RELATIONSHIP BETWEEN CORPORATE GOVERNANCE AND THE PERFORMANCE OF INSURANCE COMPANIES IN KENYA

SUBMITTED BY

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2017
DECLARATION

I hereby declare that this research project is my original work and has not been submitted for a degree in any other university or college for examination/academic purposes.

Signed…………………………………………Date……………………………………

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D61/77442/2015

This research project has been submitted for examination with my approval as the university supervisor

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Above all, I am grateful to the Good Lord, for blessing me with good health, sober mind and favor throughout my research.
DEDICATION

I dedicate this project to my father, Maurice Okok, for consistently pushing and challenging me to be better. I would not be where I am today without the pressure and continuous demand for excellence from him. He never once gave up on me, or stopped expecting better even when I was not at my best, and from that, I got to discover I could achieve anything I set my mind to.
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<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
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<tbody>
<tr>
<td>IRA</td>
<td>Insurance Regulatory Authority</td>
</tr>
<tr>
<td>PSV</td>
<td>Public Service Vehicles</td>
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<tr>
<td>ROA</td>
<td>Return on Assets</td>
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<tr>
<td>ROE</td>
<td>Return on Equity</td>
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<tr>
<td>CEO</td>
<td>Chief Executive Officer</td>
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<td>SPSS</td>
<td>Statistical Package of Social Sciences</td>
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ABSTRACT

The study was intended to investigate corporate governance and how it relates to firm performance of IRA licensed insurance companies, underwriting general business. The findings of the study were aimed to provide more knowhow in the industry which proved to lag behind despite the much potential for growth it is known to have. To achieve this, various elements of the board of directors, which is the main determinant of corporate governance were explored. These included the board composition, the size of the board and the frequency of the meetings. The cross sectional research design was used in the study to establish the relationship between corporate governance and the performance of insurance companies in Kenya. The population for the research was to cover all the 40 general business insurance companies. However, data from only 30 companies, which is 75% of the intended population was collected. This was the no. of directors, the frequency of the meetings and the composition of the boards, which were also the independent variables. Data on the net income and total assets from 2013 – 2016 was also collected for the 30 companies to derive the return on assets, the dependent variable. The study concluded that that there existed a relationship between corporate governance and firm performance, with the various independent variables showing influence on performance to different extents. With the collected data from the industry players, the board composition and the meetings’ frequencies related positively with performance, such that an enhancement would improve on the performance. The board size on the other hand displayed a negative relationship to the performance. Ultimately, the results of this study prove that a greater bit of firm performance is not achievable in the absence of proper governance, and consideration to the board of directors and the decisions made to influence the firm processes, procedures and methods should be key. The study recommends that, policies made by firms should very much consider the structure of the board of directors upon recruiting and making decisions surrounding their roles and make up.
CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

In today’s economy, any company’s success is dependent on the crucial role of its ability to compete, ensure transparency and governance structure which operates within its mandate. This is in absolute regard of the fact that economic value is created by these organizations. According to, Mudashiru et al., (2014), we cannot downplay the fact that a company’s development and economic growth is ideally influenced by good corporate governance. The much trust that company owners can have towards the management of the company is considered to be largely strengthened through corporate governance. Further to this, Shavulimo (2014) indicates that, “Corporate governance is one key element in improving economic efficiency and growth as well as enhancing investor confidence.” This clearly shows that corporate governance contributes to building a framework on which the company goals, and the means of achieving them and observing performance are determined.

Ideally, good corporate governance is meant to be attractive to both the management of organizations and the board. This is done in an attempt to ensure a balance is struck between the two parties aiming for a common goal. In various cases, proper incentives to management come to play to ensure effective monitoring measures are put in place and at the same time, owners’ comfort – in terms of returns - is realized. This is done with the full knowledge that poor governance brings with it the risk of misdirecting resources and much needed capital and resources, undermining wealth and job creation.

This study is based on the fact that insurance companies have operated in fast evolving economic conditions in the last couple of years. This has stretched capacities of the once lean industry and pressed the need to ensure excellence, as would be in any other financial institution. This has led to a complexity which has affected all stakeholders, in an attempt to bring out an actual comparison of companies with proper corporate governance versus those that are wanting. Eccles et al., (2014) argues that in as much as there is sufficient knowledge in the field, not enough facts and empirical studies have proven that there is a direct relationship between the governance and performance. Further, the ability to measure and rank corporate governance is
yet to be achieved. The proposed study wishes to evaluate corporate governance and firm performance in the insurance industry in Kenya, with inclusion of an expanded view on what determines firm performance

Stakeholder theory and agency theory as they relate to corporate governance will be the foundation of this study. For instance, stakeholder theory largely attributes to management of organizations, the values and morals attributed to the interested parties that ultimately reflect in the business ethics they develop. This brings to light the aspect of accountability and that the firm needs to address a larger audience aside from the shareholders, hence need for good governance. Agency theory – forming a backbone of the study – addresses the identification of agency relationship which makes it possible for the company owners to cede the role of management so that the company is run on their behalf. It also clearly defines how one party can work with another to achieve the goals of the company (Velampy, 2013). In both theories, it is worth noting that corporate governance plays a key role in synchronizing the firm’s activities with those managing firm and the expectations of the stakeholders. In both theories, there is an undeniable realization that to influence performance of companies - especially where stakeholders are involved and there is need to consider the external environment at large – corporate governance is consequently an area of interest and focus. Therefore, this study aims to largely establish the relationship between corporate governance and insurance companies’ performance.

1.1.1 Corporate Governance

Corporate governance has received much consideration in the modern day corporate world as a significant determinant of a company’s performance. This defines a specific path of rules, control, regulations, management, relationships, directions all aimed at balancing the expectations of the stakeholders. Most companies have acknowledged the need for proper corporate governance to ensure smooth flow of crucial information, and clarity in the practices and roles of each party to manage expectations and keep everyone happy. A study by Making (2015) has however shown – especially in developing countries – that the acknowledgement has not necessarily been backed up by knowhow and action. Further to this, the actual integration of
the principles of corporate governance has been limited especially in industries where maximum potential has not been achieved, one of them being the insurance industry.

