

# **CHAPTER ONE:INTRODUCTION**

## **1.1 Background**

As information technology continues to advance day by day, competition in the world market continues to increase even at a higher pace. Liberalization and various trade protocols like the World Trade Organization have completely changed the old business formula and organizations have to adapt to the constantly changing environment for survival (Porter, 1980). Using the words of Charles Darwin, “it is neither the strongest nor the most intelligent of the species that survive; it is the one most adaptable to change”. Industries evolve over time providing firms with continuously changing opportunities and threats. It is therefore mandatory for firms to continuously adapt their activities to the environment in order to be assured of survival (Porter,1980; Aosa, 1992). Industries differ widely in terms of competitive emphasis and it is therefore vital for the firm to evaluate the attractiveness in different industries. Managers in various industries will interpret changes in the environment differently due to their perception. While some managers will view a certain industry as attractive, others will find the same unattractive.

### **1.1.1 Industry Attractiveness**

An industry is a group of firms that market products which are close substitutes for each other (Grant, 2000). For a firm to succeed in business, it is necessary to evaluate the attractiveness of various industries in terms of their potential to generate sustainable profit (Grant, 2000). Industry attractiveness is the relative future profit potential of a market. Some industries are more profitable than others. The main reason lies in understanding the dynamics of the

competitive structure in an industry. The performance of a firm depends on the combination of the strength of the unit and the industry attractiveness. To make an intelligent investment decision, one needs to understand the whole industry. The very common measures of attractiveness are industry growth and average industry profitability.

With increasing environmental turbulence, periodical systems are no longer capable of perceiving and responding to threats and opportunities fast enough. (Pearce & Robinson, 1997). An organisation's environment consists of conditions and forces that affect its strategic options and define its competitive situation. (Pearce & Robinson, 1997). The degree of competitiveness is manifested not only in other players, but other competitive forces that go well beyond the established combatants in any particular industry. Porter observes that the knowledge of the underlying sources of competitive pressure provides the ground work for strategic agenda in action. (Porter, 1980) For firms to survive in competitive markets, they need to align their strategies to changes in the environment. The purpose of industry analysis is to identify various opportunities and threats, and match strategies to industry conditions.

There are five forces that determine competition in an industry (Porter, 1979). These are rivalry among competitors, threat of new entrants, threat of substitutes, bargaining power of buyers and suppliers. The strongest competitive force determines the profitability of an industry. Large firms who are players in unattractive industries will find it difficult to report good performance. Changes in social, political and legal environment will greatly affect the profitability of a firm. Firms will need to be on the look out and come up with strategies to adapt to such changes. To contend successfully against the competitive forces, we need strategies that isolate the firm as much as possible from the competitive forces, those that will

influence competitive pressures in favour of the firm or those that will help the firm build a strong and secure position of advantage.

It is important for the management of a firm to understand the industry's key success factors for the firm to prosper in the market place. This will enable the firm to secure sustainable competitive advantage by coining its strategy around the industry's key success factors. According to Porter (1980), competitive strategy involves finding a position in the industry where the company can best defend itself against competitive forces or can influence them in its favour. The strength of competition in the industry will largely depend on the driving forces. It is therefore necessary to establish the driving forces and their possible impact.

Porter, (1980) notes that a firm can change the industry's structure through the adopted strategies and that if the firm can shape the industry structure, this can fundamentally change the industry's attractiveness for better or for worse.

### **1.1.2 The Insurance Industry in Kenya**

Insurance can in simple terms be defined as a contract between two parties, where one party (referred to as the insurer) undertakes to indemnify the other (referred to as the insured) upon the happening of an eventuality, in return for a consideration referred to as the premium. There are two broad classes of insurance, short term and long term insurances. Short term insurances run for a period of one year and are renewable annually, commonly known as general business, while long term insurances run for a number of years, and are commonly referred to as life insurance. Companies may be registered to transact general insurance only, life assurance only or both classes (composite).

The insurance (Motor vehicle third party risks) Act Chapter 405 (GOK, 1979) requires all mechanically propelled vehicles on our roads to be insured against third party risks. The Act further requires vehicle owners to produce evidence of such insurance in the form of a motor insurance certificate issued by an insurance company, or a certificate of security issued by the minister for finance.

Insurance companies registered in the East African region are as follows:

Table 1 – Insurance companies registered in East Africa

	Kenya	Uganda	Tanzania
Life insurance only	6	Nil	Nil
General insurance only	19	11	11
Both classes	17	8	3
P.S.V. Underwriters	8	18	11
Total	42	19	14

Compiled from: Insurance Commissions of East Africa, (2007)

The Kenyan insurance industry is the most vibrant in the East African region. From the statistics shown in table 1, Kenya has the highest number of insurance companies in the region. In fact, a number of companies registered in Uganda and Tanzania have their parent companies in Kenya. The insurance industry falls under the Ministry of Finance, with the Commissioner of Insurance as the regulator, through the Insurance Act, chapter 487. An Insurance Regulatory Authority was established recently for better regulation of the insurance industry. However, the same has not taken full control as the Government is still tying up the logistics. As noted by Koima (2003), regulation of the insurance industry has not been up to standard.

The Insurance Industry in Kenya contributed 2.5% of the gross domestic product in the year 2006, with a gross written premium of Kshs 41.7Billion. 70% was contributed by general insurance business while the life sector contributed 30%(A.K.I., 2006). There are 42 registered insurance companies in Kenya. Other players in the insurance industry include insurance brokers, agents, investigators, loss assessors, loss adjusters and reinsurers(A.K.I., 2007).

