EFFECTS OF MICRO FACTORS ON THE FINANCIAL PERFORMANCE OF LISTED INSURANCE COMPANIES IN KENYA

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DECLARATION

I declare that this Dissertation is my original work and has not been previously published or submitted elsewhere for award of a degree. I also declare that this contains no material written or published by other people except where due reference is made and author duly acknowledged

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ABSTRACT

Insurance Companies in Kenya have been in the process of significance gradual change, however, they are several challenges faced, and this study establishes factors affecting financial performance of insurance industry in Kenya. The micro factors tend to be emphasized in the insurance companies. The objective of this study is to find out whether there exists relationship between micro factors and insurance profitability. The main aim of this study is to find out the effects of micro factors on financial performance of insurance companies in Kenya. The study will use descriptive research. The research design will take the form of a census that covers the insurance companies licensed to operate. The population of the study was 6 listed insurance companies. The study used fixed regression analysis to find the relationship between the micro factors in terms of the company size, liquidity, retention ratio, insurance claims and financial performance of listed insurance companies. STATA was used to analyze the data. Results of the study revealed positive and no significant effect of liquidity on financial performance of listed insurance companies in Kenya. Secondly, company size had inverse and significant effect on financial performance of listed insurance companies in Kenya. Moreover, retention ratio and claims ratio had inverse and non-significant effect on financial performance of listed insurance companies in Kenya. It was concluded that there is need for insurance companies to continuously evaluate their working capital management strategies, asset accumulation strategies, market penetration strategies and claims evaluation strategies.

Key words: Liquidity, Company size, Retention ratio, Claims ratio, Financial Performance

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LIST OF ABBREVIATIONS

AKI Association of Kenya Insurers

APT Arbitrage Pricing Theory

GDP Gross Domestic Product

IRA Insurance Regulatory Authority

IIK Insurance Institute of Kenya

ROE Return on Equity

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

One of the ways provided by intelligent human to allow the transfer of financial risk and perceive social, economic, psychological conditions is the “insurance” phenomenon. Insurance is a tool that not only does it compensates the economic losses but also provide future improvement of the standard of living of individuals and secure ground for economic growth and development. That leads to calmness in members of society, which in turn results in dynamics of social life, growth and prosperity of talents and increase of efficiency and productivity in society (Kalantari, 2013).The financial performance of insurance companies plays a key role in the growth of the entire industry, which ultimately contributes to the success of an economy. Insurance companies risk their financial performance by assuming different types of risks (Wani & Showket, 2015).

The statute regulating the industry is the Insurance Act; Laws of Kenya, Chapter 487 that was enacted in 1985. The office of the Commissioner of insurance was established under these provisions to strengthen the government regulation on insurance. The Commissioner of insurance was created as a department under the ministry of finance. In order to enhance the supervisory capacity of the regulator, the government delinked the department from the ministry to give it some autonomy. The insurance (amendment) Act number 11 of 2006 established the Insurance Regulatory Authority (IRA) with the commissioner of insurance as the managing director and the chief executive officer to take the role of regulating, supervising, and developing the insurance industry. This body replaced the functions of the commissioner of insurance. The

role of the authority is to ensure effective administration, supervision, regulation and control of insurance and reinsurance business in Kenya (Insurance amendment Act, 2006).

Insurance companies contribute widely to the economic development of a country where insurance protects purchases which is associated with insurance coverage. Worldwide insurance is a way of making businesses safer, having to purchase insurance make businesses aware of risks that it takes. Insurance is the protection and security against unforeseen risks, whose functions are to provide adequate coverage at a reasonable rate premium and to pay losses promptly and fairly hence, it does not stop the event from happening, and it acts as a cover up against the financial consequences of such risks (Barnett, 2012). Insurance companies like banks provide financial intermediation by facilitating the flow of funds from surplus spending units to deficit spending units through the process of issuing insurance cover to policyholders and investing the premium generated in productive sectors (Gatsi & Gadzo, 2013).The financial performance of insurance companies can be analyzed at micro and macroeconomic level, being determined by both internal factors represented by specific characteristics of the company, and external factors regarding connected institutions and macroeconomic environment (Burca & Batrinca, 2014).

The insurance industry is in particular part of a system of immunization and reform of an economy, and successful performance of this industry can provide the necessary power for other industries and development of the economy. However, insurance companies are always subject to a fall in the value of assets and investments when the investing condition is changing; this category greatly affects the interests of shareholders, and insurance companies may be in trouble to meet their own obligations (Nyamu, 2006).The main players in the Kenyan insurance industry

are insurance companies, reinsurance companies, intermediaries such as insurance brokers and insurance agents, risk managers or loss adjusters and other service providers (Kiragu, 2014). The industry has experienced financial innovation whereby a broad range of services and products have been created, ranging from investment products to life insurance (Ndalu, 2016).

Failure to commit by the insurance companies can have irreversible effects on the economy and community; therefore, in order for insurance to provide stability in the economy and community, it must have a decent financial performance. From this perspective, it is necessary to study the effects of micro factors on the financial performance of insurance companies in Kenya.

1.1.1 Micro Factors

Micro factors also known as internal factors; are factors close to a business that have a direct impact on its business operations and success. Micro factors refer to the factors that are in direct contact with the business organization and can affect the routine activities of business straightaway (Rauch & Frese, 2000). According to Boulding (2011), micro factors may include the study of particular firm, particular household, individual prices, wages, incomes, individual industries, and particular commodities. Micro factors influence the daily operations of a business, which is considered short term. Understanding the core micro factors affecting the business helps in planning and preparation, as well as long-term business strategy development (Bøllingtoft & Ulhøi, 2005).

Different companies in an industry are affected differently with the micro factors although they are controllable; this is because they differ in size, capacity, and strategies. For example, the raw

material suppliers are giving more concessions to large sized companies. However, they may not give the same concessions to small companies (Rauchb & Frese, 2000). Micro factors show a very interesting image of firms and suggest the most important areas to develop are those such as cost management, trade and marketing, production, technical development and finances (Volberda, Foss, & Lyles, 2010). In understanding micro factors, there are parameters involved. Neil Kokemuller (2018), six micro factors that affect almost any business are customers, employees, competitors, media, shareholders, and suppliers.

Companies measure capacity in different ways using the input, output, or a combination of the two as the measure Tybout (2000). Production capacity is considered a micro factor determined within the firm. Capacity of the firm is the amount in volumes of products or services that can be produced by a company using the resources at hand. According to Boulding (2011), micro factors assumes that all other things being equal but actually it is not so and it is called ceteris paribus. Ceteris Paribus is a limitation of micro factors.

1.2 Financial Performance

Financial performance is how a firm uses its resource to make a profit, which is measured by return on assets, return on sales and sales growth (Wei, 2012). According to Jim (2007) the performance of financial entities can be gauged in a number of categories which include profit growth, employee growth, asset growth or any other type of changeable saver or management thinks is a key maker of potential success of an entity. According to Chen and Wong, (2004), Financial Performance is the function of the ability of an organization to gain and manage the resources in several different ways to develop competitive advantage. There exists two types of

performance, financial performance and non-financial performance. Financial performance gives detailed information on variables related directly to financial report. Company's performance is evaluated in three dimensions. The first dimension is how well the company is productive or processing inputs into outputs efficiently. The second dimension is the company's profitability or the level of which company's earnings are bigger than its costs. The third dimension is market premium, or the level of which company's market value exceeds its book value (Walker, 2001). The financial performance is mostly measured using traditional accounting Key Performance Indicators which include Return on Assets, Operating Profit margin, Earnings before Interest and Tax, Economic Value Added or Sales growth (Crabtree & DeBusk, 2008). According to Chenhall & Langfield-Smith, 2007, the advantage of using these measurements is their availability, since most of the profit oriented organization produces these figures for the yearly financial reporting. However, the use of the balance sheet manipulates the choices of accounting methods which may lead to limitation of the values that only allow comparability of the financial strength of companies. Financial performance refers to a measure of how well a firm can utilize its assets from the primary mode of business and generate revenue. It can also be used as a general measure of a company's overall financial performance over a given period of time. Return on Assets (ROA) can be used to measure the company's financial performance. ROA is an indicator of a company's profit to its total assets. It shows the efficiency of how the management uses its assets to generate earnings. The assets of the company comprises of both debt and equity which are methods used to fund the operations of the firm. Investors use the ROA figure to have an idea of how effective the company is converting the money it has to invest into net income. The increase in the ROA numbers the better, because the company is earning more money on less investment. For instance, if a company has a net income of Kshs.5

million, its ROA is 20%; however, if another company earns the same amount but has total assets of Kshs.10 million, it has a ROA of 10%. Considering the mentioned example, the first company is better at converting its investment into profit. Performance is viewed as a difficult concept, as both definition and measurement. It is mostly defined as the result of activity, and the appropriate measure selected to assess firm's performance which is considered to depend on the type of organization evaluated, and the aims to be achieved through that evaluation.

Insurance companies measure their performance in accordance with their net premium written, the incurred claims, management expenses, gross income, and the shareholder's results. Financial performance is concluded from the results found from financial analysis of a company. Financial analysis is considered the selection, evaluation, and interpretation of financial data, along with other pertinent information, to assist in investment and financial decision-making. According to Drake, (2006) financial analysis is mostly used internally to evaluate issues such as employee performance, the efficiency of operations, and credit policies, and externally to evaluate potential investments and the credit-worthiness of borrowers, among other things. A well-designed and implemented financial management is expected to contribute positively to the creation of a firm's value (Padachi, 2006). Dilemma in financial management is to achieve desired tradeoff between liquidity, solvency, and profitability (Lazaridis, et al., 2007). Further analysis of financial performance has used methodologies such as financial ratio analysis, benchmarking, measuring performance against budget or a combination of these (Barnetet et al., 2006). The main goal of profitability is to achieved by efficient use of resources. It is concerned with utilization of shareholders or owners' wealth (Panwala, 2009). It can be attained through financial performance analysis. Financial performance is the firm's overall financial health over a given period.

1.2.1 Insurance Companies in Kenya

Insurance companies contribute widely to the economic development of a country this is because they provide financial services that are specialized such as underwriting of risks and mobilize large amount of funds, which are mainly for the purpose of long-term investments. Association of Kenya Insurers (AKI) under which the insurance industry operates, is a body In. Kenya, which was established in the year 1987. The insurance regulatory authority is a statutory government agency established under the insurance act (amendment) 2006, CAP 487 of the laws of Kenya to regulate, supervise, and develop the insurance industry. The role of the authority is to ensure effective administration, supervision, regulation and control of insurance and reinsurance business in Kenya (Insurance amendment Act, 2006). The professional body of the industry is the Insurance Institute of Kenya (IIK), which deals mainly with training and professional education. According to the (AKI) insurance industry report for the year 2010, there were 44 licensed insurance companies at the end of 2010. IRA 2014 annual's report, reported that the Insurance industry witnessed increased activities in mergers, acquisitions and other restructuring such as Britam acquiring Real Insurance, Metropolitan Group acquiring Cannon Assurance, Old Mutual Group acquiring UAP Holdings and Pan Africa Holdings acquiring Gateway Insurance.