In simple definition, corporate governance can be defined as a system – detailing methods and procedures - by which an organization is overseen and managed for the ultimate satisfaction of all interested parties, with keen interest on transparency and accountability. The interested parties are categorized as either internal or external based on their association with the company. Internal parties include the shareholders, board of directors, management, and employees. External parties are the clients, suppliers, regulators, auditors, actuaries – if outsourced (Larcker & Tayan, 2015)

In the exploration of corporate governance, Making (2015) further acknowledged that a lot has evolved in the study of the subject. This has allowed different industries, or companies in the same industry to come up with what works for them, depending on their external and internal environment. In the specific case of insurance companies, the kind of product in the market determines the type and quality of clients the company will attract, thus, the need to formulate practices dependent on that. For instance, Invesco Assurance Ltd, dealing with 98% Motor – PSV insurance would need different policies from Jubilee Insurance whose magnitude is leaned towards medical insurance.

It is worth noting that corporate governance as defined in most scenarios, is determined by interest of the users. For instance, Jizi et al., (2014) defines corporate governance as, “… an internal system encompassing policies, processes and the people which serve the need of shareholders and other stakeholders by directing and controlling management activities with good business savvy, objectivity and integrity.” This considers that though the ultimate execution surrounds the board of directors, there are various principles surrounding it, that give varying descriptions as situations change. A lot has been done in Kenya insurers by the regulator to reform corporate governance approach to ensure agency problems are addressed. This includes compliance with Insurance Regulatory Authority (IRA) guidelines on corporate governance, or justifications and extents on non-compliance (IRA).
1.1.2 Firm Performance

In most situations, the performance of an organization is perceived to be mainly its profitability and the much that can get distributed to the shareholders. However, modern day study of maximum satisfaction in company performance has moved from this mentality and adopted an all rounded system where other aspects are brought into play when evaluating the performance of a company. These, as supported by Adegbite, (2015) include the internal efficiencies, the returns on assets and equity, company general profitability, response to the external and to the social environment and economic rent. All these aspects are measured as the actual output or realization against the intended output. Various methods have been applied to measure firm performance. Some of these methodologies as borrowed from Adegbite, (2015) that will be explored in this study include, the shareholder based financial analysis, balanced score card and the triple line.

Due to the fact that there is an increasing need to expand the scope of determining firm performance, the selection of the performance indicators has also widened. As described by Christensen et al., (2015), there is almost no definite or standard boundary on the measurement of performance across the board. This means that not all the known indicators are applicable indiscriminately to all companies. With reference to insurance companies, performance determinants include – but are not limited to – customer satisfaction, ability to comfortable meet claims obligations, market share. In addition to this as earlier mentioned would be, profitability, response and value accorded to external environment, return on investments and internal efficiencies. According to Mercy (2014), “… firm performance is an organization’s ability to attain its goals by using resources in an efficient and effective manner.” This describes the smoothness by which firm manages available assets within its disposal to make profits.

It has been continuously perceived in most industries that performance is mainly profitability, thus limiting it to financial performance. In the modern day view of performance, a lot of other considerations have been brought to the table to measure performance, thus, influencing how goals and objectives of companies are set. Christensen et al, (2015) describes the increased measures of performance that have enabled firms stand out. However, this is mainly seen in
service industries such as insurance where customer satisfaction and internal efficiencies are key considerations to firm performance besides profitability.

Shareholders have in recent times leaned towards focusing on processes put in place to ensure goals are achieved. As a result, contents, reports relied on have to be specific as to what mechanisms are factored in. To further ensure that this does not create a conflict in terms of what the management is expected to deliver, they have in turn resorted to developing goals and objectives that capture processes as much as they do the results. While it is possible to study corporate governance independently without capturing performance, it is impossible to study the latter without the former as a determinant. Adegbite (2015) puts forward major areas in which performance can be examined. Measurements that can be used to establish performance are;

1.1.2.1 Return on Equity

This is how much net income against the percentage of the shareholders’ equity is returned. In its entirety, it measures a company’s profitability by showing the extent of profits able to be generated by a company given the amount that the shareholders have injected. Performance is deemed to be good if the ratio of the profits to equity is high compared to where low, which can be attributed to poor management of working capital. However, other considerations such as liquidity are key. Return on Equity is calculated as: ROE = after tax profit/Shareholder's Equity.

1.1.2.2 Return on Assets

Here, we look at the profitability of a company with regards to its assets. The performance indicator measures how well a company can manage its resources and use its assets to generate income. This is done by comparing the earnings of the company against the total assets held. the efficiency by which this can be achieved is highly dependable on corporate governance. While ROE is a ratio, ROA is expressed as a percentage. Return on Assets is calculated as: ROA = after tax profit + Interest (Before tax)/Shareholder's Equity. Interest expense is added back to use operating profits before deducting cost of borrowing.
1.1.2.3 Internal Efficiencies

This can be concluded by observing a company’s ability to smoothen its operations both internally and externally. The study will look into aspects such as customer satisfaction, reduced manpower in achieving set objectives thus, saving on cost of production, speed of delivery and clarity in the process flow of the company. All these are aimed at ensuring performance in a company is all rounded, a direction of evaluating performance which can be made by the board of directors.

1.1.3 Corporate Governance and Performance

Following the descriptions of corporate governance, the relationship is evident and can therefore be identified in different dimensions. Most components of corporate governance revolve around the board and in rare occasions would factor in members outside the board. This therefore links both financial and non-financial performance of a company to the decisions made by the board of governance. To the extent where the board is involved (non-independent – both executive and non-executive, and independent) decisions as to how to follow procedures, adhering to statutory requirements and to what level, disclosure of important aspects to the public are made. These therefore determine whether or not the firm will have proper processes. With proper processes, efficiency is achieved and the framework set to achieve profitability and internal efficiencies is properly followed to ensure goals are achieved.

Non board members such as the management are also crucial in corporate governance, especially because they act on behalf of the directors. This is clearly demonstrated in the agency theory. With proper relations to the board, good motivation such as issuing them stock enough to allow them work harder without provoking conflict of interest, a strong foundation to work towards achieving the set goals. This ensures that the performance of the company is boosted since there is goodwill and proper focus on the objectives, unlike where motivation would be lacking.