### **1.1.3 Public Service Vehicle Insurance Business in Kenya**

Public service vehicle (P.S.V.) class of business falls under general insurance and specifically motor insurance. Motor insurance business contributed about Kenya Shillings (Ksh.) 12 billion (42% of general insurance premium) in year 2006. Ksh. 2.2 billion was raised from PSV business, which is a mere 7.5 % of the gross premium for general insurance business(AKI, 2006).

According to a report compiled by the Association of Kenya Insurers (AKI, 2002), the government formed the Kenya Motor Insurance Pool in 1974 and was wound up in 1984. In 1985, the government revived the motor insurance pool which suffered massive losses and was eventually wound up in 1989, leaving very few companies underwriting this class of business (AKI, 2002). Out of all the players registered to underwrite motor insurance business (Thirty five), only eight of them engage in P.S.V. business. Three of these undertake the business selectively, insuring only organized fleets or vehicles plying within the urban centers.

The insurance industry has been facing a number of challenges. The major challenge in the PSV insurance sector has been cutthroat competition. Indeed it was sighted as one of the major reasons for the fall of a giant PSV underwriter in the year 2000. (Commissioner's report, 2002).

The Commissioner of Insurance (Chief Executive of the Insurance Regulatory Authority) is the regulator of the insurance industry and is charged with the responsibility of formulating and enforcing standards in the conduct of insurance business. However, as noted by Nkoima (2003), the regulation has not been up to standard mainly due to lack of capacity. The Commissioner of insurance noted the need to monitor this class of business closely and appointed a firm of Auditors that checks compliance with some underwriting criteria agreed upon by the Association of Kenya Insurers and the regulator. Quarterly reports are submitted to his office and the Association of Kenya Insurers.

#### **1.1.4 Perception**

Daft (2000), defines perception as the process that people use to make sense out of the environment by selecting, organizing and interpreting information from the environment. According to Mwaura (2002), perception is the process by which we attribute meaning to the incoming stimuli received through our five senses. Guest (1997) contends that commitment of employees to a certain cause or issue depends on their perception. It is not possible to readily determine in advance how people will react to a particular event or incident since the same is affected by one's perception and expectations for the occurrence (Kenyon1993).

If managers perceive PSV insurance business as attractive, this will affect the way they interpret information from the environment. A change in government policy for example is likely to receive different reactions from various managers due to their perception. As noted by Ngahu (2003), internal characteristics of the perceiver have an influence on the selection, organizing and interpretation of issues. Environmental factors such as culture, reference groups or the perceived risk will also have an effect on the perceiver.

## 1.2 The Research Problem

Industry attractiveness varies over time and the business environment. Industries become more attractive to those who think they are well positioned and are competitively advantaged. It therefore depends on competitors' inner motivations, objectives, goals and intents. High profitability and high growth rate makes an industry look profitable, as long as the competitor feels he has a relative advantage, Hax and Majluf(1983). The marketer's assessment of where the industry is moving, the prevailing market conditions and an assessment of the expected future business environment determines the level of attractiveness.

In Kenya, there are thirty five insurance companies licenced to transact motor insurance business. However, only eight insurance companies underwrite P.S.V. business. Six insurance companies have been liquidated in the recent past and one is currently under statutory management. Incidentally, all the seven companies have been underwriting P.S.V. business in large scale. Out of the eight companies currently in the business, four of them are newly registered. They came up after collapse of giant P.S.V. underwriters.

As noted from the statistics above, Kenya has the highest registered number of insurance companies and the lowest number of companies underwriting P.S.V. business. The proportion underwriting this class of insurance compared to those licenced to underwrite general business is as follows: Kenya – 25%, Uganda – 95% and Tanzania – 79%. It is therefore evident that this class of insurance is peculiar in Kenya.

In Kenya, the business is characterized by entry and exit by existing players, and closing down of companies underwriting this class of business and registration of new ones. This seems to send conflicting signals about this class of insurance. The business seems attractive to some companies and unattractive to others. This is a contrasting situation which needs to be addressed. The perceptions by managers who are involved in decision making largely affect investment decisions in any organization. Managers will interpret similar situations differently as the same will be affected by culture, reference groups and the perceived risk of underwriting P.S.V. business.

Other studies done by various scholars did not cover this particular area. Oluoch (2003) dealt with the perceived attractiveness in the freight forwarding industry. She concluded that attractiveness is relative and depends on the person and the standpoint of a particular company. Mutia (2002), studied the attractiveness of Kenyan market to international airlines and found out that some characteristics are general across the industries while others are peculiar to a particular industry, and the strength of the factors affecting attractiveness also differs among industries. Waithaka (2001) looked at the funeral industry attractiveness. He observed that anticipated high profits play a key role in motivating entry into the funeral sector and that government regulation is not a major factor in the industry. Other writers have focused on a particular force that determines the industry attractiveness (Isaboke, 2001; Goro, 2003; Omondi, 2004).

There is need to find out the peculiar factors in PSV insurance and the strength of the various forces. Since the perception of the managers will also play part in determining the level of attractiveness, it is important to do a separate study on PSV insurance as the determinant factors may be very different.



All the above gave the researcher a strong case to believe that this is a peculiar class of insurance in Kenya.

### **1.3 Objectives of the Study**

The study has got two main objectives:

- (i) To determine perception of managers' attractiveness of P.S.V. insurance business.
- (ii) To identify the major factors critical for making the industry attractive.

