance firms in the country did not utilize their assets efficiently to generate additional income.

4.6 Correlation and Regression Results

Correlation and regression analysis were conducted to explain the relationship between social risks and financial performance of insurance firms.

4.6.1 Correlation Analysis

Prior to analyzing the regression model results, it is important to consider the nature and degree of linear association among the variables in the model. The correlation matrix, as depicted in table 4.11 below helps to quantify the direction and strength of the relationship between pairs of variables under consideration.

Table 4. 11: Correlation matrix

	Return on Assets	Fraud	Intermediaries	Substance Abuse	Terrorism and Unrest	Moral Hazard	Lifestyle Changes
Return on Assets	1						
Fraud	-0.689** (0.000)	1					
Intermediaries	-0.541** (0.000)	0.349* (0.011)	1				
Substance Abuse	-0.548** (0.000)	0.579** (0.000)	0.274* (0.050)	1			
Terrorism and Unrest	-0.535** (0.000)	0.410** (0.003)	0.490** (0.000)	0.291* (0.037)	1		
Moral Hazard	-0.566** (0.000)	0.527** (0.000)	0.285* (0.041)	0.428** (0.002)	0.426** (0.002)	1	
Lifestyle Changes	-0.634** (0.000)	0.507** (0.000)	0.311** (0.025)	0.448** (0.001)	0.540* (0.000)	0.683** (0.000)	1

Source: Research data.

Note that the values in parenthesis are the probability values associated with the Pearson correlation coefficient. ** and * respectively, indicate statistically significant correlation coefficient at 1% and 5%. N = 52.

Importantly, the correlation matrix gives an indication as to whether multicollinearity is present among the independent variables (social risks). Correlation coefficients exceeding 0.90 indicates a possible multicollinearity issue, and a regression model estimated thereof is deemed spurious.

The correlation results shown in Table 4.11 above indicate a negative and statistically significant correlation between the companies' returns on assets (ROA) and each of the social risks. This is indicated by the Pearson correlation coefficients in the second column of the table. Specifically, the correlation coefficient between insurance fraud and ROA is found to be -0.689 , meaning they are negatively and strongly related. The relationship is statistically significant since its p-value (that is 0.000) is below 0.05. Thus, this result implies a strong, negative and statistically significant linear association between ROA and insurance fraud, suggesting that insurance companies that record high fraud cases tend to have lower ROA.

The correlation coefficient between ROA and pressure from intermediaries was found to be -0.541 , indicating a negative relationship between them. Since the probability value is 0.000, which is below 0.05, it means that the relationship is statistically significant at 5 percent level. The results also point to a negative and statistically relationship between ROA and substance abuse (coefficient is -0.548 and p-value of 0.000), suggesting that increases instances of substance abuse is associated with lower ROA among the firms.

The correlation between ROA and terrorism and political unrest (coefficient is -0.535 and p-value of 0.000) suggest a statistically significant negative relationship. This implies that periods when cases of terrorism and/or political unrest prevailed, coincided with weaker financial performance in the insurance industry. Moral hazard and ROA were found to be negatively related, as indicated

by the correlation coefficient of -0.566 . The relationship is statistically significant given that the p-value is 0.000 . It was further established that ROA and disease and lifestyle changes were negatively and strongly correlated, given that the correlation coefficient is -0.634 . With its p-value equal to 0.000 , it implies that the relationship is statistically significant.

Finally, it was found that the correlation coefficients among the pairs of social risks were positive and statistically significant. From table 4.11, these are the values reported in columns 3 to 7. The weakest correlation was between intermediaries and moral hazard (at $+0.285$) while the strongest relationship was noted to be between moral hazard and lifestyle changes (at $+0.683$). Notably, all the correlation coefficients were less than 0.90 suggesting that the regression model estimated does not suffer multicollinearity problems.

4.6.2 Regression Analysis

This section presents and analyzes the results of the analytical model used to estimate the effect of social risks on insurance firms' ROA.