1.1.4 Insurance Companies in Kenya

The Insurance industry in Kenya is undeniably gaining popularity among the masses which was not the case a decade ago. The governance of the industry is though the Insurance Act and
regulated by the Insurance Regulatory Authority (IRA). An amendment in 2006, of the Insurance Act birthed the regulatory body, Insurance Regulatory Authority (IRA) which began its operations on 1st May 2007. Its sole purpose was to ensure insurance companies are well regulated, supervised and see through the growth and efficiency of the industry.

In brief, the industry’s companies are placed under financial institutions given the fact that they accept monies from the public as security in case of an eventuality. Insurance companies’ can be defined as entities that accept risk on behalf of their clients – policyholders – upon which they compensate in case the risk occurs. Based on this, it is evident that their performance can largely be measured by how well they are able to fulfill this core mandate. Also, as described by Agogwa, (2016), the nature of their business requires that a relationship is maintained with the clients as among the many stakeholders they have. It is worth noting that intermediaries – brokers and agents – are important in the insurance chain. They engage in various activities such as distribution, underwriting and claims settlement to assist in achieving intended purpose. In many situations, it is acceptable – even with the regulator – to have the intermediaries establish a relationship that links the insurer to the policyholder, in order to assist in finding the best products and packages that suit their needs and how much they are willing to spend (Insurance Act,2013).

It has notably been established that insurance companies have a role of guaranteeing financial risks such that they are able to restore policyholder’s status after the risk occurs (Asogwa, 2016). As a result, much magnitude is placed on the industry that is key in today’s dynamic environment. It is however worth noting that due to various factors, and mainly inability to meet obligations, some insurance companies have closed operations or been placed under statutory management. However, consistency has been observed with several interested parties, including the Central Bank of Kenya, the government and IRA as the regulator working tirelessly to support and ensure growth of the industry.

1.2 Research Problem

Like many other industries, the insurance industry is not operating free of criticism and challenges from the general public and other institutions. This contributes to the challenges in
penetrating effectively into the potential market that is hugely available. Ideally, insurance companies are meant to operate as covers of clients against a risk, at a premium, thus, pays claims as they occur for continuity and trust among their clients. This is however not the case as it has been noted that many people in Kenya do not have much faith in the insurance industry and their concepts (Asogwa, 2016). This has to a large extent been perceived to be due to the increasing reports of unpaid claims, circulating in the market. Extended periods of investigations also discourage potential clients from securing their risks with insurance companies. Further, there is the limited understanding on how the concept of insurance works entirely. The perception is that the premiums received are meant to enrich the companies and not benefit the policyholders in an event the risk never occurs.

In an attempt to identify the reasons for the leniency in the growth of insurance countries and inability to compete effectively, various issues have come to light. From my own study of insurance companies, it is worth noting that among the issues insurance companies face, is the case of fraud where intermediaries or even the policyholders are dishonest in the reporting of risks. This leads to the insurance companies having to pay heavy nonexistent claims that result to a strain on their financial stability. It is also a necessity that claims need to be paid on condition that the premiums were paid in good time. However, we have cases where premiums are not received on time but insurance companies are compelled to pay claims, especially where third party covers are in play, e.g. for motor vehicle insurance.

As mentioned earlier, some insurance companies have either collapsed or gotten placed under statutory management. With the reasons identified, it is possible to see that the reasons are within the control of the players in the industry. Most of them are actually persistent because of poor or disregard of proper corporate governance. With the principles of corporate governance, a lot can be achieved with full implementation of the concept to the letter. Companies could effectively pick practices of corporate governance that work for them and committedly apply for the enhancement of their operations. It is clear that possibilities to incompetency may be found where wrong message is relayed to the public by the agents (Manyuru, 2006). The existing problem, which is the subject of this study, is the inability to identify, measure and incorporate corporate governance to influence performance, given that the idea is taken casually by most
insurance companies, such that failure to acknowledge its importance, leads to absolute implications of disregarding it.

There are also gaps that still exist in the field, despite some studies that have been done relating to corporate governance and how it relates to company performance. This research is aimed at filling the gaps that have not been explored by other researchers on the same subject. First, this research will develop a means to measure corporate governance and rank the same findings and compare against performance to prove the relationship. This will have actual percentages allocated depending on what will be reviewed as a determinant of corporate governance. Secondly, most comparisons of how the two concepts relate has focused on Return on Equity as the measure of performance. This research aims to fill this gap by exploring and measuring Returns on Assets and include aspects of internal efficiencies as part of performance of a company. The study focuses on the influence of corporate governance on the performance of insurance companies in Kenya which leads to the question; what is the relationship between corporate governance and the performance of insurance companies in Kenya?

1.3 Research Objective

To establish the existence of the relationship between corporate governance and the performance of insurance companies in Kenya, through measuring corporate governance - by demonstrating how board composition, board size and frequency of board meetings measure - and comparing against firm performance.

1.4 Value of the study

The outcome of this study will to a large extent show the role of corporate governance in insurance companies and how they relate to determine firm performance. Further, it will make available critical knowhow by stakeholders of companies so as to ensure the appropriate considerations are made when making decisions. The study will equip scholars with diverse views if they may wish to take on further studies aimed at improving corporate governance structures and for theory building. It provides a stable platform for policy making and research.
The result of this study will also play a major role and contribute to the theoretical and practical knowledge within the strategic framework for the Kenyan firms operating in the Insurance Industry on how to improve performance through corporate governance. Its significance will be achieved in documenting firm activities and practices on corporate governance. This will include the clarity on how to measure and index corporate governance through preferred variables and compare to performances as viewed by the companies.
CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter deals with the relevant literature that already is in existence in this area of study. The literature, in its entirety, can be divided into either theoretical or empirical literature. In brief, theoretical literature focuses on theories that have been developed previously and already tested. Empirical literature on the other hand pays attention to studies that have already been done in the area of research, including findings and recommendations.

2.2 Theoretical Foundation

Here, we detail the theories intended for use in the study and provide weight in the argument of the subject matter which is the relationship between corporate governance and the performance of insurance companies. This will be guided by two theories; Stakeholder theory and Agency theory.