According to an IRA annual report that was released in the year (2014), Kenya's insurance industry has been reported as the fastest growing industry. This growth has seen the number of foreign and local investors seeking to invest in the local domestic market increase and their entry is projected to enhance the industry stability since there is a likely of core capital being injected, technical expertise as well product development innovation, distribution and global networks.

Some new entrants include; Barclays Group, Prudential Life Assurance, Liberty Life Assurance, Saham Group, Leapfrog and Allianz Group.

1.3 Statement of the Problem

It has been noted that without the insurance sector, the economy, and the wealth creation associated with it can be adversely affected (International Accounting Standards Board, 2007). The insurance industry in particular is part of immune and repair system of an economy and successful operation of the industry can set energy for other industries and development of an economy (Sambasivam & Ayele, 2013).

However, insurance companies are always caught in a dilemma of crunching profit coming from underwriting and investment when the investment environment is changing and adversely pressing the interests of shareholders and might be having trouble in off-setting the obligations (Datu, 2016). According to 2015 insurance regulatory authority, Kenya's insurance industry is one of the fastest growing industries in Africa. However, the industry is facing a number of challenges that must be addressed jointly with its stakeholders since the industry is subject to controllable factors such as the interest rate, competition, profitability, and liquidity.

A good number of studies have been done on various aspects of micro factors in insurance industry. For instance, Hrechaniuk et al. (2007) examined the financial performance of insurance companies in Spain, Lithuania and Ukraine. The results showed a strong correlation between insurers' financial performance and the growth of the written insurance premiums. Chidambaram

et al. (2013) & Shiu, (2004) conducted studies into the economic performance of the U.S. property-liability insurance industry and UK general insurance industry respectively.

The analysis of Chidambaran, et al., revealed that the ratio of concentration and the share of direct underwriters are both significant determinants of insurers' financial performance. On his part Shiu revealed that liquidity, interest rate level, competition and underwriting profits were statistically significant determinants of the financial performance of insurers' performance.

The "big problems" facing insurance agents and brokers today in the developing counties are interest rate, competition, profitability and liquidity, maintaining a consistent company strategy and tactics; and company consolidation (Cazzolla, 2007). Most of the insurance companies in Kenya face challenges such as, to manage relationships and to be able to obtain operational efficiencies, also to improve profitability, which mainly associate with their risk management methods.

The insurance industry forms an integral part of the country's financial sector and its benefits cannot be over-emphasized. If this crucial sector were to collapse, the consequence on the economy would be devastating, knocking off billions of shillings from the Gross Domestic Product (GDP) index. However, the insurance sector in Kenya and other countries while providing critical interventions and creating wealth through investments, has had a fair share of company collapses (Kumba, 2011; Greene, 2000; Hagel, Brown & Davison, 2010).

A survey of the credit policies on the insurance company in Kenya found out that competing in the insurance industry is cut throat and firms have been forced to differentiate themselves in

order to survive in the long term. This explains the reason for undercutting and introduction of credit facilities (Karanja, 2010). In view of the information above, this study seeks to investigate the effects of micro factors on the financial performance of insurance companies in Kenya.

According to a study by McKinsey and Co., 25% of the professionals in the insurance industry will retire by 2018, leaving an enormous talent and experience gap in an industry that is already experiencing a worker shortage. Therefore, some factors need to be investigated in future: technological challenge facing insurers, Industry consolidation that requires the blending of technology, employees, cultures and other industry resources, and finally insurers are challenged to accommodate the changing demands of regulators and consumers due to inflexible legacy systems. This study therefore sought to find out the effects of micro factors on the financial performance of insurance companies in Kenya.

1.4 Research Objectives

1.4.1 General Objective

To determine the effects of micro factors on the financial performance of listed insurance companies in Kenya

1.4.2 Specific Objectives

i. To establish the effect of liquidity on financial performance of listed insurance companies in Kenya.

ii. To determine the effect of company size on financial performance of listed insurance companies in Kenya.
iii. To find out the effect of retention policy on financial performance of listed insurance companies in Kenya.
iv. To evaluate the effect of insurance claims on financial performance of listed insurance companies in Kenya.

1.5 Research Questions

i. What is the effect of liquidity on the financial performance to listed insurance companies in Kenya?
ii. Does company size affect financial performance of listed insurance companies in Kenya?
iii. What is the effect of retention policy on the financial performance of listed insurance companies in Kenya?
iv. What is the effect of insurance claims on financial performance of listed insurance companies in Kenya?

1.6 Significance of the Study

The study sought to find out the effect of micro factors on the financial performance of insurance companies in Kenya. the study shows how micro factors has helped to enhance financial performance by reaching levels that would not have been reached had it not been for regulating

the micro factors. This may contribute to the existing theory and knowledge, mainly improving on the theory by highlighting the changes that insurance company is going through as it develops.

The study is of great value in policy formulation. It is of great interest, importance to the government since it will help in the formulation and modification of various policies, and methods such as increasing incentives to motivate further inclusion, and changing or modifying the regulatory framework enhance inclusion (Waihenya, 2012).

In practice, this study may be of more importance to the insurance companies because it provides information of the contributions of the micro factors to the industry. The essence of the study is to provide information on the effects of micro factors to the insurance industry and their contributions towards the growth of the industry.

1.7 Scope of the Study

This study used a census of six listed insurance companies out of the 68 listed companies in Kenya. It focused on finding out how micro factors have affected financial performance of the insurance companies in Kenya. The study was confined to the various parameters of micro factors, which are the size of the company size, retention ratio, liquidity and insurance claims. The study was anchored on agency theory, innovation theory, portfolio theory and arbitrage pricing theory.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

Literature review is a comprehensive study and interpretation of literature that addresses a specific topic (Aveyard, 2010). This chapter focuses on available and related literature carried out on micro factors affecting the financial performance of Insurance Companies in Kenya. The chapter broadly examines insurance claims, retention ratio, company size, pricing policy, and how these factors affect the financial performance of insurance in Kenya.

2.2 Literature Review

This is a collection of inter-related ideas based on theories. It is a reasoned set of ideas derived from and supported by data or evidence (Macharia, 2012) this study will be guided by the following theories;

2.2.1 Agency Theory

Generally, an agency is a relationship between two parties, where one is a principal and the other is an agent who represents the principal in transactions with a third parties (Li, 2011). Agency theory concerns the relationship between a principal (shareholder) and an agent of the principal (company's managers) in business (Kulkarni, 1988). The success of any business enterprise is determined by the interaction of two major sets of factors micro factors and macro factors Campbell and Underdown (2001). Macro factors are factors, which tend to be uncontrollable by the management of an organization.

The macro factors may include; the demographics, changes in government policy, political conditions, and social conditions. The micro factors emerge from inside of the organization. In

order for the organization to survive the changing micro factors, the management ought to implement effective strategic plans. The organization's performance, which is by gross profit from the firm's activities, depends on the management's effort and chance in any of the variables.

The agency theory explains the relationship between the agents and principals in business. Agency theory mainly deals with resolving problems that can exist in agency relationships due to unaligned goals or different aversion levels to risk. The most common agency relationship in finance occurs between shareholders (principal) and company executives, agents (Eisenhardt & Martin, 2000). Agency theory concerns with the problems, which emanates due to differences between the expected goals or desires between the principal and agent. This situation may occur because the principal is not aware of the actions of the agent or limited by resources in order to acquire the information.

Agency theory is the most important role applied in the corporate governance. It emphasizes the fundamental conflict between the management and the ownership structure, when the former have the control of the firm but the latter bear most of the wealth effects. Jensen's and Meckling's (1976) original model illustrates this by describing how lower managerial takes lead to increases in non-pecuniary spending by the managers as they do not fully internalize the costs.

Agency problems of this kind generate agency costs. In Agency theory, the main shareholders cannot observe the actions of the manager without a cost. Jensen's and Meckling's insight has also lead to models, where the ownership structure matters not only in the sense how much the company insiders own, but also in the sense how concentrated the holdings of the outside shareholders are. Majority of the company's shareholders are argued to monitor the management

better than the minority shareholders as they internalize larger part of the monitoring costs and have sufficient voting power to influence the corporate decisions.

2.2.2 Innovation Theory

Innovation diffusion theory focuses on comprehending how, why and at what rate innovative ideas and technologies spread in a social system (Rogers, 1962). Diffusion of innovations is a theory that seeks to explain how, why, and at what rate new ideas and technology spread through cultures, Everett Rogers developed the theory. Diffusion on the hand is the process by which an innovation is communicated through certain channels over time among the members of a social system (Rogers, 2003). According to Fichman (2000) diffusion as the process by which a technology spreads across a population of organizations. Diffusion of innovations refers to the spread of ideas from one society to another or from a focus or institution within a society to other parts of that society (Rogers, 1962). According to Ismail Sahin, (2006) the concept of Innovation diffusion can be divided into four main elements the world is witnessing great transformations and acceleration because of the tremendous development of information technology and the steady growth of volume of information, which has led to the emergence of new types of transactions and activities in various fields (Porteous, 2006). In terms of the theories of change, Innovation Diffusion theory takes different approach to study the changes. Instead of mainly focusing on persuading individuals to change, it sees change as being primarily about the evolution or "reinvention" of products and behaviours so they become better fits for the needs of individuals and groups. According to Les Robinson, (2009) in diffusion of innovations, it is not people who change, but the innovations themselves. The Insurance industry is among the industries, which adapted the innovations in terms of new technology to improve performance and gain a competitive advantage strategy. Emerson. (2008) says in light of the extensive use of

information and communication technologies, the financial services industry and Insurance has provided new systems and applications that maximizes the use of modern technology and are now available. Because of the rapid growth of electronic insurance services by customers and the increased amount of competition, the insurance companies changed the concept of traditional banking service to remote banking. The change facilitated the reduction of costs, the ability to achieve efficiency, and attract more customers. The number of banks opening branches has decreased and this is attributed to affordable bank insurance and lower service charges (Vaness, 2010). Innovation aims at improving the infrastructure that enhances financial services and international trade.

In this study, innovation theory showed the relationship between technologies used in insurance and the structure of financial services in the organizations. Implementation, Design, and dissemination of payments systems and costs have come down according to bank case studies. Currently bank insurance is an integral part of modern banking in many countries and the market is still growing.