Table 4. 12: Regression Model Results

a) Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.819 ^a	.671	.628	2.0016914

a. Predictors: (Constant), Lifestyle, Intermediaries, Substance, Terrorism, Fraud, Moral_Hazard

b) Analysis of Variance (ANOVA)

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	368.375	6	61.396	15.323	.000 ^b
	Residual	180.305	45	4.007		
	Total	548.679	51			

a. Dependent Variable: ROA of Company

b. Predictors: (Constant), Lifestyle, Intermediaries, Substance, Terrorism, Fraud, Moral_Hazard

c) Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	14.690	1.558		9.428	.000
	Fraud	-1.099	.376	-.342	-2.925	.005
	Intermediaries	-.912	.354	-.258	-2.580	.013
	Substance	-.603	.530	-.123	-1.138	.261
	Terrorism	-.243	.363	-.075	-.670	.506
	Moral_Hazard	-.226	.446	-.062	-.506	.615
	Lifestyle	-.977	.523	-.242	-1.869	.068

a. Dependent Variable: ROA of Company

Source: Research data

The results in tables 4.12(a) and 4.12(b) determine whether the independent variables, that is, fraud, pressure from intermediaries, substance abuse, terrorism and political unrest, moral hazard and lifestyle changes, jointly predict the companies' return on assets (ROA) significantly. From table 4.12(a), the adjusted R-square value associated with the model was 0.628, implying that 62.8 percent of the variation observed in insurance companies' ROA was attributed to all the six social

risks. This implies that 37.2 percent of that changes in ROA was accounted for by other factors that have not been included in the model. Thus, since the model accounted for more than 50 percent of the changes in ROA fitted the data well.

The ANOVA results in table 4.12(b) provided a test of whether the R-square value of 0.628 is significantly greater than zero. The F-statistic was found to be 15.323 with a probability value of 0.000 (which is less than 0.05), suggesting that the test statistic is statistically significant. Therefore, the F-test results implied that, jointly insurance fraud and intermediaries have had a statistically significant effect on ROA. In summary, the overall regression model was found to be significant given that $F(6, 45) = 15.323, p < 0.05, R^2 = 0.628$.

Table 4.12(c) displays the model coefficients for each social risk in relation to ROA. It also shows which of the social risks have a statistically significant effect on ROA. The findings showed that the coefficient of each social risk was negative, indicating that increased social risks caused ROA of insurance companies to decrease. The fitted regression equation as per equation 3.1 in chapter three can therefore be stated as follows

$$FP = 14.69 - 1.099IFR - 0.912INI \quad (4.1)$$

The interpretation of the constant is that, in the absence of social risks, insurance firms' ROA would be significant value of 14.69. The coefficients of insurance fraud (IFR) is found to be – 1.099 suggesting that insurance fraud has had negative effect on financial performance. The p-value is 0.005, which is under 0.05, suggests that the effect is statistically significant. With regard to the role of intermediaries, the results indicate a negative coefficient of –0.912, meaning that pressure from intermediaries have caused a negative effect on ROA. The effect is statistically

significant since the p-value is 0.013, which is smaller than 0.05. Finally, the effect of the other social risks, that is, substance abuse (SA), terrorism and political unrest (TER), moral hazard (MOR) and lifestyle changes (LIF), although negative, were statistically insignificant, since their p-value was above 0.05. In summary, the regression results point to the significant contribution of insurance fraud and pressure from intermediaries in explaining financial losses experienced in Kenya's insurance sector.

4.7 Discussion of Results

Overall, the results from this study indicated a negative and significant effect of insurance fraud and pressure from intermediaries on financial performance of insurance firms in Kenya. The findings on the effect of insurance fraud support those of Kathanga, Awino Kabiru (2016) and Chepkoech & Rotich (2017) for Kenya's insurance sector. The former indicate that huge insurance claims had affected the liquidity and profitability of the insurance companies, and that growth and sustainability of the insurance business had been adversely affected by the occurrence of fraud as well as lack of corporate governance mechanisms. Chepkoech & Rotich (2017) report that the number of fraudulent claims reported to the insurance regulatory authority (IRA) had declined over time, thus hampering the long-term growth in the sector.

With regards to the effect of the pressure from intermediaries, the findings of this study is supported by Ngethe (2012), who found out that most insurance firms in Tanzania struggled to eradicate unethical practices that have led to huge loses in the industry. The unethical practices took the form of collusion between different stakeholders such as investigators, assessors, police

force, loss adjusters and internal staff, with the insured, and in turn caused significant leakages among the firms.

On the effect of disease and lifestyle changes, the results of this study supported the findings contained in the report by KPMG (2016), which indicated that diseases increased the chances of lifetime payouts and consequently, huge health insurance claims. To a large extent, such diseases arose from unhealthy lifestyle behaviors on the part of the insured (Al-Maskari (2010)). With regards to moral hazard, the results concur with the findings of Debebe et al., (2012) who found that the insured often engage in very costly behavior change in the use of healthcare products, leading to misuse of insurance. As a result, health insurance claims rise.