2.2.1 Stakeholder Theory

The Stakeholder theory was developed by Freeman. The theory states the fact that besides the shareholders of a company, many other parties – directly or indirectly involved with the company – need to have value created for. These include; potential employees and customers, surrounding communities, trade unions, government institutions, and the general public (Freeman, 1994). In addition to this is a few circumstances where competitors are also viewed as stakeholders. In this theory, values and morals are developed in such a manner as to consider all the relevant stakeholders so as to shape the business ethics and the culture.

In the stakeholders’ theory, how strategy is viewed by the interested parties is key in the integration of resource based and market based views. It also factors in the undeniable possibility of a socio political level. Being that there is a possibility of implications of corporate governance on the performance of the economy, the realization that companies have a huge role to play to other parties besides the shareholders is worth a consideration. What gives however, is indeed the impact that the different categories of stakeholders may have, as far as the performance of the...
company is concerned, its behavior and largely, economic growth. Harrison & Wicks, (2013) speak conclusively of analysis done to identify impact of corporate governance on one of the aspects of firm performance which is the economic growth.

It is deemed fit to consider any incentives that may be enjoyed or not by the participants who have an input in the general performance. It is worth noting that using the input-output model of corporations, all internal stakeholders’ inputs are converted into outputs fit for customer purchase, thus, ensuring an equity benefit to the company (Harrison & Wicks, 2013). It however only brings to play the internal stakeholders, thus limited to the investors, customers, suppliers and employees. This model therefore, shifts the responsibility of information disclosure to the members of the board, ultimately affecting the decision making of the internal and external stakeholders both.

2.2.2 Agency Theory

This theory was initially explored Alchian and Demsetz (1972) and later on developed further by Jensen and Meckling (1976). It has its foundation in the economic theory. In simple terms, it can be defined as a relationship between two parties being the principal and an agent, creating a circumstance under which the agent works on behalf of the principal. The principals, from various studies and as established by Alchian, and Demsetz, (1976) are the shareholders (owners of the company). The agents on the other hand would be the company management and executive. The responsibility or running and managing the company as per the set standards falls squarely on the management (agent) (Mitnick, 2013).

The existence of this theory does not go without the realization that the agent – managers and employees – may at times act in the interest of self. Padilla, (2000) clearly highlights the possibility that they may act against the owners’ will. There are chances of falling into self-interest and exploring opportunities and behaving in a manner suggesting the lack of synchronization between expectations of the principal and the intentions of the agents. At times, the knowhow of what is at stake may also have different approaches.

This therefore brings forth the emphasis that the decisions made and actions are inclined to the principal’s interests. As such, we realize that the endgame should be made clear by the owners.
Therefore, corporate governance comes to play in the establishment of the interests of the owners that in this case, have the capacity to either make, or break the company. This further reflects in the performance of the firm. Thus, the theory clearly shows that the basis is to separate ownership and control (Pepper & Gore, 2015). The agent should follow rules by the owners/principals to realize maximum value, thus, the application of a rather individualistic view.

Harrison & Wicks, (2013) demonstrate that, “… agency theory posits that the firm is not a reality, but a legal fiction created by a ‘nexus of contracts’ of the principal-agent variety.” Thus, the relationship of the principal and agent is purely contractual. This makes it necessary for there to be a written contract so as to have the interests aligned and avoid cases of misguided performances based on changes of interest. The same is also done with other internal stakeholders to minimize misunderstandings. The agreement also normally makes it quite a challenge to fully observe the agents’ behavior. As a result, the principal has the option to reward the agent accordingly based on the outcomes measured against the set goals. In turn, it has been established that workable contracts entail the trade-off between the cost of measuring behavior and the cost of measuring outcomes (Harrison & Wicks, 2013). The risk is therefore largely transferred to the agent compelling them to hold their end of the bargain. Therefore, mechanisms of corporate governance are shaped to work around agency problems. Firms with better corporate governance mechanisms have higher performance.

2.3 Determinants of Performance of Insurance Companies

Corporate governance has been established to revolve largely around, but not limited to, the board of directors. This is a key consideration towards developing a means of rating and determining whether proper governance is appreciated or not. This section reviews the different components of the board that influence the outcome of the quality of governance, thus, major determinants of performance of the organizations, in this case – Insurance Companies. These include:
2.3.1 Board Composition

This plainly describes the makeup of the board of directors which has various categories including spread of the executive and the non-executive directors and gender balance or diversity of the board. The gender diversity will be explored in this study. In description, an independent non-executive director is defined as one who has no direct ties to the company besides following their lead (Van Grembergen & De Haes, 2017). Various perceptions have been developed about how the composition of the board affects the outcome of governance. This is in fact true given that most well balanced boards enjoy the benefit of a wide view of options making the possibility of proper governance easily realizable. There is a seeming perception that boards with more independent directors will make different and better decisions than boards dominated by dependent and executive directors.

2.3.2 Board Size

This is an important aspect of the board structure. It is deemed that large boards have the capacity to ensure diverse views enabling companies access important resources while minimizing uncertainties of the environment. However, according to Romano and Guerrini (2014), the ability to make decisions, coordinate and communicate greatly sets back and affect company performance with a large number of directors. Thus, compromises may need to be made depending on prior experiences or value added with every change regarding increase or decrease of board members. Though recommendations by Velnampy (2013) would rather have member maintained between 7 and 8, it is important to note that this is highly dependent on an industry.

With reference to the research, we note that insurance companies have not exactly displayed consistency in the number of the members of the board. This notwithstanding, this research will be able to establish that ultimately, the number as a function of corporate governance will enable to measure the corporate governance and further compare against firm performance and prove the relationship. In support to this research, Velnampy (2013) notes that financial performance can benefit from a large board because of widespread advantage in business relations. Company objectives evolve over time and thus, the need to review every often to accommodate the growth
if any. With this, the research will factor in as well the size of the insurance company when determining the role of the size of the board in establishing the relationship of corporate governance to the firms’ performance.