### **1.4 Importance of the Study**

The study will benefit the following: -

- i) All companies registered to underwrite general insurance business that may want to join the P.S.V. sector or any new entrants who may be interested in this class of business. Investors will make decisions on whether to invest or not based on the perceived attractiveness. If the business is perceived to be attractive, then they will invest and vice versa.
- ii) The government and policy makers in general, to understand this class of insurance better and for them to formulate better policies to govern the P.S.V. sector. This will be done by changing policies that will be indicated as restrictive to entry into the business and therefore attracting investors.
- iii) Scholars who may want to widen their knowledge. They will be able to understand the industry better and can also use the information as a reference point to research on the application of porter's model to other industries.

iv) Existing companies who may want to come up with new strategies to improve operations. The research will help them understand issues surrounding the business, for example the level of competition, the strength of buyers and service providers. This will enable them make well informed strategic decisions.

# **CHAPTER TWO: LITERATURE REVIEW**

## **2.1 Introduction**

An industry is defined as a group of firms that market products which are close substitutes of each other. According to Porter (1980), industry attractiveness is determined by the strength of five forces of competitive pressure in an industry. These are the threat of new entrants, rivalry within the industry, threat of substitutes, bargaining power of suppliers and the bargaining power of buyers. The collective strength of these forces determines the firm's ability to make profits. The core of the firm's business environment is formed by its relationship with customers, suppliers and competitors (Grant, 2000). For the firm to position itself strategically in the industry, there is need for the management to have a thorough understanding of these forces and the firm's environment in general. It is therefore necessary for the firm to conduct an industry analysis.

## **2.2 Industry Analysis**

This is an orderly process that attempts to capture the structural factors that define the long term profitability prospects of an industry (Hax & Majluf, 1996). Rowe et al (1994) define industry analysis as an environmental scan to determine what forces in a firm's external environment have a direct impact on its competitive position and what competitive actions need to be taken to achieve a sustainable competitive advantage. It is therefore a systematic process of gathering and analyzing information about an industry and determine the true areas in which a firm can compete, by ensuring that the key success factors are understood by the management.

According to Porter (1980), the essence of formulating a competitive strategy is relating the firm to its environment. Industry analysis involves identifying various opportunities and threats posed to the firm and come up with appropriate strategy. The purpose of conducting industry analysis is therefore mainly to understand the forces behind the industry's performance in order to match strategy to industry conditions. It will be necessary to determine what competitors are doing, the existing opportunities and threats, whether a firm should enter, remain or exit an industry (Rowe et al, 1994). Industry analysis is a basis for gaining familiarity with the products, competition, resource requirements and constraints peculiar to the line of business (Comeford and Callaghan, 1990).

### **2.3 Industry Attractiveness**

According to Porter (1980), industry attractiveness is the high potential profitability of an industry that is measured through the long term return on the capital invested as determined by the five sources of competitive pressure. The five forces determine the industry profitability because they influence the prices, costs and the required investment of firms in an industry.

The researcher will use the modified porter's model as it is popular in assessing a firm's potential to make profits.

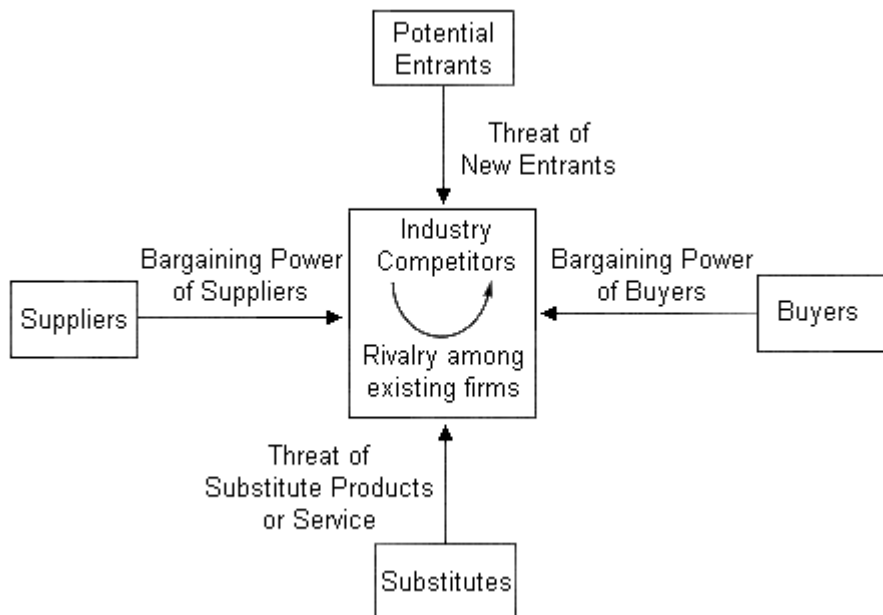


Figure 1 : Source: Porter M. E. 1980

The collective strength of the forces determines the profit potential of an industry. The stronger the forces collectively, the lower the profitability of the industry and vice versa (Wheelen & Hunger 1995). Changes in the characteristics of each of these factors are responsible for generating new opportunities and threats (Boseman and Patak, 1989).

An attractive industry will have high returns on investment, clear barriers to entry, reasonable market growth, no threat of substitutes, low bargaining power of suppliers and low bargaining power of buyers (Koch, 1995). Changes in the characteristics of each of the forces generate new opportunities and threats. Traditionally, rivalry has been the strongest force and was mainly centered on price competition. Some firms would charge prices below unit costs to push small firms out of business. This is currently changing and firms have in one way or the other agreed to co-exist. Examples include Castle breweries and East African breweries, Celtel and Safaricom, and the various media houses.

### **2.3.1 Rivalry within the Industry**

This force describes the intensity of competition between existing players in an industry. It takes the form of jockeying for positions. Firms will use tactics such as price competition, advertising battles, increased customer service or warranties (Porter, 1980). Rivalry occurs because one or more competitors either feels the pressure or sees the opportunity to improve position. Competitive moves by one firm may call for retaliation or adoption of a “me too” strategy by other firms.