The results of this study on terrorism and political unrest supports that of existing evidence. While Keitany and Baras (2012) found that terrorist activities had adversely affected Kenya's financial markets significantly, the findings in this study indicates an insignificant effect on performance of insurance firms. The differences in the finding is partly because the study by Keitany and Baras (2012) considered the broader financial market. The research findings of this study are further supported by evidence by Czinkota et al., (2010) who posited that political and terrorist acts affected performance directly (through loss of life, and destruction of business infrastructure) and indirectly (through loss of business arising from lower demand for products, higher transaction costs and interruptions in international supply chains).

CHAPTER FIVE:

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter discusses the key findings, draws conclusions, offers policy recommendations and suggests areas for further research.

5.2 Summary

The study sought to examine the effect of social risks on financial performance of insurance firms in Kenya, with a focus on six sources of such risks. These were: insurance fraud, insurance intermediaries, substance abuse, terrorism and political unrest, disease and lifestyle changes, and moral hazard. Financial performance was measured by return on assets (ROA).

The main finding from the study was that insurance fraud and pressure from intermediaries were the key social risks singled out by the respondents to have had an effect on financial performance of insurance firms in Kenya. Further, whereas terrorism and political unrest were perceived to be of less importance, the influence of social risks arising from substance abuse, lifestyle changes and moral hazard were perceived to be moderate. The study has therefore established that the effect of social risks on insurance firms' ROA ranges from moderate to significant, thus insurance firms need to be cognizant of the potential that these risks can have on the reputation and the insurance business as a whole. The least effect of social risks from terrorism and political violence could be explained by the infrequent occurrence of terrorist acts and violence from political activities.

The study further found that insurance fraud took the form of increased insurance claims and high adjustment costs, for example on insurance claims. With regards to the role of insurance

intermediaries, social risk was associated with three scenarios, namely, the failure by those intermediaries to promptly remit premiums collected, their actions of taking business to rival firms at lower rates, and their misrepresentation of product information to clients. It was further revealed from the study that disease and lifestyle changes were reflected in increased claims on health insurance, higher premiums on health insurance products and re-negotiation and/or cancellation of products. These results imply that social risks in the insurance business, to a large extent, emanate from the manner in which insurance claims and premiums are processed and how insurance products are packaged.

The correlation results revealed a negative and statistically significant linear association between companies' returns on assets (ROA) and each of the social risks considered. This reflected the fact social risks alters the social and business environment, in turn adversely affecting revenue streams of insurance firms. The regression model results indicated that social risks associated with insurance fraud, intermediaries and lifestyle changes had a negative and statistically significant effect on financial performance. The effects of substance abuse, terrorism and political unrest, and moral hazard were negative statistically insignificant.

5.3 Conclusion

The results derived from the study underscored the potential effects that social risks, particularly arising from insurance fraud, intermediaries and lifestyle changes could have on the financial position of insurance companies in Kenya. With regards to fraud, the study concluded that insurance companies with weaker internal controls were at greater risk of recording huge financial

losses due to fraudulent practices. An examination of existing control systems, if any, would have to be re-examine in order to seal potential loop-holes and opportunity for fraud.

Furthermore, insurance intermediaries while discharging their role of linking consumers with insurers in a competitive market, their conduct in representing the insurer could be a source of risk to the insurance business. In fact, according to Cummins and Doherty (2006), insurance intermediaries that are perceived as dealing inappropriately in their operations expose the companies to liability lawsuits for errors and omissions. Some intermediaries could enter into collusive arrangements with clients (Ngethe, 2012) while others misrepresent insurance products or under-cut their insurer for selfish gain. Such actions could, not only be a source of financial leakages, but also have the potential to impact adversely on profitability and reputation of the industry.

On the issue of disease and lifestyle changes, the study observed that unhealthy lifestyle changes reflect social behavior that has been the cause of many chronic diseases, which have necessitated expensive treatment plans, and in turn driven up the cost of health-care to the insurance sector. Finally, while the regression results point to the statistical insignificant influence of disease and lifestyle changes, substance abuse, terrorism and political unrest, and moral hazard on financial performance, according to empirical evidence (see for example, Cummins & Venard, 2008), even the seemingly insignificant risks on their own have the potential to interact with each other, or with the significant ones, to adversely impact on profitability of insurance companies. This observation can be implied from the correlation results of this study, whereby a positive and statistically significant relationship was found to exist between each of social risks. This meant for instance

that over the five-year period under consideration, instances where insurance firms faced high risks arising from disease and lifestyle changes, were also associated with periods when they faced risks from moral hazard. Further, such periods were also associated with weaker financial performance.

5.4 Recommendations

Four recommendations are suggested in this study. Firstly, is for insurance companies to carefully re-consider, re-assess and re-evaluate their various social risk mitigation measures so as to lessen the adverse effects on profitability. The process should even target those social risks which were found to have insignificant influence on insurers' profitability because they seem to interact each other to affect financial performance.