2.2.3 Portfolio Theory

A portfolio is a group of financial assets consisting of investment tools such as stocks, asset-backed securities bonds, gold, foreign exchange, real estate, certificates, and bank deposit that are held by a party or parties. Portfolio construction is a problem in financial economics, and plays an important and influential role in both theory and practice.it was developed by Harry Markowitz and published under the title "Portfolio Selection" in the 1952 where a quantitative approach for portfolio selection was first presented. Harry came up with mathematical

framework for the problem and obtained a feasible solution to the problem that was simple and intuitively appealing.

He maintained a single-period economy and formulated the portfolio selection problem as a static mean-variance optimization problem, where the variance or the standard deviation was used as a measure of risk and mean as a measure of portfolio return. The simplified framework of the Markowitz model is justified when the distribution of return is normal, or when the investor has a quadratic utility function. In the Markowitz mean-variance portfolio selection, the optimal portfolio selection is done by minimizing the variance of the portfolio's return for a given level of expected portfolio return, or maximizing the expected portfolio return for a given level of variance of the portfolio return. The mean-variance paradigm also provides a simple geometric representation for portfolio selection including investment opportunities, portfolio diversification, and efficient frontier. Portfolio theory is a theory of finance that attempts to maximize portfolio expected return for a given amount of portfolio risk, or equivalently minimize risk for a given level of expected return, by carefully choosing the proportions of various assets. Although it is widely used in practice in, the insurance industry and several of its creators won a Nobel memorial prize for the theory. The theory quantifies the benefits of diversification in business line of revenues (Koivu, 2012).

2.2.4 Arbitrage Pricing Theory

Ross (1976) introduced the Arbitrage Pricing Theory (APT). The theory assumes a positive relationship between risk and expected return. The APT model is an expansion of the CAPM and

describes returns as a linear function of several rather than of one variable. Some of these variables are macroeconomic factors and others are market indices (Sadiye, 2014). An investor will explore the possibility of forming an arbitrage portfolio in order to increase the expected return of his current portfolio without increasing its risk. The investors will buy underpriced or the undervalued assets and sell overvalued assets. Arbitrage investors help to bring back mispriced assets or securities back to expected prices. The APT is less restrictive compared to CAPM, and has three major assumptions being; capital markets are perfectly competitive; investors always prefer more wealth to less wealth with certainty (Ouma&Muriu, 2014). APT agrees that although there are many different driving forces that can influence the return of any individual firm, these particular effects tend to cancel out in large and diversified portfolio. This is the principle of diversification and it has an influence in the field of insurance (Suheyli, 2015). APT uses multiple variables and is a multi-beta model.

The sensitivity of movements in each variable represented with a beta coefficient, which is factor specific, and indicates the unique sensitivity of each particular variable (Sadiye, 2014). The model also attributes the expected return of a capital asset to multiple risk factors, and in the process measures, the risk premiums associated with each of these risk factors (Ouma&Muriu, 2014). According to this model, total risk is a combination of both systematic and unsystematic risk. Systematic risk is also termed as market risk and it is not possible to eliminate it. Therefore, expected return of the asset is dependent upon the systematic risk. Systematic risk includes macro-economic factors, which are not diversifiable (Saeed&Akhter, 2012). The APT relates the various types of risk associated with a security such as changes in interest rates, inflation and productivity with the expected return of that same security (Ouma&Muriu, 2014). Thus, an insurance company has no way of knowing whether any particular individual will become sick or

will be involved in an accident, but the company is able to accurately predict its losses on a large pool of such risk. However, an insurance company is not entirely free of risk simply because it insures a large number of individuals (Suheyli, 2015).

2.3 Empirical Literature

2.3.1 Liquidity Ratio and Financial Performance

Liquidity is the ability of a firm to meet its short term obligations Bhunia (2010). According to Mainelli (2007) defines liquidity as the probability that an asset can be changed in to an expected amount of value within an expected amount of time. It is the ability to realize monetary value; the most liquid of assets. The most liquid asset is considered to be money. Liquidity in terms of accounting is the ability of current assets to meet current liabilities (working capital). In investment, Liquidity is the ability to quickly convert an investment portfolio to cash with little or no loss in value. Company is termed to be liquid when it stores enough liquid assets and cash together with the ability to raise funds quickly from other source to enable it meet its obligation concerning to its payments and financial commitment in a timely manner. According to Mahavidyalaya et al., (2010) the term liquidity refers to the capability of a firm to meet short term financial obligations by converting the short term assets into cash without suffering any loss. There are ratios used to measure liquidity. Which include: the current ratio, which is the simplest measure and is calculated by dividing total current assets by total current liabilities; and the quick ratio, calculated by deducting inventories from liquid assets and then dividing by current liabilities? The current ratio and the quick ratio are almost similar. The quick ratio gives a more accurate assessment of a business's ability to pay its current liabilities. The quick ratio tends to cut out all but the most liquid of current assets. The quick ratio is a measurement used to

evaluate the business's short term liquidity. It is used to gauge the company's ability to meet its short term obligations with its most liquid assets. The higher the quick ratio the better the firm's position, Bolek et al., (2012) suggested that liquidity can be defined in three contexts; where they distinguish the asset, asset-equity, and cash aspects of financial liquidity. The financial liquidity of company's assets – is the ability to convert assets into cash in the shortest possible time, at the lowest possible costs and without losing their value. The liquid elements of the assets, including cash, are the enterprise's protection against the loss of financial liquidity.

Price is one of the most flexible elements of the marketing mix, which interferes directly and in a short term over the profit-ability and cost effectiveness of a company (Simon, Bilstein, & Luby, 2008). Pricing policy is the determination or an approach used to control and regulate the pricing decisions of an organization. According to Monroe (2003), price decisions are one of the most important decisions of management because it affects profitability and the companies' return along with their market competitiveness. A company's survival and profitability depends upon its pricing decisions, thus price is the only element in the marketing mix that produces revenue and thus ensures profitability (Kotler & Keller, 2006).According to Hinterhuber (2004), the impact of price levels on profitability is high, which means that even the impact of small increases of price on profits and corporate profitability by far exceeds the impact of other leverages in managing best results. In other words, of all the elements available to managers, the price is what has the larger impact on corporate results, reflecting on representative gains (Kohlia & Surib, 2011).

Different insurance companies face difficulties in pricing because of insufficient data on micro insurance. The group is much less uniform and also there is much less reliable data on the low-

income target market. It is very difficult for insurance companies to accurately determine what price they should charge for the cover. The target market of low-income population has much less disposable income, and a small increase in the price will make it much less affordable thus reducing the demand (Adriaan, 2014).Price is flexible element of marketing strategy, while pricing decisions can be implemented relatively more quickly than other elements of marketing strategy (Avlonitis & Indounas, 2005). Adjusting prices can be called pricing strategy. The objective of pricing strategy is stability of optimal price along maximizing current profit and quantity of sale (Dolgui & Proth, 2010). The small insurance product risks are also unknown; therefore, insurers would like to charge an additional margin in the premium to protect them against possible unforeseen related losses. Cost of distribution is much higher as a percentage of the premium for low-premium policies. In order for the firm to be profitable, insurers rely on achieving large volumes of sales.

According to (Shipley & Jobber, 2001) pricing is an activity that should be replicated and is a continuous and nonstop process. This continuity is a result of environmental changes and lack of stability in market conditions and necessitates the modification of price. Competition is forcing the insurance companies to adjust rates more frequently to retain existing customers and attract new customers/clients. Yet many firms take weeks, if not months, to implement a new rating structure, and the effective performance of these models rapidly deteriorates over time. Inevitably, insurance is changing its approach with regards to product pricing from their competitors based on customer services, claims experience, and financial strength, but mostly by price. According to Stuart, (2013) to gain a competitive advantage, insurers are beginning to use price optimization to see how demand varies at different price levels and come up with recommendable prices that will improve profit. Despite of the challenges faced, it is of great

importance that product pricing is done accurately so that the premium rates are competitive and of good value. If this is ignored, the company will be at risk of charging low premiums which will lead to liquidity constraints in the event of multiple claims arising (Dror & Armstrong, 2006). Most jurisdictions regulate micro insurance since it is an emerging trend in the financial market. The Insurance Regulatory Authority (IRA) developed a regulatory framework for micro insurance which clearly distinguishes it as a form of insurance business rather than a subclass as previously perceived. This will improve the supervision of micro insurance which will lead to potential growth in the insurance industry sector.

it is important to develop micro insurance in order to attract the potential market of low income earners, most insurance firms face big problem in coming up with suitable products for the target market. Downsizing of the traditional insurance products so that they can be suitable to low income earners is not the best approach of micro insurance. According to Sebstad & Cohen, (2001) downsized formal insurance sometimes ignores the more frequent and stressful shocks facing the low income earners as well as positive attributes of the informal strategies that poor people already use to cope with risk Micro insurance growth can be measured by analyzing the product awareness and the client's satisfaction. This can be done by analyzing the renewal ratio, coverage ratio or the growth ratio. The awareness and satisfaction performance indicators focus on how readily the target market enrolls in the micro insurance programme and retain the coverage (Wipf & Garand, 2010).

A sensible and fair approach to product pricing is to design products in such a way that they can be compatible to the needs of the target market. This is done by doing research on the basic risks that the target market is facing and coming up with reliable products that help in reducing the

risks which may occur. An insurance firm cannot set its prices based on known production cost and distribution like most business enterprises. Instead, the insurance companies need to project the costs of future claims by reviewing historical data. The process is reliable only when the insurance company uses a sufficient amount of correct detailed data. This is what is termed as product pricing. According to Roth et al., (2007) potential micro insurance clients are exposed to a myriad of risks, all of which cannot be feasibly insured the products formed fail to meet consumer expectation this is according to Brown &McCord, (2000). Micro insurance products in Kenya do not meet the consumers' needs adequately (Mbogo, 2010). This is because there is inadequate differentiation between products from different insurance firms, making it difficult for consumers to differentiate between competitor offerings in terms of product features (AKI, 2008).

Product design affects the quality of the product, micro insurance clients may not afford to pay high prices on insurance products, but they need high quality genuine products, better quality micro insurance product (faster settlement of claims, fewer exclusions and wider coverage) to attract them to insurance (Njuguna, 2012). Prahalad (2005) shows that the low income earners too are brand conscious. Low-income earners buy insurance if the products meet their needs and are fairly priced this is according to Brown & McCord, (2000). The Price to be charged should cover all claims and operating expenses and make the firm profitable. In most cases, micro insurance policy premium is less than the cost incurred in administering the products, hence most firms avoid micro insurance or tend to overprice their product this limits the uptake. The main aim of having micro insurance products is to target the low income earners. These means that the products of the companies should develop and must be cheap and at the same time cover the expected risks that the policy holders will be experiencing and settle the administration costs

incurred while developing the products of the firm. According to IRA Policy Paper, (2014) most products are usually bundled together such that one product can cover various types of risks insurance companies find it cheaper to underwrite group risks compared to individual risks. When accurate pricing is done, the firm will be able to meet the cost of issuing micro insurance products in the market. However, the value of the product will determine the reception of the target market.