Rivalry intensifies as the number of competitors increase and as they become more equal in size and capabilities or where there is low market growth rates and barriers for exit are high. The firms will be competing for the same customers and resources and the fight for market share becomes fierce. If one firm launches a strong competitive strategy, it intensifies the pressure on the remaining firms. This may provoke counter-response from other players as each firm attempts to position itself competitively. This can lead to industry wide misery in the form of depressed profits and loss of market growth (Keegan, 1995). The intensity of rivalry can be referred to as cut throat, intense, moderate or weak, based on the firms’ aggressiveness in attempting to gain advantage. Price undercutting and product or service improvements have become the major weapons for rivals in the P.S.V. insurance sector. Premiums charged have become unsustainable and many other benefits offered free of charge (Commissioners report, 2003). Competition in this industry has been described as cut-throat, stiff, unhealthy, and shallow with destructive consequences; (Ikiara, 2001 and Wamaina, 2001).

### **2.3.2 Threat of Substitutes**

To an economist, a threat of substitutes exists when a product demand is affected by price change of a substitute product. Mintzberg and Quinn (1991) defines substitutes as those products that appear different but can perform the same function as another product. Substitutes limit the potential returns of an industry by placing a ceiling on the prices firms in the industry can profitably charge (Porter 1980). Availability of substitutes gives customers an opportunity to compare prices, quality and performance (Thompson & Strickland, 1989). The threat of substitutes is determined by factors like brand loyalty of customers, close customer relationships, switching costs and the current trends. The strength of the competitive pressure from substitutes depends on whether attractively priced substitutes are available, how satisfactory they are in terms of quality and performance. If the level of substitution is high, profitability decreases and vice versa.

### **2.3.3 Threat of New Entrants**

New entrants in an industry brings with them new capacity, technology, the desire to gain market share and often substantial resources. The extent of this threat depends on the existence of barriers to entry, coupled with reaction that the entrant can expect from the existing competitors. Whether entry barriers are considered to be low or high depends on resources and competencies possessed by the pool of potential entrants. High profits will always attract new entrants, motivating them to commit the needed resources to overcome the barriers to entry. With high profits therefore, entry barriers become irrelevant. The entry of new players disrupts the industry's profitability, increases the industry capacity and destabilizes the price structure, leading to a decrease in profitability (Keegan 1995). The law of demand and supply applies here i.e. with increase in capacity, supply is high and therefore

the prices are depressed. What is required to maintain the barriers is to have unique capabilities which are not transferable to competitors, and which can make entry for the firm easy and unacceptably difficult for everybody else (Hax & Majluf 1996). According to Porter, there are six barriers to entry which includes economies of scale, product differentiation, capital requirements, switching costs and government regulations.

#### **2.3.4 Bargaining Power of Suppliers**

Powerful suppliers can lower the profitability in an industry by threatening to raise prices or reduce quality of purchased goods and services. Suppliers are powerful if the industry is dominated by few suppliers, high switching costs, high possibility of forward integration, the industry is not an important customer of the supplier or the supplier's product or service is an important input in the buyer's business (Porter 1980). Singh and Wah (1997), found out that firms and their suppliers needed to have a good relationship for their mutual benefit. Leverick and Cooper(1998), observed that organizations have tended to move away from adversarial relationships with suppliers towards a more cooperative way of doing business. With the good relationship, the power of the supplier will not affect the firm negatively.

#### **2.3.5 Bargaining Power of Buyers**

Buyers will normally compete with the industry by bargaining for lower prices, higher quality products or more services and most importantly, playing competitors against each other at the expense of the industry profitability. Buyer power is high when the volume of purchases of the buyer is high, there are alternative sources of supply, cost of switching supplier is low, there is threat of backward integration or where the buyer has full information about demand,



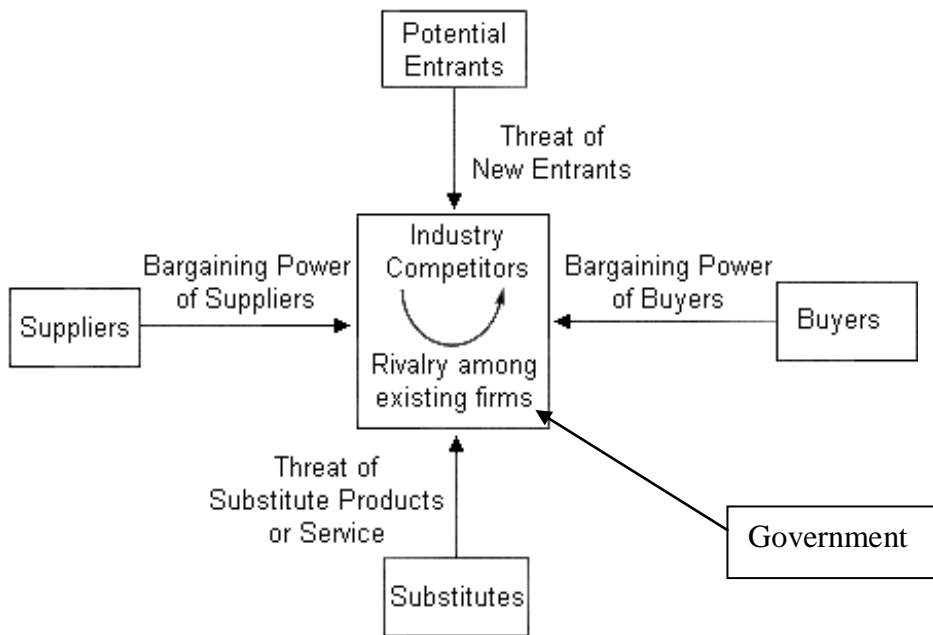
actual market prices and supplier costs. Buyer's interests are served if they can drive down profitability in the suppliers industry (Keegan, 1995). Njau (2000), notes that with the entry of castle breweries in the brewing industry, traditional buyers from East African Breweries became more demanding.