2.3.3 Board Meeting Frequency

In simple terms, this aspect as a mechanism of corporate governance describes the number of times in a period – say a year – that the board members meet, and how many of the board members actually attend the meetings. According to Adegbite (2015), there is a tendency to maintain formality in the board meetings while reviewing the current affairs as opposed to management assessment. This approach of board attendance, means that how often they meet determines how many issues are addressed and if the same is done in a timely manner. As this study aims to prove, much is covered with comprehensive meetings rather than increased frequency and a balance created when both considerations mentioned above are made. Making (2015) has noted the association of too many meetings with reduced performance. Kimaite and Omvia (2016) also adds on the impact of the frequencies where there exists a crisis. These findings have however not been able to particularly measure corporate governance actualize a comparison, hence, the gap that this study aims to fill.

2.4 Conceptual Framework

The conceptual framework basically will identify how selected variables in the study relate to one another. They will be divided in two categories being:

- Independent variables – Stands alone and influences other outcomes
- Dependent variables – results are as a response to the independent variable

In this study, independent variables are derived from corporate governance while the dependent variables are the result of performance based on the influence of corporate governance, thus, can be measured to determine the impact of the independent variable to its outcome.
A control is introduced to ensure that the study is done on a level playing ground to enhance the authenticity of the findings. Among the insurance companies (general and life business), the control will be to use general business companies.

<table>
<thead>
<tr>
<th>Independent Variable</th>
<th>Dependent Variable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate Governance</td>
<td>Firm Performance</td>
</tr>
<tr>
<td>• Board Composition</td>
<td>• ROA</td>
</tr>
<tr>
<td>• Board Size</td>
<td></td>
</tr>
<tr>
<td>• Board Meeting Frequency</td>
<td></td>
</tr>
</tbody>
</table>

Figure 2.1: Conceptual Framework

2.5 Empirical Literature Review

Mercy (2014) in the study of corporate governance with respect to Nigerian banks opted for a survey research design with a specific sampled banks in Delta State. The data was obtained through questionnaires distributed to 100 respondents to establish the suitability of the study. The researcher concluded that failure of most Nigerian banks is due to failure to implement principles of corporate governance. In other cases, there was attempted implementation which still ranked as poor governance thus, resulted to issues of funds misappropriation, unjustifiable remuneration by executives, fraud, bankruptcy all of which ultimately indicated poor performance and collapse of the banks. The available data after distribution of the questionnaires was analyzed using the statistical package for social sciences (SPSS) regression software to validate the argument of dependency of performance on corporate governance, acceptable corporate behavior and corporate social responsibility.

Further, Otieno (2010), focused his study on companies listed on the Nairobi Stock Exchange and whether their performance is influenced by corporate governance practices implemented. The study was based in factors of corporate governance that did not necessarily surround the board of directors. For instance, emphasis was placed on the separation of duties between the chairman and the CEO. Also, the tenure of the CEO in a certain company was largely exploited. Data was obtained from financials of companies and evaluated through rating governance as per
Globe and Mail rankings. It was concluded that best performing stocks were from companies that rated highly on corporate governance.

Okiro et al, (2015) brought a different angle to the study so as to research corporate governance alongside compliance to the regulatory bodies and capital structure as influencers to the performance of companies listed at the East African community securities exchange. The reasoning behind this argument was due to the fact that regulators require disclosure of board of directors structures. This was explored, including the fact that regulators have a bare minimum on the appropriate spread of capital depending on the capital injected. This results in the calculation of the risk based capital to determine company performance. The conclusion of the research evidently showed that among the three determinants, corporate governance strongly contributed to the outcome and to some extent, influenced the capital structure and compliance extent as well. There was the realization that the relationship is positive and highly significant.

Sueyoshi et al. (2010) also used a rather unique methodology in establishing direct influence of corporate governance to performance. The study was done on Japanese firms. This focused on the changes experienced in performance after reforms on corporate governance were spearheaded by the government, thus, making them more acceptable. It was concluded the improved performance is a direct product of proper governance. Further, the study implication of having foreign shareholders in an organization as opposed to maintaining local shareholders only. It was established that foreign shareholders bring competitive managerial skills and expertise which improve quality of corporate governance and ultimately company performances.

Asogwa (2016) did a study in Nigeria on corporate governance and organizational performance where the data was analyzed with t-test. Here, the focus was on transparency and how much it could be incorporated in the decision making and implementation. The issues explored were focused on the details of the board of directors and board operations being transparent to allow informed scrutiny from the stakeholders and potential shareholders to enhance quality of decisions made. The findings revealed that in most organizations, corporate governance had to have transparency as a key determining factor in the organization, where a path can be traced to how the final output is arrived at.
Manyuru (2006) in his study of corporate governance also focused on companies listed in the NSE. The study sampled out forty-seven companies and a conclusion was made that there is a correlation between performance and corporate governance. The unique discovery here however, was that the magnitude of the correlation was highly dependent on the industry and further, the market segment captured. This study also concluded that a lot of firms listed that had high level governance were foreign owned or subjects of intense regulatory standards. Generally, the higher the governance practice, the higher the performance.

Misangyi and Acharya (2014) focuses on composition of the board as a crucial aspect of corporate governance. He argues that independents can assist resolving agency issues and maintaining neutrality. Also, the inclusion of other categories such as ethnic and gender diversity in the measure of corporate governance under board composition, enables to widen the scope of decisions that could be made and influence reached. The research recognized the mixed feelings towards this aspect, indicating the possibility that the inclusion of more non-executive board members, especially in monitoring management, results in better decisions, and thus performance. This research finds that the more non-executive and independent directors, the better the chances of proper corporate governance.

(Dehaene et al., 2001), opines that the impact of board composition as an influence to performance is limited to depending on the diversity. The study is done on Thailand Life Assurance companies. The researcher argues that, the directors should have different qualities pertaining to them which widens the scope of possibilities. This is also viewed by the researcher as a basis of corporate governance, with little focus on the size and the board meetings. The conclusion is that that the composition influences profitability positively while not so much the same on ability to take risks for life insurance firms in Thailand. With reference to insurance companies, this study aims to come up with an independent conclusion in how the same affects performance of insurance companies in Kenya.

2.6 Summary of Literature Review

In summary, literature review summarizes previous studies that have been done on the same subject to enable identify what has been covered and existing gaps. It is worth noting that there
have been many studies, but different findings have been arrived at depending on theories looked into and variables explored. Various mechanisms of governance are availed for use by companies in enhancing performance. Theories that can assist in exploration of the subject are identified in this section. Empirical literature on the other hand focusses on studies done towards the area of study. In essence, they help shape the nature of the research by identifying the gap or areas not tackled or those which could be researched/ developed further. With different scopes of study, it has been established that there is the possibility of identifying mixed findings on the same matter., for instance, the role of independent directors and why their percentage in the board matters.