Micro insurance products should be economically viable to both the insurance firm and to the target market. If the products can be afforded, this will increase the uptake of the product thus increase the growth of the industry at large. There are major issues that currently influence micro insurance firms development in Kenya and globally. Most underwriters are less informed about the capacity to develop, underwrite the products and process the claims necessary to accommodate the unique features of micro insurance. According to the Kenyan micro insurance policy paper, insurance companies are struggling to keep the transaction and administrative cost low which has a major impact on the pricing of products.

Several theories have been developed to study the effect of liquidity on financial performance. High liquidity is considered to be a sign of financial strength Chandra (2001), however according to some authors as Neto (2003); a high liquidity can be as undesirable as a low. This would be a result of the fact that current assets are less profitable then the fixed assets. This means that the money invested in current assets generates less returns compared to fixed assets, representing thus an opportunity cost. The amounts employed in current assets generate additional costs for maintenance, reducing thus the making the firm profitable. Arnold (2008) points out that holding cash also provides some advantages, such as it provides the payment for daily expenses, such as

salaries, materials and taxes. The fact that future cash flows are uncertain, holding cash gives a safety margin for eventual downturns. And finally the ownership of cash guarantees the undertaken of highly profitable investments that demands immediate payment. Hence it is an important task for the financial manager to achieve the appropriate balance between the adequate liquidity and a reasonable return for the company. Thus, according to Perobeli, Pereira and David (2007), the decision about the liquidity level should be based on optimal levels of liquidity. The importance of liquidity to company performance might lead to the conclusion that it determines the profitability level of company. This issue was the subject of many theoretical and empirical studies which were conducted, among others, by (Gill, Biger and Mathur, 2010; Attari and Raza, 2012; Banos-Caballero, Garcia-Teruel and Martinez-Solano, 2012; Owolabi and Obida, 2012). Hence, it should be emphasized that although a number of studies, the nature of liquidity impact on profitability is still not entirely recognized. Liquidity is essential for company existence. It principally has an effect on financial costs reduction or growth, changes in the sales dynamic, as well as it influences on company risk level. The decisive significance of liquidity means that it is important for company development and at the same time it is one of the fundamental endogenous factors which are responsible for company market position. The importance of effective inventory management in WCM was also found in a study by Garcia-Teruel & Martinez-Solano (2007). They studied effects on working capital management on Spanish SME's profitability and concluded that additional value can be created by reducing inventories and the number of day's accounts outstanding. Shortening the cash conversion cycle can also be a means to improve firm's profitability.

2.3.2 Company Size and Financial Performance

According to Shaheen and Malik (2012), the size of a firm as the quantity and array of production capability and potential a firm possesses or the quantity and diversity of services a company can make available concurrently to its clients. Insurance firms seek to increase their firm size in order to gain the competitive edge with their competitors by lowering the cost of production and their market shares. The size of the insurance firm is important because of the phenomenon of economies of scale. Large firms can manufacture items on much lower costs compared to smaller firms. According to Langlois (2002), some economies of scale result from the specialization and division of labor. The nature of the relationship that exists between company size and its profitability is an essential matter that may shed some light on the factors that enhance profits (Abdurahman, Awad, Erik, & Jeffrey, 2003)

According to Vijayakumar and Tamizhselvan (2010) in their study they found out that there is a positive relationship between the firm size and profitability they used different measures of size and profitability while applying model on a sample of 15 companies operating. The company size is the amount and variety of production capacity and ability a company possesses or the amount and variety of services a company can provide concurrently to its customers (Jonsson, 2007). According to Glancey (2012) when large companies take advantage of the scale economies, then a positive relationship between profitability and size of the firm is expected.

When the shareholder of a company tends to gain profit for enlarging business or increasing their personal income, then organizations become grow. When the management of small firms is interested in non-monetary returns then the firms gain low profitability. There can be a positive relationship of company size and profitability but at a specific threshold size, it may become negative. The increase in firm size aims at profiting from economies of scale. Economies of scale

is when a given proportionate increase in inputs results in a larger than proportionate increase in output. Reinhard's (2017) oligopoly model suggests that size is positively related to a firm's ability to produce technologically complicated products that in turn leads to concentration. These type of markets are supplied by few competitors hence they are more profitable. larger companies have access to the most profitable market segments. The relationship between a company's size, structure, and profitability has found that size is positively correlated with profitability, with the profit rate of the market positively correlated with the concentration ratio and negatively correlated with the marginal concentration ratio (Collins & Preston, 2007). Further, it showed that the positive association between firm size and profitability stems from implementing greater differentiation and specialization strategies and should therefore lead to higher efficiency.

The company size shows a contingent factor that falls into the category of organization characteristics. According to Woodward (2018), the best indication of ‘‘bigness’’ is the size of the management group. Company size is mostly measured by gross sales or gross value of assets number of employees and sales turnover. Larger companies are able to produce the same goods more cheaply because they have achieved more learning and greater cumulative experience and they are able to spread their fixed costs over a greater amount of production. Similar to the argument advanced by-Bowman suggested that quality management is able to achieve the dual goals of higher market share and higher profitability (Abreu & Mendes, 2001).Firm size a major factor which influences characteristics in organizational studies. According to Chen and Hambrick (1995), whose study provides a summary and overview of the importance of firm size? Company sizes have also been shown to be related to industry- sunk costs, concentration, vertical integration and overall industry profitability (Dean *et al*., 1998). Larger life insurance

firms have extra layers of management, greater number of departments, increased specialization of skills, functions, greater centralization, and greater bureaucracy than smaller life insurance companies (Daft, 1995).

A study by Ahmed *et al*. (2011) investigates the impact of firm level characteristics on performance of the life insurance sector of Pakistan over the period of seven years. For this reason, company size, profitability, age, risk, growth, and tangibility are selected as explanatory variables while ROA is taken as dependent variable. Hafiz Malik (2011) found that there exists a positive and significant relationship between tangibility of assets and profitability of insurance companies and argued that the highest the level of fixed assets formation, the older and larger the insurance company is. In contrast to this, Yuqi Li (2007) in United Kingdom (UK) found no significant relationship between tangibility of assets and profitability of insurance companies.

Pavelkova and Knápková (2009) posit that when a firm becomes larger, it enjoys economics of scale and its average cost of production is lower and operational activities are more efficient. Yang and Chen (2009) opines that large firms face less difficulty in getting access to credit facilities from financial institutions for investment, have broader pools of qualified human capital, and may achieve greater strategic diversification. Akbas and Karaduman (2012) while citing Hardwick (1997) stated that larger firms have some advantages such as greater possibility of taking advantage of scale of economies which can enable more efficient production, a greater bargaining power over both suppliers and distributors or clients, exploiting experience curve effects and setting prices above the competitive level. Akbas and Karaduman (2012) also argued that larger firms are more stable and mature and they can generate greater sales because of the

greater production capacity and finally, those firms have the chance of capital cost savings with the economies of scale.

The understanding of the relationship between firm size and performance was advanced by Symeou (2012) when he examined whether firms enjoying higher growth potential are better performers, arguing that small economy size could contain firm growth potential and by extension firm performance. Controlling for the effects of competition, firm governance structure, and institutional risk, inter alia, the findings suggest that firm growth potential is not necessarily a limiting factor as both firms in small and large economies can operate efficiently. The effect of firm size on profitability of virtually all the branches of Bank of Ceylon (BOC) and Commercial Bank of Ceylon Ltd (CBC) with 10 years accounting period was studied by Velnampy and Nimalathasan (2010). The correlation analysis conducted on the secondary data indicates that there is a positive relationship between Firm size and Profitability in Commercial Bank of Ceylon Ltd, while there is no relationship between firm size and profitability in Bank of Ceylon.Salman &Yazdanfar (2012) identified that company size has a critical role in determining profitability. Increasing trend of profitability is greater in larger firms, because compared with smaller companies, the larger ones have more access to resources, and consequently they have more flexibility to the changes in a dynamic market. And also older companies may benefit from their business experience, formed relationship with customers, and the quick access to resources this proves that there exists a positive relationship between the company size and its profitability.

The size of an insurance company affects its financial performance in many ways. Large insurance companies normally have greater capacity for dealing with adverse market fluctuations

than small insurance companies. They can easily recruit able employees with professional knowledge unlike small insurance companies. Also, large insurance companies have economies of scale in terms of the labour cost which is the most significant production factor for delivering insurance services thus being more efficient compared to small firms. In addition, small firms may have less power than large firms hence they may find it difficult to compete with the large firms particularly in highly competitive markets. Malik (2011) in his Pakistan study found that there is significantly positive association between the size of a company and profitability. The study indicated that profitability is more likely to improve by emulating industry best practice in terms of technology and management structure than by increasing the size. In this aspect, the empirical literature has not produced conclusive results.

It has been suggested that company size is positively related to financial performance. Brown, Carson and Hoyt (2001), identified important economic and market factors and insurer specific characteristics related to the life insurer performance. In his paper, firm performance was positively related to the size and liquidity band portfolio returns whereas negatively related to anticipate inflation. Large insurance companies normally have greater capacity for dealing with adverse market fluctuations than small insurance companies. Additionally, large insurance companies usually can relatively easily recruit able employees with professional knowledge compared with small insurance companies.