### **2.3.6 The Government**

The government has a direct or indirect influence on business through laws and regulations. Wheelen & hunger, (1990) argues that the government is a force on its own due to its strong influence on business. Other writers such as Grant (2000); Thompson (1998) and Albaum et al, (1990) share the same view, while porter argues that the government is an entry barrier. This has led to the modification of the porter's model.

The key factors in the modified model can be applied in Kenya. Palvia et al (1990) argues that the use of Porters model is appropriate in a free market where the government does not interfere with business and therefore modification is needed to suit developing countries environment. Grant (2000) purports that the model has critical limitations because it does not take into account the dynamic character of competition. The model is criticized for assuming that the buyers, competitors and suppliers are unrelated and can not collude (Coyne & Subramaniam, 1996). It does not therefore take into account synergies and interdependencies within the portfolio of large corporations.

Figure 2 : Source: Porter M. E. 1980 (Modified)



Industry attractiveness is measured through the long term return on the capital invested. The very common measures of attractiveness are industry growth and average industry profitability. There are five underlying sources of competitive pressure, which will have an impact on profitability. It is therefore important to measure the strength of these forces since they have an effect on profitability, which is a measure of attractiveness. The collective strength of these forces determines the overall industry attractiveness. These include rivalry within the industry, threat of substitutes, threat of new entrants and the bargaining power of buyers and suppliers. On the other hand, every individual has a perception field that is unique to them because of their unique experiences. Given the same stimulus, managers will react differently and make different decisions. The modified porter's model is popular in assessing the firm's potential to make profits.

## **CHAPTER THREE: RESEARCH METHODOLOGY**

### **3.1 Research Design**

The researcher used descriptive survey design. Churchill (1991) notes that a descriptive study can be used when the purpose is to describe the characteristics of certain goods or to estimate the proportion of the population who behave in a certain way. Mugenda and Mugenda (1999) notes that survey research attempts to collect data from members of a population and describes existing phenomena by asking individuals about their perception, attitude, behaviour or values.

### **3.2 The Population**

The population of study comprise of insurance companies licenced to underwrite general insurance business in Kenya. This is mainly because all the insurance companies underwriting general insurance business can engage in PSV business. Some have been in the business and later exited while others may be intending to move into this business in the near future.

The total number of companies as noted earlier is forty two, and seven of them underwrite life business only. The remaining thirty five companies underwrite general insurance business, and are the population of study.

### **3.3 Data Collection**

Primary data was collected using a questionnaire. According to Kibera and Waruingi (1988), a questionnaire is used when researchers require information on consumer feelings and attitudes. Tull and Hawkins(1993) also indicates that a survey can provide data on attitudes, feelings, belief and descriptive items. The questionnaire was hand delivered to managers of the insurance companies and collected later.

The questions format was based on a five point likert scale, where respondents were assessed on their extent of agreement or the importance they attach to various variables that determine the level of attractiveness, and other open ended questions.

Out of the thirty five questionnaires sent to the managers, twenty two fully completed responses were obtained (63%), while two incomplete responses were discarded. Data was summarized and presented in the form of mean scores, percentages and tables where appropriate.

### **3.4 Data Analysis**

The responses were coded to facilitate statistical analysis by use of descriptive statistics. The six sources of competitive pressure were allocated points, from one to five, one being the lowest and five the highest. The effect of the various factors on profitability were analysed based on the rating allocated by the respondents. The points on all responses were added and the mean taken. Mean scores were used to measure and summarise data about perceptions.

The mode was used to determine the major variables that are perceived to be critical for making the industry attractive. The items with the highest mode are the major variables that the managers perceive to be critical.

# **CHAPTER FOUR: DATA ANALYSIS AND FINDINGS**

## **4.1 Introduction**

This chapter presents an analysis of data collected from managers in the insurance industry, who work in firms licenced to transact general insurance business.

## **4.2 Profile of Respondents' Firms**

The gross general insurance premium for the year ending 31<sup>st</sup> December 2007 was Ksh.29 billion. Out of the twenty two responses obtained, three companies had a gross premium of over two billion, with one PSV underwriter in this category while five companies had a gross premium of over one billion. The other respondents had a premium income ranging from four hundred million to eight hundred million apart from two respondents who had less than two hundred million. 55% of the respondents indicated having engaged in underwriting PSV business but stopped in 1989. This could be attributed to the fact that the motor insurance pool was disbanded in the same year. It was mandatory for all companies licenced to underwrite general insurance business to participate in the motor insurance pool which had been created by the government. The number of branch offices ranges from one to fifteen. Out of the twenty two responses obtained, four respondents confirmed having over ten branch offices. Incidentally, they had confirmed that they are currently underwriting PSV business. 95% of the respondents agreed with the proposition that you need a countrywide branch network to distribute PSV insurance effectively. The respondents' firms have been in business for periods ranging from three years to over forty years. It is noted that four PSV underwriters started insurance business less than fifteen years ago. Seventeen respondents were underwriting managers while five were marketing managers.

### 4.3 Perception of Managers' Attractiveness of PSV Insurance Business

#### 4.3.1 Introduction

According to Porter (1980), industry attractiveness is the high potential profitability of an industry that is measured through the long term return on the capital invested as determined by the five sources of competitive pressure. The five forces determine the industry profitability because they influence the prices, costs and the required investment of firms in an industry. The perception of attractiveness is therefore analysed using the modified Porter's model, i.e. using the six sources of competitive pressure.