The literature in this chapter aims to set a foundation of corporate governance. It further develops the performance measurement standards which will be used across the insurance companies. Though a lot of awareness has been raised to the importance of corporate governance, it had not been of much consideration in the insurance industry. Consistency in the campaign to implement corporate governance practices is key for the credibility of the performance of companies. Different researchers – as mentioned earlier – have made different conclusions. One consistent outcome is that there is a direct relationship between corporate governance and performance of insurance companies.
CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

In this chapter, focus is placed on the framework of the research methodology intended to be applied in the study. Here, the research designed will be demonstrated and the target population of the design. The chapter also clearly indicates the sample and sampling techniques, and the methods of data collection. It also displays how a conclusion is thereafter made based on the data analysis and lastly data presentation method applied in this study.

3.2 Research Design

The Cross-sectional research design will be used in this study. This design reflects on available data regarding the subject of study – in this case, available information on corporate governance and insurance companies as held by the regulator, or reported in the Annual Statements. This seeks to observe and analyze situations to identify trends, predictable behaviors and those that would re occur given the same situations. It seeks to establish the, who, what, where, when, or how much. A defined set of investigative questions relating to the components of corporate governance – as mentioned in the literature review is used. This assists in achieving a formal and well-structured premise.

This method further allows the identification of different variables and how they relate, and whether or not they are independent. The endgame here is to realize the extent of the association. According to Cooper and Schindler (2008), the studies under this design are undertaken once and represent findings at the particular point. This design is selected with regards to the type of data collected – secondary data - and analysis done. Therefore, it enables the researcher to establish the relationship of corporate governance to insurance companies in Kenya.

3.3 Population

According to Mugenda & Mugenda (2009) population can be defined as a whole collection of subjects which could be events, objects or individuals that portray similar observable characteristics. This section therefore, looks into the population intended for study upon which a
conclusion is drawn – based on the findings – and is deemed applicable the entire population. Data will be collected from all the 40 licensed general business insurance companies with performance reviewed between 2013 to 2016.

3.4 Data Collection

Secondary data will be used. This will be obtained by reviewing the Annual Statements and the financial statements for all the 40 licensed general business insurance companies, and the IRA Industry reports. The method allows for proper selection of proper and relevant information and content to maintain relevance to the purpose of the study. As previously stated, the data will be obtained from the insurance companies’ published information between 2013 to 2016. This will be collected on both the corporate governance and performance publications.

3.5 Data Analysis

The statistical package for social sciences (SPSS) version 20 will be used to do an analysis on the quantitative data obtained. Both descriptive and inferential statistics will be used. Mean, standard deviation, percentages and frequencies will be used to present the descriptive statistics. The relationship between the independent and dependent variables (corporate governance and performance) will be determined using correlation and linear regression analysis.

The multiple regression model shown below, guides the study:

\[ Y = \alpha + \beta_1X_1 + \beta_2X_2 + \beta_3 X_3 + \epsilon \]

Where: \( Y \) = Insurance company’s performance measured by Return on Assets (ROA)

\( \alpha \) = Constant

\( X_1 \) = Board composition, a measure of gender diversity among the board of directors

\( X_2 \) = Board Size, the number of directors in the board, includes both the independent and non-independent directors
$X_3 =$ Board meeting frequency, the number of board meetings held during the year, and the attendance by the board members

$\epsilon =$ Error term

$\beta_1 - \beta_3 =$ Beta coefficients
CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSIONS

4.1 Introduction

This chapter offers an analysis of the data collected from the secondary sources. It includes the descriptive statistics of the sample data, and regression analysis to understand topic of study. This study is descriptive in nature and quantitative analysis used in forming the means, median and standard deviation for the variables in relation to the corporate governance in insurance firms in Kenya. The Annual Statements of 30 general business insurance companies were reviewed, and the corporate governance statements used to come up with the required data, between 2013 – 2016. The financial statements were also reviewed for the same companies between 2013 – 2016 to analyze performance based on the Return on Assets.

4.2 Presentation of Data

Figure 4.2.1: Board Size
The average number of board members in the industry firms was found to be between 4 and 12. Most insurance companies also demonstrated the preference of having odd numbered board of directors rather than an even number. The highest number was recorded by CIC General Insurance Co. Ltd at 12 board members, whereas the lowest number recorded by Cannon Assurance Company at 4 members.

Figure 4.2.2: Board Composition – Gender Diversity

On average, majority of the firms had gender diversity on the board. However, the minority gender in most firms was less than the recommended 33%, with APA, Cannon, ICEA, Invesco, Jubilee, Kenya Orient, Madison, Occidental, Takaful and Xplico Insurance having 100% of the majority gender, i.e male board members. Generally, there was low female board membership with just Resolution, Kenindia and First Assurance having 33% minority membership. This was attributed to the commitment of these firms to improving their corporate governance performance considering that gender diversity has significant effects on board inputs as well as
in the firm outcomes. However, it is worth noting that majority of the firms attempted to diversify, and upon resignation/retirement of some members, replacement would be with a member of the same gender as was the case in Fidelity Shield and CIC Insurance.

Figure 4.2.3: Board Meeting Frequency

On average, the recommended number of times in which the sampled firms hold board of directors’ meetings was 4 times in a year. This was also established to be separate and independent of meetings held by the board committees. The idea behind this was to enable quarterly review of the companies, an observation that is upheld by most firms. However, in some instances there were more than 4 meetings held. Under this variable, two concepts of; number of board meetings held, and the general attendance by the board members were incorporated. This seems as an important element in corporate governance and has a significant role in corporate performance of insurance companies in Kenya. There was consideration and rating of every firm on the number of meetings they held annually. The rate was further subjected to the extent of attendance of the meetings by the members of the board, to establish
the actual performance in this category. APA scored 100% as a company that held exactly 4 board of directors’ meetings with 100% attendance in all meetings.