Different researches have been conducted explaining the relationship between the firm's size and the firm performance. Discussions of the role of firm size in explaining firm performance have been ongoing in the fields of business organization and industrial economics. Early research, notably by Jelic et al (2001) and Kakani et al (2001) emphasizes the importance of

scale economies and other efficiencies in larger firms. On the other hand, the structure-conduct performance paradigm highlights the importance of market concentration and conduct in explaining profitability. In particular, Baumol (1967) argues that the advantages of larger firms stem from their market power and greater access to capital markets. Caves and Porter (1979), and Porter (1998) also attribute variations in profitability to group strategic behavior in different industries. With a few exceptions, notably Hagedoorn and Cloodt (2003), there is considerable evidence in early empirical studies (e.g. Liargovas and Skandalis, 2008; Merikas et al, 2006) to support a positive relationship between firm size and profitability. However, as Prasetyantoko and Parmono (2008) point out, many of these studies neglect the possible effects of other factors, such as market structure, entry barriers and firm strategies. More recent studies have attempted to control for these market and firm-specific characteristics and found more equivocal support for a relationship between firm size and profitability. For instance, Tarawneh (2006) find a firm's market share instead of its size plays a 5 significant role in explaining its relative performance. Amato and Amato (2004) find evidence in US retailing industries to support Porter's (1998) conjecture that both small and large firms can effectively capture niche markets, while middle-sized firms are 'stuck in the middle' in the sense that they are less competitive than their counterparts in either end of the firm size distribution. Organizational size effects have been the focus of many prior studies. The benefits of organizational size may accrue to the financial performance of the organization. Larger organizations seem able to generate stronger competitive capability than their smaller rivals as a result of their superior access to resources, greater market power, and economies of scale and scope (Glen et al, 2003). However, organizational size effects are mixed, since some studies confirm them (e.g. Tarawneh, 2006;

Sarkaria and Shergill, 2000), while others find either mixed effects or no effects at all (e.g. Goddard et al, 2006; Mariuzzo et al, 2003).

Wanyama and Olweny (2013) investigated effects of corporate governance on financial performance of listed insurance firms in Kenya. The research concluded that firm size was found to negatively affect the financial performance of insurance companies listed at the Nairobi Security Exchange.

2.3.3 Retention Policy and Financial Performance

The retention policy is also known as the retention rate of an organization (Orwel, 2010). Retentions refer to the part of trading profits which is not distributed in the form of dividends but is retained by directors for future expansion of the company (Dinayak, 2014). Retention ratio is the percentage of the underwritten business that is not transferred to reinsurers. High retention ratio with low claims ratio have a positive impact on the performance of insurance company. A very effective insurance company should have growth in profits since it is able to maximize on its net premiums and net underwriting incomes (Charumathi, 2012).

Campbell (2012) observed that the prime idea behind earnings retention is that the more the company retains the faster it has chances for growth. According to Chasan (2012) there is always a conflict in determining the ratio or earning to be retained. Managers in any organization want a higher earnings retention ratio while the shareholders of the organization would like higher plowback ratio since they would have more control over their shares and finances within the firm. Revenue retentions also called retained earnings or retained surplus refer to the portion of a company's profits that is kept for reinvestment into the business or for debt payments,

instead of being paid out rather as dividends to shareholders (Chasan, 2012). Some organizations prefer to retain more earnings and plow it back into operations especially when they have viable investment opportunities (Campbell, 2012).Arnott and Asness (2003) suggested that the positive relationship between current dividend payout and future earnings growth is based on the free cash flow theory. This is prominent for firms with limited growth opportunities or a tendency towards overinvestment. Paying substantial dividends that in turn would require managers to raise funds from issuance of shares, may subject management to more scrutiny, reduce conflicts of interest, and thus curtail suboptimal investment (Arnott & Asness, 2003)

Lie (2005) argues that firms that increase payouts have excess financial flexibility and exhibit positive concurrent income shocks and decreases in income volatility, but there is limited evidence of subsequent performance improvements. His study revealed that firms that increase payouts have lower past volatility of operating income than other firms. The volatility decreases even further. This can be explained by the fact that managers increase the firm's payout when they believe that the probability of sustaining the current level of income is high. Firms that decrease dividends on the other hand, have higher past volatility than other firms, and this volatility is on the rise.

The relationship between dividends payout ratio and financial performance remains an unresolved issue. According to some studies in the finance literature, dividend payout ratio can predict future earnings and hence be used to determine financial performance. Miller and Modigliani (1961) used logical analysis to explain firms' dividend policy. They asserted that in a perfect market, the value of a firm would be independent of its dividend policy and that a change in dividend policy would indicate a change in the management's view of future earnings hence

impact on a firm's financial performance. Benartzi, et al., (1997) found limited support for the view that dividend changes have information content about future earnings of a firm. They stated that, while there is a strong past and concurrent link between earnings and dividend changes, the predictive value of changes in dividends seems minimal. Since investors want to see a steady stream of sustainable dividends from a company, the dividend payout ratio analysis is important. A constant trend in this ratio is usually more important than a fluctuating ratio. Since it is for firms to declare dividends and increase their ratio for one year, a single high ratio does not mean that much. Investors are mainly concerned with sustainable trends. For instance, investors can assume that a company that has a payout ratio of 20 percent for the last ten years will continue giving 20 percent of its profit to the investors'. Conversely, a company that has a downward trend of payouts is alarming to investors. For example, if a company's ratio has fallen a percentage each year for the last five years might indicate that the company can no longer afford to pay such high dividends. This could be an indication of poor operating performance. Generally, more mature and stable companies tend to have a higher ratio than newer startup companies (Nissim et al., 2001). According to Mozes and Rapaccioli (1998), the relationship between dividends and corporate earnings, they provided evidence that large dividend payout ratios lead to a decline in future earnings and small dividend increases lead to an increase in future earnings. They further investigated that if a company reported a loss, a decrease in dividends would have to reach a certain amount before it provided enough information that the firm would continue to report a loss. Mozes and Rapaccioli suggested that the relationship between the dividend decrease and future earnings would not be positive and linear. Teresiah C. (2014) investigated the relationship between dividend payout and financial performance: a study of listed companies in Kenya. She adopted descriptive design; secondary data was collected from

annual financial statement. Data was analyzed using regression analysis. Results of the study revealed that there was a positive relationship between dividend ratio and the two financial performance variables namely, sales growth and market book value. The results of the study indicated that the financial performances are statistically significant in influencing dividend payout ratio.

Akinyomi, (2014) investigated the relationship between dividend payout and financial performance of manufacturing firms in Nigeria. He adopted descriptive design; secondary data the results revealed a significant and positive relationship between dividend payout and profit after tax of the manufacturing firms. This shows no significant relationship between shareholders' funds of the manufacturing firms and dividend payout.

2.3.4 Insurance Claims and Financial Performance

An insurance claim is a demand by a person or an organization seeking to recover from an insurer for a loss that an insurance policy might cover (Brooks, Popow, & Hoopes, 2005). A claim is the moment in the relationship between insurance company and its customer as it creates the chance to show that the years spent paying premiums were worth the expense (Butler & Francis, 2010). These Insurance claims can range from simple domestic building and contents claims that are settled within days of notification to complex bodily injury claims that remain open for many years (Michael, 2008). The need to shift from claims handling to efficient claims management has now been recognized by insurers (Amoroso, 2011).Insurance companies that are used to administering mainstream insurance may not always be equipped to handle the demands of micro insurance, especially if it involves investing in new technology with reduced profit margins to pay for it. Insurance is an intangible product for the insurance clients until they

receive a payment for an insured loss. Client understandings and their satisfaction with insurance can be influenced by the claims experience. Positive claims may result in a long-term client experience and champion of the insurance programme, a negative experience leads to mistrust, and policy termination. Claims management is therefore an integral part of an insurer's efforts to provide good customer service and to retain clients. Insurance claims seem to contribute to the profitability and the long-term sustainability of the insurance firms; this is through the customer's satisfaction, policy renewal and the customer's retention.

According to SAS (2012), an insurer that manages claim will also make effort to minimize cases of fraudulent claims. According to (2012) 10% of all insurance claims are fraudulent. However, claim situations should be properly monitored in order to identify recovery opportunities from salvage, subrogation, or third parties. In the case experienced with missed or no recovery situations the firm will have implications on its profitability. The speed that claims are processed may hold greater importance for low-income households, since they have limited resources to cover expenses. If the insurance customers do not receive payouts quickly, they may need to sell assets or borrow funds, sometimes from moneylenders and often with impoverishing effects. Consequently, the client value of many micro insurance products, and trust in the principle of insurance itself, is often reinforced or diminished based on how a claim is managed.

A comprehensive set of best practices for insurance claims handling was published by AIRMIC1 in 2009. Micro insurance should follow similar principles of best practice, although their application may be different due to the unique features of micro insurance programmes. The study considers issues in claims management that may impact the application of best practices for micro insurance in ways that differ from those suited to mainstream insurers. Influencing

factors include organizational philosophy, client needs, product design and the distribution value chain.

According to India Insure, (2010) claims management in insurance companies is a major area of interest and concern since it has a big impact on customer satisfaction and an equally impact on the insurer's bottom line Existence of insurance depends on claims. Lack of no claims does not rise in the insurance companies. Different insurance products and their pricing are largely depends dependant on claims. Claims are said to be an important moment in the customer relationship and for any insurance company; success is defined by the customers experience around the claim. (India Insure, 2012). Important aspects of the functioning of an insurance company are the Claims and underwriting settlement. Claims are the opportunities of building lifelong relationships between the insurance firms and the customer. Every claim is considered important because building a reputation in claims is a slow and tiring process. Good claim services rapidly increases customer retention that in turn decreases customer procurement cost. Insurance company tends to differentiate themselves and support their brand strategies with claims management as a keystone (India Insure, 2010). In a very competitive insurance market, differentiation through new and more effective claims management practices is one of the most important and effective ways to maintain market share and profitability (India Insure, 2012).

2.4 Knowledge Gaps

Micro Factors tends to propel the performance many businesses in many developing countries but the effect on insurance firms remain unknown. As the Insurance companies become more complex and more levels of management added, they tend to distant themselves from the customers leading to poor performance of insurance firms. Studies in Kenya and around the world have focused on determining the effect of micro factors on financial performance of end users who include the targeted customers. Driven by this knowledge gap, this study sought to determine the effect of micro factors on financial performance of insurance companies in Kenya.

2.5 Conceptual Framework

A conceptual framework is a diagrammatic presentation of variables, showing the relationship between the independent variables and dependent variable. The study sought to investigate how the independent variables influence the financial performance of insurance firms in Kenya. Financial performance is measured using return on assets. Return on assets is the financial ratio that shows the percentage of the net profit in relation to the total assets. The study was conceptualized in a framework explaining the relationship between the independent variables and the dependent variables as shown in the schematic diagram below.