#### 4.3.2 Intensity of Competition

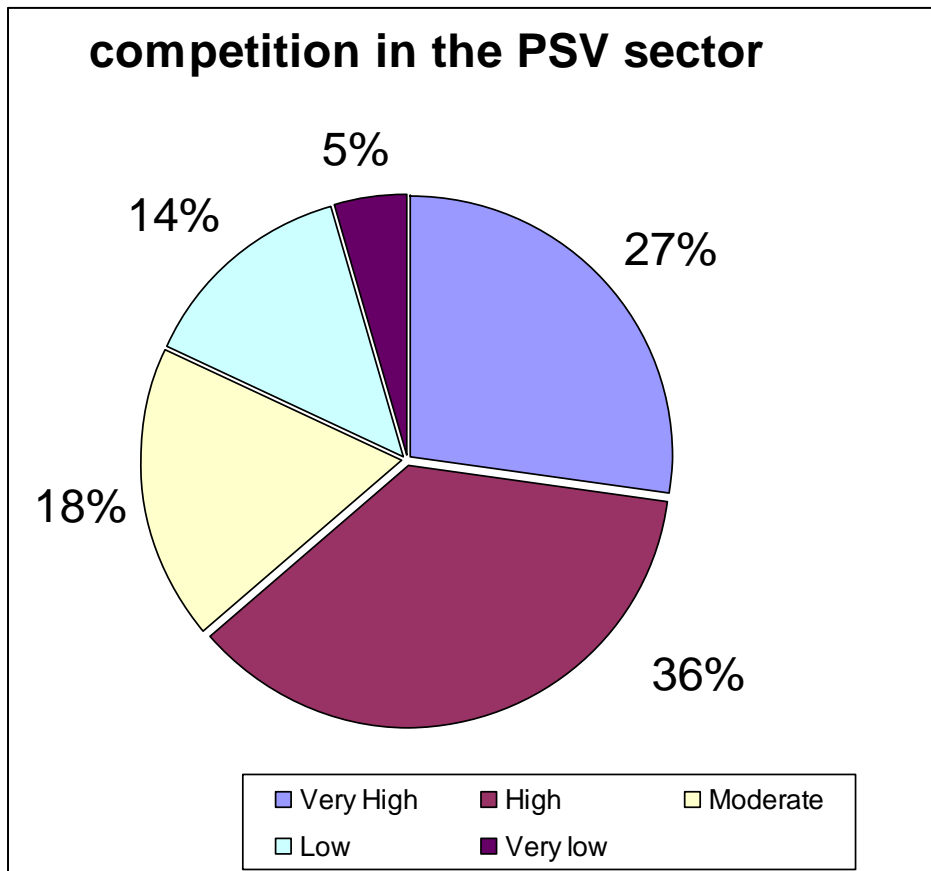
The intensity of competition can be referred to as cut throat, intense, moderate or weak, based on the participating firms' aggressiveness. Firms will in one way or another be attempting to gain advantage over competitors. In an attempt to measure the level of competition in PSV insurance, managers were requested to rate the intensity of competition, the effect of competition on profitability and the strategies adopted by various firms to face competition. Table 2 and figure 3 shows the analysis of the level of competition as allocated by the respondents.

**Table 2 – Effects of Competition on Profitability**

	Very High	High	Moderate	Low	Very Low
Total Points	85	116	60	46	16
Percentage	27	36	18	14	5
Mean	30	32	12	6	1
Mean of Means	16.2				

Source : Research Data

**Figure 3 - Level of competition**



Source : Research Data

The level of competition is quite substantial. 63 % of the respondents rated it as high and very high, while only 19 % rated it as being low and very low. Companies have adopted various strategies such as teaming up with various saccos, sponsoring workshops and funding the annual general meetings of the various saccos. Others have employed route managers on commission basis all in an attempt to win the business. All these goes to reducing the profit of the firm, making the business unattractive. Other strategies include prompt settlement of claims (out of court negotiations), quick issuance of policy documents and granting special favours to intermediaries. Advertising and online processing of proposal forms does not seem popular with most underwriters. The mean for this factor is 16.2, meaning that this is a very

strong factor in determining the level of attractiveness. With the high level of competition, the business is unattractive to most of the managers and therefore the low number of underwriters engaging in this class of business.

### 4.3.3 Barriers to Entry

Whether entry barriers are considered to be low or high depends on resources and competencies possessed by the pool of potential entrants. High profits will always attract new entrants, motivating them to commit the needed resources to overcome the barriers to entry. With high profits therefore, entry barriers become irrelevant. The respondents were requested to describe the barriers to entry in this class of business, the rating they would allocate to some identified aspects of the business and their overall assessment of industry entry barriers.

Table 3 shows a summary of the analysis.

**Table 3 – Analysis of Barriers to Entry**

	Very High	High	Moderate	Low	Very Low
Total Points	100	148	63	62	23
Percentage	25	37	16	16	6
Mean	17	25	11	10	4
Mean of Means	13.4				

Source : Research Data

There appears to be a host of barriers to entry in this class of business. High start up costs, premium undercutting (price wars) and high operational costs seems to be the main barriers to entry. This will therefore affect decisions as to whether to invest in the business or not. The big players have the habit of charging very low premiums so as to push new entrants out of the business. This has indeed been cited as reasons for PSV underwriting companies becoming insolvent, as the level of premiums charged does not match the risks involved.