Figure 4.2.4: Corporate Performance

Corporate performance in the selected insurance firms was measured in terms of the return on assets (ROA). This calculated the ratio of the net income against the company assets for a period of four years. The findings showed that there was negative return on assets in Xplico, Resolution, AMACO, First Assurance with the lowest ratio of -0.19 for Cannon Assurance. Kenya Reinsurance recorded the highest return on assets at a ratio of 0.1. The findings in the corporate performance are attributed to the board composition, the board size and the frequency of the board meetings.
4.3 Regression Analysis

Table 4.3.1: Pearson Correlation Coefficients

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<thead>
<tr>
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<th>Board composition</th>
<th>Board size</th>
<th>Board meeting frequency</th>
</tr>
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<tr>
<td>Pearson Correlation</td>
<td>1.000</td>
<td>.633*</td>
<td>-.612*</td>
<td>.554*</td>
</tr>
<tr>
<td>Corporate governance</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>and performance</td>
<td>.633*</td>
<td>1.000</td>
<td>.436*</td>
<td>.652*</td>
</tr>
<tr>
<td>Board composition</td>
<td>.633*</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Board size</td>
<td>-.612*</td>
<td>.436*</td>
<td>1.000</td>
<td>.018*</td>
</tr>
<tr>
<td>Board meeting frequency</td>
<td>.554*</td>
<td>.652*</td>
<td>.018*</td>
<td>1.000</td>
</tr>
</tbody>
</table>

The Pearson Product-moment correlation coefficient is basically the measure of the strength of the linear relationship between two variables. It is normally denoted by “r”. Basically, it tries to draw a line of best fit through the data of two variables. The Pearson moment Correlation was done so as to measure corporate governance and performance of insurance firms in Kenya by finding the relationship between the various variables, “r”. This was done by showing how far apart the data points are from the line of best fit. Here, a range is taken of values from “+1” to “-1”. Obtaining a zero value shows that no relationship exists between the selected variables. A study by Wong and Hiew (2005), indicated that when the value of “r”, ranges from 0.10 and 0.29, it is concluded to be weak, where the range is from 0.30 to 0.49 it is viewed as being moderate, whereas a range of 0.50 to 1.0, it is deemed to be strong. Although, Field (2005)
asserts that the correlation coefficient need should not exceed 0.80 in order to avoid the issues of multi-collinearity.

In the model of this study, the highest correlation was found to be 0.652, shown between board composition and board meeting frequency that is less than 0.8. This then means, there is no multi-collinearity issue in this study. From the table, all the predictor variables have been shown to have a positive relationship with the strongest shown by board composition (0.652) except the board size (weakest) (-0.612*) which is being shown by the relationship of board size and the corporate governance and performance. This means that board size has a significant negative relationship with performance of insurance firms and this is supported by the negative ROA values of the selected firms from the previous section (Figure 4.2.5).

4.4 Coefficients of Regression

The multi regression model applied factored in the three independent variables represented in such a way that it would measure the extent to which they affect the dependent variable in this case firm performance.

The model was represented as;

\[ Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \epsilon \]

Table 4.4.2: Coefficients of regression

<table>
<thead>
<tr>
<th></th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
</tr>
<tr>
<td>(Constant)</td>
<td>.260</td>
<td>.460</td>
</tr>
<tr>
<td>Board composition</td>
<td>.131</td>
<td>.048</td>
</tr>
<tr>
<td>Board size</td>
<td>-.170</td>
<td>.045</td>
</tr>
<tr>
<td>Board meeting frequency</td>
<td>.251</td>
<td>.023</td>
</tr>
</tbody>
</table>
Dependent Variable: Firm Performance

Out of the findings of this study, it can be noted that the three independent variables i.e, the composition, size and frequency of meetings of the board relate to corporate governance and as such, performance, in which a substantial increase or decrease in each of the variables impacts performance in the insurance firms. The establishment of the multiple linear regression equation becomes:

\[ Y = 0.260 + 0.131X_1 - 0.170X_2 + 0.251X_3 \]

**Where**

Constant = 0.260, indicates that with board composition, board size and board meeting frequency being held constant (0), companies’ performance would be 0.260

\( X_1 = 0.131 \), indicates that a unit change in board composition results in 0.131 unit’s growth in performance of insurance firms in Kenya.

\( X_2 = -0.170 \), indicates that one unit change in board size results in - 0.170 unit’s growth in performance of insurance firms in Kenya.

\( X_3 = 0.251 \), indicates that a unit change in board meeting frequency results in 0.251 unit’s growth in performance of insurance firms in Kenya.
CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

In this chapter, the findings are summarized as per the data analysis. The aim of the study was to find the relationship between corporate governance and firm performance amongst the Insurance firms in Kenya. Focus was placed on the general business insurance companies to research on firms with the same practices, regulatory requirements and challenges.

5.2 Summary of the Findings

Corporate Governance and Performance

With reference to firm performance, the findings clearly indicate that performance was affected by the makeup of the board, size and the frequency by which the board of directors met. It was established to be significantly influenced. The frequency meetings and board makeup had positive connection with corporate governance and performance but size of the board (no. of directors), exhibited a negative relationship to the same.

Board Composition

From the findings of this study, the sampled insurance firms in Kenya showed that board composition can be measured by directors’ gender diversity, being proportion of the male to female board members. It was established that, most of the board of directors had more male representation with only Resolution, Kenindia and First Assurance meeting the recommended threshold of 33% minority membership in a board. All of the other companies recorded low female representation with some of them (APA, Cannon, ICEA, Invesco, Jubilee, Kenya Orient, Madison, Occidental, Takaful and Xplico Insurance) having 0% female representation. This is considered to influence corporate governance and performance in the insurance firms. The study revealed that board composition had quite a relevant influence on performance. The findings are supported by the statistics: $\beta = .131$. 
Board Size

From the findings in this study, it was revealed that on average the committee members in the firms are between 4 and 12. This variable was considered to have a significant but negative association with corporate governance and performance among insurance firms in Kenya. This is because the board size depends on the amount of operations exercised in these firms. The findings are supported by the statistics: $\beta=-.170$.