Independent variables **Dependent variables**

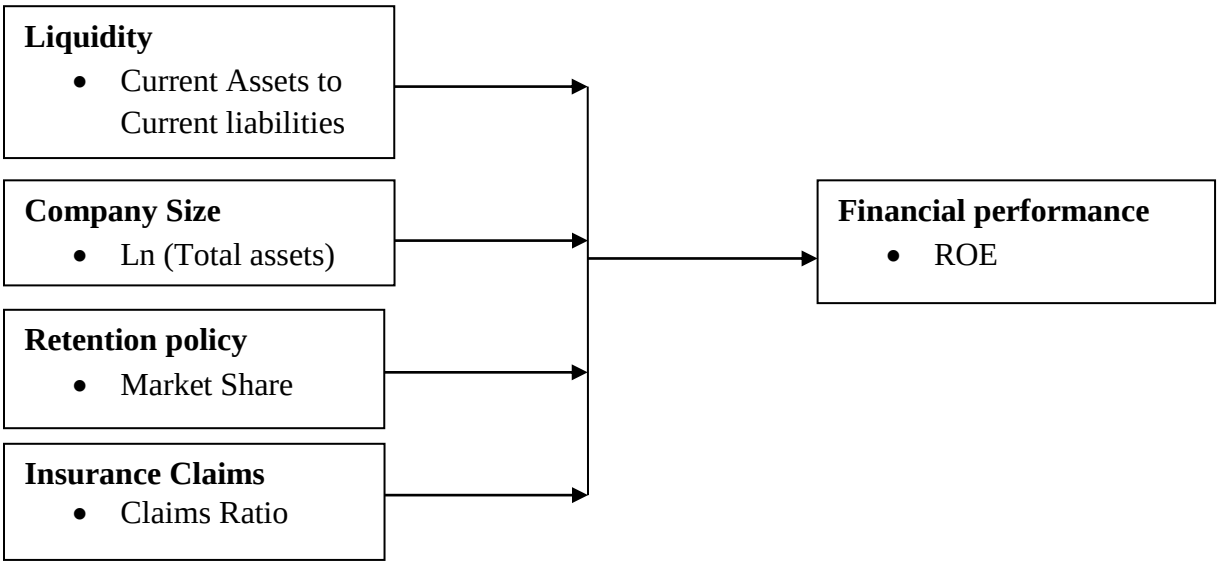

Figure 2.1 Conceptual Framework

2.6 Operationalization of Variables

Operationalization is a process in which a concept is measured and spelled out. It involves the identification of research procedures, which will be used to gather data.

Table 2.1 Operationalization of Variables

Variable	Type of variable	Indicators	Measure	Scale of measurement	Tools of Analysis
Financial Performance	Dependent	Improved productivity	Profitability ratio	End of financial year intervals	Descriptive and use of regression.
Liquidity ratio	Independent	Market forces	Liquidity ratio	End of financial year intervals	Descriptive and use of regression.
Company size	Independent	Improved productivity	Ln (Total Assets)	End of financial year intervals	Descriptive and use of regression.
Retention policy	Independent	Improved productivity	Market Share	End of financial year intervals	Descriptive and use of regression.
Insurance claims	Independent	Reported fraud claims	Claims ratio	End of financial year intervals	Descriptive and use of regression.

CHAPTER THREE

RESEARCH DESIGN AND METHODOLOGY

3.1 Introduction

This section of the study outlines methodology used in this research project. It gives details of research design target population, sampling design, and data collection procedure and data analysis.

3.2 Research Design

The study adopted descriptive research design. According to (Glass & Hopkins, 1984) descriptive research involves gathering data that describe events and then organizes, tabulates, depicts, and describes the data collection. Descriptive survey design is a research design involved in either identifying the characteristics of an observed phenomenon or exploring possible correlations among two or more phenomena. It is a survey of the effects of micro factors on the financial performance of insurance companies in Kenya. The main aim of a survey was to provide detailed data for the entire population under investigation. A survey gives a description of some pertinent characteristics of the population as well as allow for inferences of cause and effect.

Survey designs are of particularly of great value for instance when one is seeking help on identifying effects of micro factors on the financial performance of listed insurance companies in Kenya. A descriptive survey design thus, enable the researcher to collect in depth data on the population being studied and allow the researcher to be more focused in giving specific and relevant recommendations.

3.3 Target Population

According to Kothari (2011), the target population in a research is the total number of the individuals in a group that the research is intending to work on. Sekaran and Bougie (2013) define population as a set of elements with widespread attributes that can be generalized. The target population therefore is the overall number that can be worked on in a research. The purpose of the target population is to show the number of the larger group that the researcher intended to manipulate so as to get the required information. The target population for the study constituted of six listed insurance companies which were British American Insurance company limited, Jubilee Insurance, Sanlaam, Kenya Reinsurance, Liberty insurance and CIC Group as shown in Appendix I. Since the target population was small census approach was adopted, it was in congruence with Kiriba (2015) who investigated the effect of lagging macroeconomic indicators on stock return of listed insurance companies in Kenya.

3.4 Research Variables

Four variables are included in this study. The dependent variable is financial performance(Y). This variable is defined as a set of financial indicators which offer information on the degree of achievement of objectives and results (Lebans & Euske, 2006). The first independent variable is liquidity ratio(X_1). This variable was measured by the current ratio. The second independent variable is company size(X_2). This variable was measured using natural logarithms of total assets. The third independent variable is retention policy(X_3).This was measured by market share. The fourth independent variable is insurance claims(X_4). This variable was measured by claim ratio.

3.5 Data Collection

According to Flick (2009), data collection entails the process of gathering of empirical information with a purpose to gain new insights as regards the situation under study and to answer the research questions. This study employed secondary data which was published in IRA financial report for all listed insurance companies in Kenya. These data were extracted from IRA annual report.

3.6 Instrumentation

A research instrument is a survey, questionnaire, test, scale, rating, or tool designed to measure the variable(s), characteristic(s), or information of interest, often a behavioral or psychological characteristic (Birmingham, 2003).

Different Data collection methodologies exist and each researcher should choose the one which is most cost effective. In this regard panel data will be collected over a period of seven years starting from the year 2011 to 2017 of insurance companies listed at the Insurance Regulatory Authority. In this study panel secondary data was specifically mined from the sample insurance audited financial reports of the past 7 year's performance. The year from 2011 to 2017 was selected since most of the companies were listed within this period hence this guaranteed a high response rate.

3.7 Data Processing and Analysis

Data analysis enables the researcher to find the structure, order and meaning of the data (Sekaran & Bougie, 2013); STATA was used in analysis. For this research, the data analysis also will use

both inferential and descriptive statistics. Data processing was done as per advice given by Kothari (2011) i.e. coding, editing and tabulation. Coding will be done using excel and statistical software, STATA tool was used for all the diagnostic and regression tests. Tabulation was the final stage used to prepare, feeding the data and graphs used to present and display findings. This allowed presentation of data in a clear and meaningful way which was easy to interpret (Kothari, 2004). The research followed a panel data analysis option. Data underwent diagnostic tests to determine the presence of autocorrelation, heteroscedasticity and multicollinearity. Oscar (2007) stated, when interested in analyzing the impact of the variables that vary over time data Hausman test was used to differentiate between fixed effects model and random effects model. Random effects regression method was used to analyze longitudinal data with repeated measures on both independent and dependent variables.

Autocorrelation is a characteristic of data in which the correlation between the values of the same variables is based on related objects. It violates the assumption of instance independence, which underlies most of the conventional models. It generally exists in those types of data-sets in which the data, instead of being randomly selected, is from the same source. Autocorrelation refers to the correlation of a time series data with its own past and future values. It is also called lagged correlation or serial correlation, which refers to the correlation between members of a series of numbers arranged in time. Serial correlation was tested using Wooldridge test.

Heteroscedasticity is a condition where the variances of the error terms differ across observations. Likelihood ratio test is best used for assessing if heteroscedasticity is present (Oscar 2007). Multicollinearity (also known as collinearity) is a phenomenon in which two or

more predictor variables in a multiple regression model are highly correlated, meaning that one can be linearly predicted from the others with a substantial degree of accuracy.

3.7.1 Analytic Model

The multiple linear regression equation which takes into consideration three independent variables for the 10 insurance companies from 2016 to 2018 period, it will be presented as follows:

$$Y_t=\alpha+\beta_1 X_{1t}+\beta_2 X_{2t}+\beta_3 X_{3t}+\beta_4 X_{4t}+\varepsilon_j$$

Where; Y = Performance of insurance companies

β_1, β_2, β_3,β_4 =Regression coefficients

α = Constant/Y intercept

X_1 = Liquidity

X_2 = Company Size

X_3= Retention Policy

X_4 = Insurance claims

ε = error term.

3.8 Ethics in Research

Honesty report data, results, methods and procedures, and publication status no fabrication, falsified, or misrepresented data. Striving to avoid bias in experimental design, data analysis, data interpretation, peer review, personnel decisions, and other aspects of research where objectivity is expected or required. Protect confidential communications, such as papers or grants submitted for publication, personnel records. Avoiding discrimination against colleague or students based on sex, race, ethnicity, or other factors not related to scientific competence and integrity.

CHAPTER FOUR

ANALYSIS AND FINDINGS

4.1 Introduction

In this section analysis, presentation and interpretation of the study findings will be presented. Secondary data was collected from annual financial statements of 11 insurance companies. Dummy codes were adopted to avoid breaching confidentiality of insurance companies. The chapter commences with exploratory data analysis, then panel diagnostic tests and finally modeling of conceptualized model in chapter two.

4.2 Exploratory Data Analysis

Prior explaining the effect of micro economic factors on firm performance of insurance companies in Kenya, pictorial presentation shown in Figure 4.1 revealed that there were different rates of firm performance across insurance companies, for example insurance company one had down ward trend followed by upward trend, similar pattern was observed in company three.

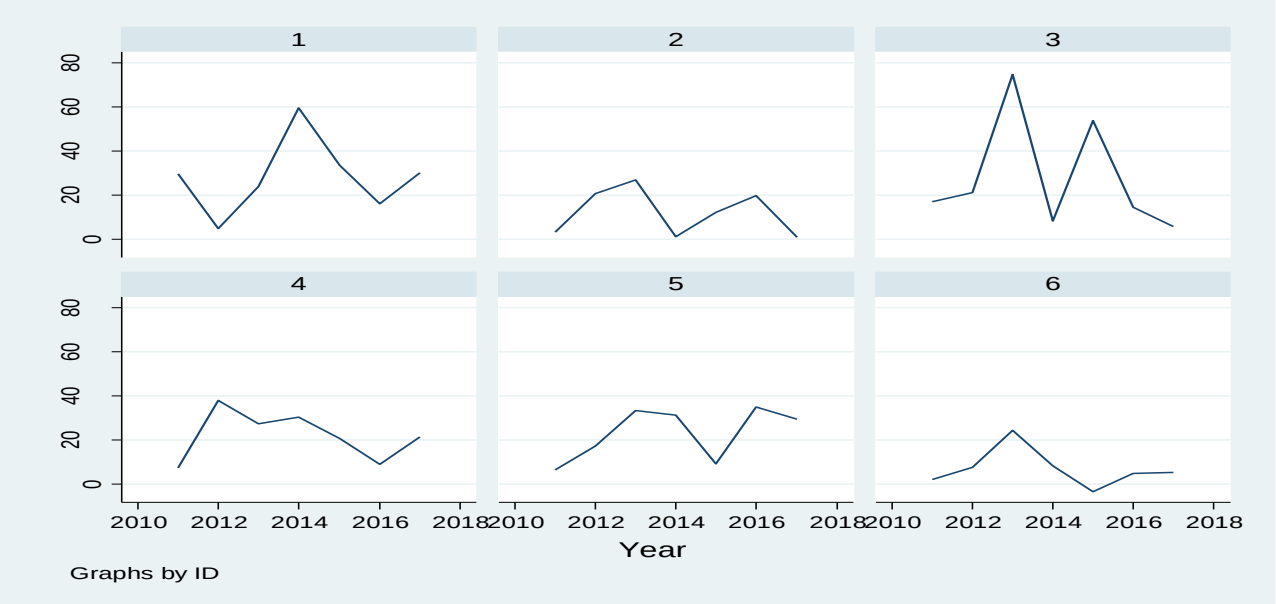

Figure 4.1 Trend Line for Financial Performance

Pictorial presentation in Figure 4.2 shows overlay graphs which were testing slopes differences amongst insurance companies. From the findings it can be deduced that there were differences of slope coefficients amongst insurance companies with some having upward followed by downward patterns. A close scrutiny revealed that insurance companies had different intercepts.