Other barriers like government licencing, access to brokers and agents, and information technology seems to have minimal impact. On the overall, barriers to entry into this class of insurance business can be said to be high, with 62% of the respondents rating the barriers as high and very high. The mean for this factor is 13.4. Though it is a major factor in determining the level of attractiveness, it is not as high as the level of competition. 80% of the respondents agreed that underwriting PSV business is very involving, requires a lot of manpower and a country wide branch network. Since there is a lot of competition and therefore depressed profits, entry barriers are still relevant in the industry. This therefore explains the reasons for having very few underwriters undertaking this class of business.

#### **4.3.4 Bargaining Power of Customers**

Customers will exert their power in the industry by bargaining for lower prices, higher quality products or more services and most importantly, playing competitors against each other at the expense of the industry profitability. Buyer power is high when the volume of purchases of the buyer is high, there are alternative sources of supply, cost of switching supplier is low, there is threat of backward integration or where the buyer has full information about demand, actual market prices and supplier costs. Data was collected on ratings allocated by the respondents to an identified set of customers and the percentage of business obtained from each. The respondents were also requested to give their overall assessment of the customers' power over the underwriters. Table 4 shows a tabulation of the average percentage of business controlled by various customers.

**Table 4 – Percentage of Business From Various Customers**

Type of customer	Percentage of business
Insurance Brokers	52
Insurance Agents	21
Direct Clients	16
Saccos	7
Parastatals	4

Source : Research Data

The bargaining power of insurance brokers and agents appears to be very high while that of parastatals is moderate. Direct clients and Saccos have negligible bargaining power. Sixty eight percent of the respondents indicated that over seventy percent of their business is through insurance brokers and agents. Customers’ bargaining power is determined by the volume of business that they control. Though direct clients also contribute some sizeable business, they do not seem to have a high bargaining power.

**Table 5 – Effect of Bargaining Power of Customers on Profitability**

	Very High	High	Moderate	Low	Very Low
Total Points	155	120	90	24	6
Percentage	39	30	23	6	2
Mean	31	24	18	5	1
Mean of Means	15.8				

Source : Research data

The overall assessment of the customers’ power over the PSV underwriters can be said to be high as 69% of the respondents rated it as high and very high, while only 8% rated it as low and very low, and 23% as moderate. The industry seems to be dominated by two strong

customers and therefore the high bargaining power. The mean of this factor is 15.8, meaning it is a major factor in determining the level of attractiveness.

### 4.3.5 Bargaining Power of Suppliers

Powerful suppliers can lower the profitability in an industry by threatening to raise prices or reduce quality of purchased goods and services. Suppliers are powerful if the industry is dominated by few suppliers, high switching costs, high possibility of forward integration, the industry is not an important customer of the supplier or the supplier’s product or service is an important input in the buyer’s business. The respondents were requested to rate the power of some identified suppliers over the underwriters, the effect of their power on profitability and the overall assessment of their customers’ power. The responses are analysed in table 6.

**Table 6 – Effects of Power of Suppliers on Profitability**

	Very High	High	Moderate	Low	Very Low
Total Points	40	112	168	66	4
Percentage	10	29	43	17	1
Mean	7	19	28	11	1
Mean of Means	13.2				

Source : Research Data

Suppliers have a moderate influence on firms within the industry. 39% of the respondents rated their effect as high and very high, while 43% rated it as moderate. The rest rated it as low and very low. Lawyers and doctors have the biggest effect on profitability. Collusion between doctors and lawyers may escalate the amount of compensation payable therefore reducing the level of profitability, hence attractiveness. Other suppliers such as loss assessors

and investigators have negligible effect on profitability. The overall mean under this factor is 13.2. This shows that it is not a very major factor in determining the level of attractiveness.

#### 4.3.6 Effects of Substitutes on Profitability

Substitutes are those products that appear different but can perform the same function as another product. Substitutes limit the potential returns of an industry by placing a ceiling on the prices firms in the industry can profitably charge. Availability of substitutes gives customers an opportunity to compare prices, quality and performance. The respondents were requested to rate the effect of fake insurance certificates on the premium charged, profitability and public perception. Table 7 shows the analysed responses.

**Table 7 – Effects of Substitutes on Profitability, Public Perception and premiums**

	Very High	High	Moderate	Low	Very Low
Total Points	45	40	39	36	16
Percentage	26	23	22	20	9
Mean	15	13	13	12	5
Mean of Means	11.6				

Source : research data

The substitute products available in PSV insurance are mainly fake certificates. However, these do not affect the premiums charged by most of the underwriters, but has some little effect on profitability. The fake certificates have a major effect on public perception. For example, where members of the public are injured in an accident and no compensation is available simply because the insurance certificate on the motor vehicle was a fake one, members of the public associate this to poor services by the insurance company and therefore worsening the already existing poor public perception. The mean on this factor is 11.6, meaning that this is not a major factor in determining the level of attractiveness.

### 4.3.7 Government Policies

The government has a direct or indirect influence on business through laws and regulations. The government plays a major role in regulating the underwriting of PSV insurance. As noted earlier, the insurance regulatory authority has a major role in determining how the insurance companies carry on this business. The respondents were requested to assess the effects of various aspects of government regulation on profitability. The analysis of the responses is shown in table 8.