Secondly, while insurance intermediaries play a critical role in enhancing insurance business in Kenya, aligning their interests with those of the insurance companies, would help to mitigate social risks arising from the actions on intermediaries. Thirdly, the study has linked poor financial performance of insurance companies in Kenya to increased fraudulent practices. Thus, it is recommended that management need to have in place an effective fraud risk management framework in their firms that will institute controls that can detect and respond promptly to fraudulent cases in the organization. Furthermore, efficient information sharing mechanism, when in place, will help to minimize the impact that fraudulent practices could have on profitability in the industry.

Lastly, on lifestyle changes, the study proposes a comprehensive public health approach to promoting healthy lifestyles among the citizens in general, so as to lower health insurance costs and claims.

Furthermore, insurers could partner with other stakeholders in the healthcare sector on a number of disease-preventing and healthy lifestyle change, such as financial initiatives, public awareness and health education campaigns. These could help lower medical cost and insurance claims in the long run.

5.5 Limitations of the Study

The survey conducted in this study was based on qualitative research methods. While this approach was appropriate and validated, some of the social risks were found have had a statistically insignificant effect on financial performance. This partly reflected on how the variables were measured. Further, the study used ROA as a measure of financial performance as opposed to overall firm performance, and hence the inferences made thereof may not have been conclusively drawn.

5.6 Implications for Policy and Practice

The study has identified social risks that have been of concern to the insurance business in Kenya. It has shown that the effect of the social risks on financial performance range between moderate to significant levels. This guides insurance firms to formulate, re-formulate and/or review existing policies that help them mitigate the effects that those risks have on their profitability, and in turn drive them along the path of sustainability. The measures that insurance firms need to have in place should help to mitigate on likely huge financial losses and leakages while strengthening the role that intermediaries play in growing the insurance business for a financially sound industry.

In terms of insurance practice, the study points to importance of securing more reinsurance, strengthening systems to tame insurance fraud, seeking stronger working relationships with

stakeholders, and engaging in consumer education and awareness of risk prevention measures. These will lower the extent to which the industry is exposed to social risks.

5.7 Further Research

The focus of this study was on the effect of social risks on financial performance of insurance firms in Kenya. In order to provide further insights on the subject, further research can be done on the same area, but to include both financial and non-financial performance measures in order to give a better impact evaluation. Additionally, the impact of social risks on the insurance sector has not been adequately studied in the literature, and further empirical evidence can be explored to include the influence of other emerging risks in insurance business such as health pandemics, climate change, cybersecurity and cybercrime.

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APPENDIX I: QUESTIONNAIRE

This questionnaire is meant to gather information on the effects of social risks on the financial performance of insurance companies in Kenya. Your responses will be used for academic purposes only, and will be strictly confidential.

SECTION A: BIO DATA

1. In which year did the company commence operations in Kenya?
2. How many years of experience do you have at the Corporation?
 1-5yrs [] 6-10yrs [] 11-15yrs [] 16-20yrs [] Over 20yrs []
3. The company offers insurance products in:
 General [] Life [] Both General and Life []
4. Does the company have a parent/international affiliations or branches?
 Yes [] No []

SECTION B: SOCIAL RISK IN INSURANCE BUSINESS

5. Based on your experience in the Kenyan insurance industry, which are the main social risks that the industry should be concerned with today
6. Has your organization suffered losses as a result of Social Risks? Yes [] No []
7. Which methods does the company use to analyze social risks (tick those that apply)
 [] Risk assessment questionnaire [] Personal inspection
 [] Evaluating contracts, documents and records [] Benchmarking
8. How often does your organization capture information on social risks and communicate to the relevant stakeholders?
 [] Very frequently [] Frequently [] Moderately [] Rarely [] Never
9. From the list of social risks below, rate on scale of 1 to 5, the extent to which they affect your company's financial performance. Where: 1 = Not at all, 2 = Least significant, 3 = Moderately, 4 = Significantly, 5 = Highly significant

SOCIAL RISKS	1	2	3	4	5
Fraud					
Alcoholism & Substance Abuse					

Terrorism & Political Unrest					
Pressure from intermediaries					
Moral Hazard					
Lifestyle Changes					
Other (please specify).....					

SECTION C: SOCIAL RISKS AND FINANCIAL PERFORMANCE.