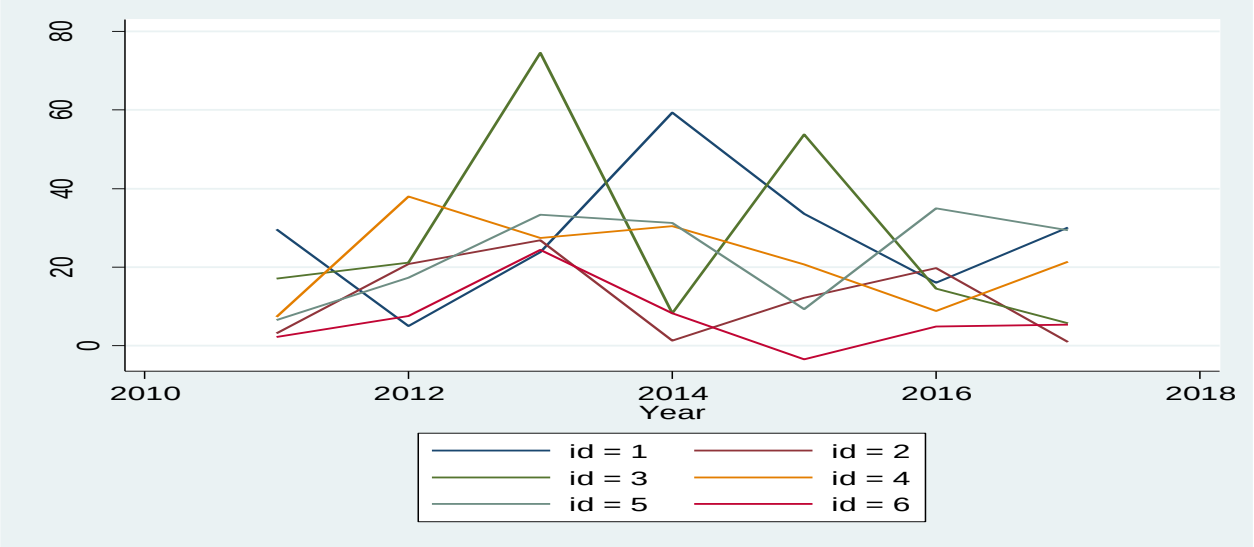

Figure 4.2 Financial Performance Overlay Graph

4.2.1 Multicollinearity Analysis

Collinearity analysis was carried out to examine the strength of relationship between variables and the degree of collinearity between independent variables. As shown in Table 4.1, liquidity had positive and insignificant effect on firm performance of listed insurance companies in Kenya (rho = 0.014, p value >0.05). Secondly, company size had negative and insignificant effect on financial performance of listed insurance companies in Kenya (rho = -0.124, p value >0.05). Thirdly, retention ratio had positive and non-significant effect on financial performance of listed

insurance companies in Kenya (rho = 0.167, p value >0.05). Fourthly, claims ratio had positive and non-significant effect on financial performance of listed insurance companies in Kenya (rho = 0.122, p value >0.05). Since none of independent variables had correlation coefficient greater than 0.7, then it can be concluded that there was no collinearity between independent variables. Moreover, none of VIF was greater than 10 and tolerance limits less than 0.1, hence independent variables were not correlated.

Table 4.1 Correlation Analysis

	Financial Performance	**Liquidity**	**Company Size**	**Retention Ratio**	**Claims Ratio**	**VIF**	**Tolerance**
Financial Performance	1						
Liquidity	0.247	1				1.09	0.92
	0.115	-----					
Company Size	0.017	0.231	1			1.31	0.76
	0.917	0.141	-----				
Retention Ratio	-0.084	0.043	-0.401	1		1.22	0.81
	0.599	0.786	0.009	-----			
Claims Ratio	-0.031	0.028	-0.108	0.0008	1	1.02	0.98
	0.846	0.860	0.495	0.996	-----		

4.3. Diagnostic Analysis

In the forthcoming section, panel data diagnostic tests which included Breusch-pagan LM test, fixed effects test, heteroscedasticity and serial correlation test. The null hypothesis for LM test states that there is zero variance across entities or there is no panel effect against an alternative which states that there are panels. Results of the study shown in Table 4.3 of Chi square 0.24 and

p value = 0.6256, indicated that there was no enough evidence to warrant rejection of null hypothesis and consequently pooled effects OLS model can be fitted to show the effect of micro factors on firm performance of insurance companies in Kenya.

Table 4.2 Chi-Square values for the Breusch-Pagan LM Test

Model	Dependent variable	χ^2-value	p-value
1	Firm Performance	0.14	0.7059

To investigate the relevance of time fixed effects while running fixed effects model. Testparm test was applied; it tests the null hypothesis to see whether dummies for all years are jointly equal to zero. Results shown in Table 4.3 revealed that P value >0.05, therefore there was no enough evidence to warrant rejection of the null hypothesis that coefficients for all years are jointly equal to zero. Thus, no time fixed effects were needed in this study.

Table 4.3 Test Results for Fixed Time Effects

Model	Dependent variable	F-value	p-value
1	Firm Performance	0.05	0.8310

Heteroscedasticity was tested using Breusch Pagan Godfrey test chi square test. The null hypothesis for the test was that there was uniform variance against an alternative that there was no uniform variance. Results of the study revealed that Chi square test was 32.82and p value <0.05. Consequently, there was enough evidence to warrant rejection of the null hypothesis and conclusion that there was no uniform variance across the error. To overcome for heteroscedasticity either robust standard errors or generalized linear model (GLM) can be fitted. Therefore, regression model with robust standard errors was fitted. First order serial correlation was tested using Woodridge serial autocorrelation test. The null hypothesis stated that there was no serial correlation against an alternative that there was serial correlation. Since the p value was

less than 0.05, there was enough evidence to warrant rejection of the null hypothesis and conclusion that there first order serial correlation. To overcome this challenge regression model with robust standard errors was fitted.

Table 4.4 Test for Heteroscedasticity and Serial Correlation

		Test for heteroscedasticity		Serial Correlation	
Model	**Dependent variable**	**χ^2-value**	**p-value**	**F-value**	**p-value**
1	Firm Performance	27497.85	0.000	213.0425	0.000

4.3.1 Panel Data Descriptive Analysis

Results shown in Table 4.5 revealed that average liquidity insurance companies in Kenya had average liquidity of 7.80, with a maximum of 26.28. This shows most listed insurance had huge amount of resources pegged on current assets, it is important to note that there is some insurance which are financing their needs using current liabilities and thus they have negative liquidity. On overall insurance companies retained their market share to an average of 19.65 percent. Average claims ratio was 63.42% this calls for thorough examination of insurance claims and examination of premium evaluation techniques to minimize possibilities of failing to pay claims on time.

Table 4.5 Panel Data Descriptive Analysis

Variable		Mean	Std.Dev.	Min	Max
Liquidity	overall	7.80	6.80	0.15	26.28
	between		4.56	2.68	15.33
	within		5.34	-.59	25.54
Company Size	overall	16.71	0.789	15.14	37.96
	between		0.700	15.9	17.47
	within		0.451	15.93	18.63
Retention Ratio	overall	19.65	18.87	2.21	68.54
	between		18.93	6.07	57.73
	within		7.08	2.17	38.44
Claims ratio	overall	63.42	10.18	20.8	88
	between		4.50	56.33	67.93
	within		9.29	27.89	83.83

Hausman test was applied to test the most appropriate model to fit between random effects model and fixed effects model. Hausman test; was based on null hypothesis that the most appropriate model to fit the data was random effects. As shown in Table 4.6, Chi square value of 0.44, with p value >0.05, then there was enough evidence to warrant rejection of the null hypothesis and conclusion that the most appropriate model to fit was random effects.

Table 4.6 Hausman Test

Variable	Fixed	Random	Var(Diff.)	Sqrt(diag(V_b-V_B)) S.E
Liquidity	0.19	0.30	-0.11	0.16
Company Size	-2.87	-2.10	-0.77	2.42
Retention Ratio	-.16	-0.11	-0.05	0.20
Claims Ratio	-0.05	-0.05	0.00	0.07
Chi Square = 0.44 d.f = 4 P value = 0.9788				

Regression results in Table 4.7 revealed that 6% of variation in insurance companies' performance can be accounted for by liquidity, retention ratio; company size and claims ratio and the remaining percentage can be accounted by other factors which were excluded by other factors which were included in the model. There was positive and non-significant effect between

liquidity and insurance company performance in Kenya (β = 0.30, p value > 0.05). Secondly, there was negative and non-significant effect company size on insurance company performance in Kenya (β = -2.10, p value >0.05). Thirdly, retention ratio had negative and non-significant effect on insurance performance in Kenya (β = -0.11, p value >0.05). Finally, there was negative and significant effect of claims ratio on insurance company performance in Kenya (β = -0.05, P value >0.05).