**Table 8 – Effects of Government Policies on Profitability**

	Very High	High	Moderate	Low	Very Low
Total Points	40	72	90	46	7
Percentage	16	28	35	18	3
Mean	10	18	23	12	2
Mean of Means	13				

Source : Research Data

44% of the respondents rated the effect of government on profitability as being high and very high, 35% as moderate and the rest rated it as low and very low. The Michuki rules have been sighted as a major contributor in terms of the level of attractiveness. It is noted that some PSV underwriters became interested in the business when the Michuki rules were introduced, but later lost the interest in the business when the government stopped enforcing the rules to the letter. This made them to pull out of the business. It is noted that the government collects taxes such as premium tax, licencing fees, stamp duty, insurance training levy and policy holders' compensation fund. However, these do not have an impact on PSV business alone as they are also applicable to other classes of insurance. The effect of government policies on PSV insurance business can be said to be moderate, with a mean of 13.

#### 4.4 Critical Factors For Making the Industry Attractive

An attractive industry will have high returns on investment, clear barriers to entry, reasonable market growth, no threat of substitutes, low bargaining power of suppliers and low bargaining power of buyers. It is important for managers to understand the key success factors to enable them come up with the appropriate strategies. Depending on the managers' perception, there are different factors that they consider critical for making the industry attractive. The managers were requested to give reasons for their rating on the level of attractiveness of the business and to give reasons why they are not currently engaging in the business. Other factors were listed for them to indicate if they agree with them or not.

**Table 9 – Analysis of Factors Critical for Making the Industry Attractive**

<b>Factor</b>	<b>Mode</b>
Claims Management	22
Countrywide Branch Network	21
Availability of Manpower	18
Improved Cash Flow	2
High Level of Computerization	15
Requires Little Effort to Get	1

Proper claims management and country wide branch network appears to be the key factors for making the industry attractive, with a mode of 22 and 21 respectively. Availability of manpower and the computerization level of the company can also be said to be major factors with modes of 18 and 15 respectively. With high computerization levels, this would reduce the paper work involved and reduce costs, thus making the business attractive. Among the reasons given for not engaging in this class of business includes poor claims experience, the

requirement for country wide branch network and the manpower required. Others have stated that the business is not profitable and would not want to face the risk of closure.

# **CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMEDATIONS**

## **5.1 Summary**

The insurance industry generally operates within the porters' framework, with the six underlying sources of competitive pressure affecting profitability and therefore determining the level of attractiveness. Table 10 summarizes the results.

**Table 10 – Means of the Various Forces**

<b>Competitive Force</b>	<b>Mean</b>
Level of Competition	16.2
Barriers to Entry	14.2
Bargaining Power of Customers	15.8
Bargaining Power of Suppliers	13.2
The Government	13.0

Competition is the major factor that makes managers perceive PSV insurance business as unattractive. It has the highest mean of 16.2 followed by the bargaining power of customers with a mean of 15.8. Competition is stiff in the PSV sector with companies adopting different strategies to beat competition. However, Most of the companies licenced to underwrite motor business do not participate in PSV underwriting citing various reasons, the common ones being the huge losses associated with this class of business and the driving habits of Matatu drivers. The insurance brokers and agents seem to have a high bargaining power over the PSV underwriters (mean of 15.8). They have pushed the underwriters into accepting very poor risks without proper documentation, negotiated higher commissions and other favours,



therefore lowering the level of attractiveness. Barriers to entry in this class of business can be said to be moderate with a mean of 14.2. High start up costs and high operational costs are the main barriers to entry. To be able to offer services effectively, one requires a countrywide branch network and a lot of man power since too much paperwork is involved. This goes to increasing the cost and therefore lowering the level of attractiveness.

The suppliers and the government have a moderate effect on profitability with a mean of 13.2 and 13 respectively. However, it is noted that the collusion between the suppliers may ruin the future of a firm through exaggerated claims. Apart from the increase in accidents and their severity due to non compliance with the road safety rules, the government does not apply other special rules to insurers of this class of business in terms of levies and taxes.

The level of substitution is low in PSV insurance, with a mean of 11.6. This is mainly because the insuring public is becoming more and more enlightened on the importance of a valid insurance cover. Others fear that the same will be detected by the traffic police officers who are charged with the duty of ensuring that every motor vehicle on the road is insured.

## **5.2 Conclusion**

Attractiveness is relative and not absolute. It mainly depends on the perceiver and their frame of reference. If the industry overall profit prospects are above average, the industry can be considered to be attractive. PSV insurance profit prospects appear to be below average therefore making the industry unattractive. This is mainly due to strong sources of competitive pressure and therefore the low number of firms engaging in this class of business.

### **5.3 Recommendations**

It is noted that only seven insurance companies engage in underwriting PSV insurance business. Some companies started underwriting this class of business when the Michuki rules were introduced, but lost interest in the business after the implementation was relaxed. It is strongly recommended that these rules should be enforced to the letter so as to make the business attractive. It is also noted that all the insurance companies that have closed shop engaged in this class of business. There is need for the government to intervene and strictly regulate this class of insurance business and rebuild public confidence in insurance.

The driving habits of matatu drivers have been cited as a major problem. There is need for the government to come up with stringent rules regarding the licencing of matatu drivers. The insurance industry can also chip in by organizing workshops for the drivers to sensitize them on the need to drive carefully. This will reduce road accidents and claims and therefore improved profitability. The industry may also need to come up with a system of recognizing good drivers and reward them accordingly so as to encourage good driving habits.

### **5.4 Suggestions for Future Research**

PSV insurance business is generally viewed as unattractive by managers in the insurance industry. It is noted that most of the managers cite high claims as the reasons for not engaging in this business. There is need to carry out a study to establish whether it is the magnitude of these claims or the multiplicity that makes the business unprofitable.

### **5.5 Limitations of the Study**

The researcher was not able to get a number of questionnaires back as most of the respondents appeared not to have enough time to complete the questionnaire.

Reluctance of some managers to give information requested for e.g. the premium volume.

Lack of enough resources – The researcher did not have enough funds for the project.

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