PART I: INSURANCE FRAUD

10. Which of the following contribute MORE to cases of fraud in the company

- Service providers Customers Brokers/Intermediaries
 Employees Other (please specify)

11. State the form of insurance fraud that the company mostly faces (Tick those that apply)

- Exaggerated legitimate claims Presenting illegitimate claims
 False information on application forms Staging an accident/injury/theft/arson
 Others

12. For each of the social risks, rate on a scale of 1 to 5 the extent to which they affect your company's financial performance. Where: 1 = Not at all, 2 = Least significant, 3 = Moderately, 4 = Significantly, 5 = Highly significant

INSURANCE FRAUD	1	2	3	4	5
Increased Claims					
Increased premium rates					
Reduced profits					
Increased operational costs (e.g. claims adjustments, investigations etc.)					

BROKERS AND INTERMEDIARIES	1	2	3	4	5
Taking business to rivals at lower rates					
Sharing company's information with rivals					
Misrepresentation of product information to client(s)					
Failure to remit collected premiums promptly					

ALCOHOLISM AND SUBSTANCE ABUSE					
Drunk driving and road carnage have increased claims on motor insurance					
Road carnage has increased third-party claims					

TERRORISM AND POLITICAL UNREST					
Have increased the number of claims as a result of damage to property					
Led to loss of business from foreign clients who have relocated					
Led to loss of business from local clients whose businesses could not be reestablished					

MORAL HAZARD					
Increased policyholders' claims due to carelessness					
Led to loss of business due to declined claims and negative publicity from careless clients					
Have increased the cost of provision of certain products to clients					

LIFESTYLE CHANGES (Please rate based on your knowledge and/or experience on life insurance in Kenya)	1	2	3	4	5
Claims on health insurance have soared as a result of lifestyle changes					
Premiums on these products have risen					
Some product have been re-negotiated or cancelled due to losses					

13. Are there other ways in which social risks have affected the financial performance of your company, other than above? List a few:

.....

14. In your own words that reflects facts, what should be done about the social risk that mostly affects the financial performance of the organization?

.....

APPENDIX II: SECONDARY DATA COLLECTION FORM

Kindly indicate the financial performance, for the last five years, of your company in terms of the following measures:

FINANCIALS	2014	2015	2016	2017	2018
Total Assets (Ksh.)					
Total Shareholders' Equity (Ksh.)					
Net Income (Ksh.)					

The end.

Thank you for your time

APPENDIX III:

LIST OF INSURANCE COMPANIES AS AT DECEMBER 2018

1. AAR Insurance Company Limited
2. Africa Merchant Assurance Company Limited
3. AIG Kenya Insurance Company Limited
4. Allianz Insurance Company of Kenya Limited
5. APA Insurance Limited
6. APA Life Assurance Company Limited
7. Barclays Life Assurance Kenya Limited
8. Britam General Insurance Company (K) Limited
9. Britam Life Assurance Company (K) Limited
10. Metropolitan Cannon General Insurance Company Limited
11. Capex Life Assurance Company Limited
12. CIC General Insurance Company Limited
13. CIC Life Assurance Company Limited
14. Corporate Insurance Company Limited
15. Directline Assurance Company Limited
16. Fidelity Shield Insurance Company Limited
17. First Assurance Company Limited
18. GA Insurance Limited
19. GA Life Assurance Limited
20. Geminia Insurance Company Limited
21. ICEA LION General Insurance Company Limited
22. ICEA LION Life Assurance Company Limited
23. Intra Africa Assurance Company Limited
24. Invesco Assurance Company Limited
25. Kenindia Assurance Company Limited
26. Kenya Orient Insurance Limited
27. Kenya Orient Life Assurance Limited
28. KUSCCO Mutual Assurance Limited
29. Liberty Life Assurance Kenya Limited

30. Madison Insurance Company Kenya Limited
31. Madison General Insurance Kenya Limited
32. Mayfair Insurance Company Limited
33. Metropolitan Cannon Life Assurance Limited
34. Occidental Insurance Company Limited
35. Old Mutual Assurance Company Limited
36. Pacis Insurance Company Limited
37. MUA Insurance (Kenya) Limited
38. Pioneer General Insurance Company Limited
39. Pioneer Assurance Company Limited
40. Prudential Life Assurance Company Limited
41. Resolution Insurance Company Limited
42. Saham Assurance Company Kenya Limited
43. Sanlam General Insurance Company Limited
44. Sanlam Life Insurance Company Limited
45. Takaful Insurance of Africa Limited
46. Tausi Assurance Company Limited
47. The Heritage Insurance Company Limited
48. The Jubilee Insurance Company of Kenya Limited
49. The Kenyan Alliance Insurance Company Limited
50. The Monarch Insurance Company Limited
51. Trident Insurance Company Limited
52. UAP Insurance Company Limited
53. UAP Life Assurance Limited
54. Xplico Insurance Company Limited

Source: IRA (2018)