Board Meeting Frequency

From the findings, it has been revealed that board meeting frequency enhances corporate governance and performance in Insurance firms in Kenya. The findings are supported by the statistic: $\beta=.251$. The findings in this area also showed that board attendance contributed to frequency of the board meeting and so is effective corporate governance and performance in Insurance firms in Kenya. Also, it showed the importance of ensuring the attendance of meetings regardless of how may are attended, is keenly observed, as it allows to discuss issues conclusively with 100% input and representation.

5.3 Conclusion

This study was intended to explore how performance is influenced by corporate governance among the Insurance firms in Kenya. Based on the results in this study showed that board composition and the frequency of meetings positively influence performance and this is supported by the positive regression model in which if a unit change on board composition and board frequency meeting (independent variables) improves corporate governance and performance. However, board size was shown to have a noticeable negative relationship to corporate governance, hence, performance. This is because the size of operations in a firm influence the board size. Therefore, growth in the size of the board would not necessarily imply improved performance in the general business insurance firms in Kenya.

Good corporate governance practices have an effect of improving the corporate governance and in turn, the outcome of insurance firms which is measured in terms of the return on assets in this study. The three elements of corporate governance explored have in one way or another
displayed a relationship and influence to the firm performance. It is essential for the management to make sure that these elements have been adhered to, by the firms as they result to improved wealth maximization among the shareholders.

**5.4 Recommendations**

The Insurance Regulatory Authority being the regulatory body has its recommended method of calculating capital of insurance companies. This is based on the spread of assets and liabilities and how much is admissible. To ensure uniformity and proper comparison, the regulator could publish the Industry report with inclusion of the risk based capital. This is doable because the information is provided to the regulator quarterly. This could be used as another aspect of measuring performance.

Also, there is need for inclusion of comprehensive commentary on corporate governance, under the corporate statement, and firm performance under the Financial Statements by insurance companies so that investors can use the information to make effective investment decisions. This also shows the increasing need to acknowledge corporate governance as an important tool to achieving excellent operations. Poor corporate governance practices have been common that have seen management make changes or manipulate the financial reports to serve various roles hence making it quite a challenge for the shareholders to develop their confidence. For full disclosure purposes, IRA could also include corporate governance statements, in summary, in the quarterly and annual release.

When reporting on corporate governance, it has been noted that most companies focus on the board of directors and ignore other serious aspects like engagement of the external stakeholders in influencing corporate governance. It is therefore highly recommended that the regulator works together with the companies, to explore more categories of this concept so as to enhance accountability, processes and enable third parties make decisions based on very comprehensive and important to know disclosures. Any further research with this information available, would give very conclusive findings.

Most insurance firms do not actively differentiate between the executive and non-executive directors, such that directors intended to be non-executive get involved in the daily running of
the organization. It is highly recommended that the proper practices are documented by the regulator to allow all board members participate only to the extent they declare to be involved. This will allow for the category to be used for analysis in future studies and enhance the validity of the board composition as a measure of corporate governance.

5.5 Limitations of the Study

The industry is not quite populated as it has a capacity to be, with many potential clients shying away, and companies lacking in proper skill to remain stable. Many companies have either gone under receivership, merged with others in the industry to achieve the Risk Based Capital recommended by the regulator. As such, the data collected was only for the companies that have their material available and have been in operation at least between 2013 and 2016. The insurance firms in the recommended sample have been registered at different times by IRA. Thus, the study achieved only 30 out of the 40 companies previously intended, thus covering only 75% in that category.

The control applied was differentiating between the life and long term business companies, and the general business companies. As a result, elements such as compliance to regulations, ownership of the companies (whether locally owned or a multinational), listing in the NSE were not factored in. An assumption was made of all companies playing on level ground. The findings therefore work of the assumption that the components mentioned above do not in any way affect the corporate governance structure and performance of a company. It is however an improvement from previous studies that have looked into corporate governance wholly, without distinguishing between life and general business despite the risks being totally different.

5.6 Suggestions for Further Research

As previously indicated, the study was aimed at establishing the existence of a relationship between corporate governance and how it influences performance of insurance firms in Kenya. Further research could be conducted with emphasis on more variables of corporate governance besides the board of directors. It is important to further evaluate this area to understand other elements that influence corporate governance. Also, the inclusion of other corporate governance determinants that are not related to the board of directors will be useful. It could also go a long
way if other measures of firm performance, besides the Return on Assets were used to measure performance, such as internal efficiencies. This could provide alternative benchmarks for the topic and more conclusive conclusions on how the two concepts of corporate governance and firm performance relate.
References


Ngeno (2009) MBA unpublished University of Nairobi; Corporate Governance Practices and Challenges of International Non-governmental organizations in Kenya


# APPENDICES

## LIST OF LICENCED GENERAL BUSINESS INSURANCE COMPANIES IN KENYA

<table>
<thead>
<tr>
<th></th>
<th>Company Name</th>
<th>Address</th>
<th>City</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>AAR Kenya</td>
<td>P.O. Box 41766 – 00100</td>
<td>Nairobi</td>
</tr>
<tr>
<td>2</td>
<td>Africa Merchant Assurance Company (AMACO)</td>
<td>P.O. Box 61599 – 00200</td>
<td>Nairobi</td>
</tr>
<tr>
<td>3</td>
<td>AIG Insurance Company</td>
<td>P.O. Box 49460 – 00100</td>
<td>Nairobi</td>
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<tr>
<td>4</td>
<td>Allianz Insurance Company</td>
<td>P.O. Box 66257 - 00800</td>
<td>Nairobi</td>
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<tr>
<td>5</td>
<td>APA Insurance Company</td>
<td>P.O. Box 30065 – 00100</td>
<td>Nairobi</td>
</tr>
<tr>
<td>6</td>
<td>Britam General Insurance Company</td>
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<tr>
<td>7</td>
<td>Cannon Assurance Company</td>
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<td>Nairobi</td>
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<tr>
<td>8</td>
<td>CIC General Insurance Company</td>
<td>P.O. Box 59485 – 00200</td>
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<td>Directline Assurance Company</td>
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</tr>
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<td>-----</td>
<td>----------------------------------------</td>
<td>-----------------</td>
<td>--------</td>
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<tr>
<td>12</td>
<td>East Africa Reinsurance Company</td>
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<tr>
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<td>Fidelity Shield Insurance Company</td>
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<td>GA General Insurance Company</td>
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