Table 4.7 Effect of Micro Economic Factors on Performance of Insurance Companies in Kenya

```
Random-effects GLS regression                   Number of obs      =        42
Group variable: id                              Number of groups   =         6

R-sq:  within  = 0.0361                         Obs per group: min =         7
       between = 0.2194                                        avg =       7.0
       overall = 0.0674                                        max =         7

Random effects u_i ~ Gaussian                   Wald chi2(4)       =      5.56
corr(u_i, X)       = 0 (assumed)                Prob > chi2        =    0.2341

                                               (Std. Err. adjusted for 6 clusters in id)
------------------------------------------------------------------------------
             |               Robust
financial_~e |      Coef.   Std. Err.      z    P>|z|     [95% Conf. Interval]
-------------+----------------------------------------------------------------
   liquidity |   .2992894   .4554013     0.66   0.511    -.5932808     1.19186
company_size |  -2.104525   2.315634    -0.91   0.363    -6.643085    2.434035
retention_~o |  -.1107757   .1055011    -1.05   0.294     -.317554    .0960025
claims_ratio |  -.0501294   .1347777    -0.37   0.710    -.3142889      .21403
       _cons |   45.41108   42.75278     1.06   0.288    -38.38283     129.205
-------------+----------------------------------------------------------------
     sigma_u |  8.4628453
     sigma_e |  11.686577
         rho |  .34400184   (fraction of variance due to u_i)
------------------------------------------------------------------------------
```

CHAPTER FIVE

SUMMARY DISCUSSION CONCLSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents summary, discussion, conclusion and recommendations emanating from study findings.

5.2 Summary

The current study emanated from the identification of contextual, empirical, methodological and conceptualization gaps emanating from past studies. Conceptually past studies have examined each of selected micro economic factors independently, secondly there has not considered data from insurance sector after enactment of new companies' act. Methodologically, even though most studies had drawn panel data majority of them had shied away from examining panel data diagnostic tests and those studies which has adopted regression modelling they had not tested classical regression analysis tests despite of them being paramount prior to fitting regression more so to minimize possibilities of yielding biased findings. There has not been any contextual consensus with some studies reporting positive, negative, significant and non-significant findings. Consequently, the current study was conceived to examine the effect of micro economic factors on insurance company performance. Despite of existence of several micro economic characteristics the currents study was limited to liquidity, retention ratio, company size and claims ratio since they have been consistently investigated in developed economies and in different financial sector in exclusion of claims ratio which is unique in insurance sector. The study was guided by the following research questions: What are the effects of liquidity ratio on the financial performance of insurance companies? Does company size affect financial performance of insurance companies in Kenya? What are the effects of retention policy on

financial performance of insurance companies in Kenya? What are the effects of insurance claims on financial performance of insurance companies in Kenya?

To achieve the overall objective, the study adopted descriptive research design. Purposive sampling was adopted to select 6 listed insurance companies. Panel secondary data was collected as recorded in annual reported prepared by Insurance Regulatory Agency (IRA). The study was anchored on agency theory, innovation theory, portfolio theory and arbitrage pricing theory. Data was analyzed using descriptive statistics, correlation and random effects multiple regression analysis and presented in graphs and tables.

Regarding the first research question, results of the study revealed that liquidity had positive non-significant effect on financial performance of insurance companies in Kenya. Secondly, there was negative and non-significant effect of company size, retention ratio, claims ratio and insurance company performance in Kenya.

5.3 Discussion

The study findings were in concurrence with Milan et al. (2013), market penetration-based pricing strategies, meaning the practice of lower or smaller prices, presented a significant and negative relationship with the business performance of the companies investigated. Such fact could be explained by its relationships to offering lower prices than the competition. Therefore, low prices are more strongly associated with lower profits and vice versa (Simon et al., 2008) According to Hinterhuber (2008), prices have a high impact on companies' profitability, and pricing strategies vary considerably between sectors and market situations. Nonetheless, researchers mostly agree that pricing strategies can be categorized in three big groups: cost-based

pricing, competition-based pricing and customer value-based pricing (Nagle & Holden, 2003). Despite the importance a price has on the performance of businesses, it seems that such element has not received the proper attention by many academics and marketing professionals (Avlonitis&Indounas, 2006). Nagle and Hogan (2007) argue that companies which do not manage their prices lose control over them, impairing their profitability and cost effectiveness mainly due to the customers will on paying a determinate price, which not only does it depend on the perceived value, but also depends on the prices set by the leading competitors.

A company must decide what is going to be the strategy for the product in addition to what will be the proposed objectives before setting the price, since the clearer these decisions, the easier it will be to establish prices (Hinterhuber&Liozu, 2013).Product Pricing involves looking at the frequency and severity of insured risks and the expected average pay-out resulting from these risks. Its framework mainly focuses on actuarial control cycle which entails relying on historical data to predict future behavior for premium rate creation and an analysis on the administration expense, risk analysis and financing structure (Annals of Actuarial Science, 2014). Pricing is usually done by calculating the expected claims, administration cost, risk premium and profit margin of a product before it is released in the market (Association of Kenya Insurers, 2012). In addition, there is need for insurance management to adhere to provisions of agency theory so as to protect interest of shareholders.

These findings contrasted Yegon, Mouni and Wanjau (2014) who suggested that what determines a firm size is the ownership of physical assets which are critical resources. The neoclassical theory of firm size supported by Lucas (1978) also looked at the firm size in terms of per capita capital in form of investment return and research and development. Pervan and

Višić (2012) emphasized on the conceptual framework that advocates a negative relationship between firm size and profitability which is noted in the alternative theories of the firm. The theory, as stated, suggests that large firms come under the control of managers pursuing self-interested goals and therefore profit maximization as the firm's objective function which may be replaced by managerial utility maximization function. Akbas and Karaduman (2012) claimed that size could impact the profitability negatively, for firms that become extremely large due to bureaucratic and other reasons. The nature of the relationship between firm size and economic performance has received considerable attention in the literature but has provoked vigorous debate as existing literatures provide conflicting results (Symeou, 2012). Some industries, organizations and sectors link large firms to better performance in line with the neoclassical theory of firm size while some research findings support the conceptual framework that advocates a negative relationship between firm size and profitability.

These findings are in congruence with argument that insurance firms should acquire skills and expertise in case of a loss claims predictions this will increase its profitability. According to James (2009), 20 to 30 percent of an insurer's claims are in litigation. However, claims that involve attorneys often double the settlement amount and significantly increase an insurer's expense (SAS, 2012). The cost of claim payouts and expenses is the largest spending category for an insurer, accounting for up to 80 percent of premium income (Harrington &Niehaus, 2006; Amoroso, 2012). Claims costs are the total losses an insurer incurs and also the adjustment expenses. Claims management is a key challenge and opportunity for all types of insurers, as their reputation and financial stability depend on their ability to pay claims efficiently and transparently. Efficiency in claims administration is a particular challenge for micro insurance providers, who must deliver services similar to those of mainstream insurers, yet with smaller

margins (based on smaller premiums) to work with. Large micro insurance programmes may serve many thousands of clients, who are often hard to reach through conventional methods. Identification of clients and beneficiaries is a challenge, as is finding claims management solutions that allow high volumes to be handled in an efficient way. Fraud management needs to be balanced with cost-effective processes. Effective data management systems are crucial for leveraging claims data in order to improve products and service.

5.4 Conclusion

From the study findings it can be deduced that the study achieved the study achieved the main objective of examining the effect of micro economic factors on performance of insurance companies in Kenya. Since there was positive relationship between liquidity and insurance company's performance in Kenya, there is need for insurance companies to evaluate for insurance companies in Kenya to evaluate their working capital management strategy. Rather than insurance companies holding huge resources inform of current assets there is need for them to devise short term investment strategies which would amplify their financial performance.

Secondly, there was an inverse effect of company size on insurance company performance in Kenya. There is need for insurance companies to evaluate their assets acquisition strategies. This will enhance adoption of financing option which will be geared towards maximization of shareholder's wealth and minimization of operational costs. Furthermore, there is need for insurance companies to evaluate their asset base and avoid accumulation of assets which are expensive to maintain.

Thirdly, there was inverse effect of retention ratio on insurance company performance. Consequently, insurance companies ought to examine their market penetration strategies. Depending on marketing strategies insurance will be better placed to achieve superior performance. Moreover, insurance companies should invest on strategies geared towards enhancing insurance market penetration.

Finally, there was positive and significant relationship between claims ratio and insurance company performance. This shows that the findings were in congruence with signaling hypothesis which depicted superior performance of insurance owing to its ability to pay claim signified superior performance. There is need for insurance to evaluate claims prior to payment to mitigate possibilities of paying nonexistent claims. Furthermore, there is need for insurance to devise measures to ease their claims processing procedures.

5.5 Recommendations

Based on study findings the following recommendations can be deduced; insurance companies in Kenya should adopt matching working capital management or aggressive strategies so as to be profitable. Furthermore, they should continuously current asset management strategy adopted. This will enhance they profitable, otherwise current strategies have high chances of leading to massive losses.

Secondly, there is need for insurance companies to evaluate their asset base; alternative methods of asset acquisition ought to be adopted rather than reliance on cumulative accumulation of non-currents assets whose capital expenditure may be high and may lead to massive restricting of

balance sheet and contractual agreements which may be exclude shareholders influence in company management.

Thirdly, there is need for all insurance to evaluate their market penetration strategies more so after entrance of banking sector with banccassurance products. Currently insurance penetration is less than 5 % thus cannibalization of commercial banks signals loss of existing markets share. To retain market shares insurance companies should pattern with commercial banks so that the later can finance and former provide insurance covers.

Finally, there is need for adoption of inclusive and efficient evaluation of claims. Through this insurance companies would ensure they address to customer claims on time and they can mitigate against financial implications which can arise in situations when insurance companies have high number of insurance claims. To enhance insurance financial performance, financial department should devise robust working capital market which will ensure insurance are financially stable and their return from long term and short term are profitable.

5.5.1 Suggestions for Further Studies

The current study was based on short panels there is need for subsequent study to carried out to examine the effect of micro economic factors on financial performance of insurance companies in Kenya. Secondly, insurance companies can be broadly classified into listed, non-listed there is need for comparative analysis to be carried out to examine the effect of micro economic factors on insurance company's performance in Kenya. Thirdly, a study ought to be carried out to examine moderating effect of insurance segment (general or life) on the effect of micro economic factors on performance of insurance companies in Kenya. A long period of data should

be considered rather than considered three years only. There is need to examine the effect of changes in regulatory policies in insurance more so commencement of IRA and changes in companies Act.

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APPENDICES

Appendix 1: Insurance Companies Listed in the

Britam Life Assurance Company (K) Limited

CIC General Insurance Company Limited

Liberty Life Assurance Kenya Limited

The Jubilee Insurance Company of Kenya Limited

Kenya Re-Insurance Corporation Ltd

Sanlaam Insurance Company Limited

Appendix II: Data Collection

		Liquidity		Company size	Retention Ratio	Claims Ratio	Financial performance	
Company	**Year**	**Current Assets**	**Current Liabilities**	**Total Assets**	**Market Size**	**Claims Ratio**	**Equity**	**PAT**