Influence of Financial Prudence on the Performance of the Insurance Industry in Kenya

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Abstract

The measure of performance of insurance companies must not be just on their rate of return on investment but should also include aspects that relates to financial prudence like levels of customer satisfaction, speed of claims settlement and also quality of underwriting services. Financial Strategic Intelligence is the key and road map to be followed by any insurance company that aspires to succeed in the undefined industry climate. It was however found that there are marked differences in the conformity and usage of strategic intelligence and its components in the insurance industry with a measurable difference between large and small organisations. It is, however, generally viewed that the use of a strategic intelligence framework could greatly enhance decision-making.

Key word: Insurance, Financial, Prudence, Performance, Management

Introduction

Organizations must continuously evaluate the environments in which they compete and decide on appropriate strategy (Hitter al., 2005). Strategy deals with the future, a long-term, uncertain future. Preparations are to be made, plans established, and actions taken together with a provision for alternative actions should the future consist of unexpected characteristics (McGee, 2006). Pearce and Robinson (2005) argue that strategy consists of large-scale, future-oriented plans that are developed for interaction with the organization's competitive environment to achieve organizational objectives while Hittet al. (2005) and Carpenter and Sanders (2009) further explain that strategy is an integrated and coordinated set of commitments and actions designed to exploit core competencies and gain a competitive advantage in order to pursue the organization's goals and objectives. McGee (2006) identifies an orientation to the future as an essential ingredient in the ideal of strategy.

Carpenter and Sanders (2009) define Strategic management as the process by which a firm manages the formulation and implementation of strategy while Robbins and Coulter (2009) is of the opinion that Strategic Management is simply what managers do to develop an organisation's strategies. Morden (2007), states that strategic management is concerned with the character and direction of the enterprise as a whole. It is concerned with the basic decisions about what the enterprise is now, and what it is to be in the future. It determines the purpose of the enterprise. It provides the framework for decisions about people, leadership, customers or clients, risk, finance, resources, products, systems, technologies, location, competition, and time. It determines what the enterprise should be capable of achieving, and what it will not choose to do. It will determine whether and how the organisation will add value, and what form that added value should take. Strategic Management is also concerned with management planning and

decision-making for the medium to long-term future. It is concerned with the anticipation of that future, and with the establishment of a vision or view of how the enterprise should develop into the future that it may face. Pearce and Robinson (2005) define strategic management as the set of decisions and actions that result in the formulation and implementation of plans designed to achieve a company's objectives while Mellahi, Frynas and Finlay (2005) minimally define strategic management asthe process of setting long-term direction for the organization.

While dynamic in nature, the strategic management process consists of a full set of commitments, decisions, and actions required for an organisation to achieve strategic competitiveness and earn above-average returns. Strategic inputs are derived from the analysis of the internal and external environment, and are necessary for effective strategy formation and implementation. The strategic management process is utilised to match the conditions of an ever changing market and competitive structure with the organisations continuously evolving resources, capabilities, and core competencies. (Hittet al., 2005; Carpenter and Sanders, 2009; Robbins and Coulter, 2009).

Over the last decade, the external environment of insurance sector had significantly changed, becoming very instable and complex. In these circumstances, we believe that the proper managerial approach, not only for anticipating the future problems, opportunities and threats but also to improve profitability, is the strategic management. Due to the unstable and complex environment in which insurance companies activate, dealing with a large number of risks related to their main activities and other economic agents risks, it is obvious that we need to identify and also take into consideration the external influences, to value opportunities and to avoid possible

threats. This is possible by promoting and using the strategic management approach (Ion Verboncu, 2009).

In the process of establishing its strategy, an insurance company must take into consideration a series of factors such as company's resources and capabilities, the internal and external environment in order to obtain positive results and to minimize the negative consequences of them. The Kenyan insurance market has a very high potential for growing and development but this potential is influenced by the economic evolution of our country and by the level of public awareness for insurance need. Also, when we talk about the insurance market, we must talk about the intense regulation and supervision. Nowadays, one important trend in management is to overcome the stage of elaborating and implementing a simple strategy and move towards a more complex process called strategic management (Ndulu, 2008).

The linkage between Strategic Intelligence and Strategic Analysis

From the unifying point of view, strategy becomes a fundamental framework through which an organization can assert its vital continuity while at the same time purposefully managing its adaptation to the changing environment to gain competitive advantage. Having a strategic thinking mindset does not, in itself, always generate a fully functional strategy for an organization. On the other hand, Strategic planning does not guarantee strategic thinking. Most strategic planning systems rely on historical data and numbers generated internally. These systems often require long and exhaustive analysis. The result is an extrapolation of history into the future. Strategic thinking, on the other hand, incorporates an assessment of both the internal and external environment. The process involves a qualitative evaluation of the business and its

environment and is both introspective and extraspective. When discussing strategic planning, strategic design or strategic thinking, it is important to give consideration as well to strategic management. The essence of formulating competitive strategy is relating a company to its environment highlights several key dimensions of strategic management. The first part of the statement, the essence of formulating, indicates that there must be a process at play. Whether structured or unstructured, formal or informal, rational or irrational, the organization must proceed through a number of steps before it can arrive at a strategy. This dimension of strategic management, which looks at the how of strategy, is referred to as the strategy process (Verboncu I, 2009).

An organisation's strategic direction can be influenced by global developments outside of management's control. An organisation is not isolated from the environment in which it operates; its future development, the results it can achieve and the constraints within which it operates, are functions of the business environment (Mellahi*et al.,* 2005; Carpenter and Sanders, 2007; Carpenter and Sanders, 2009; Robbins and Coulter, 2009). Documented organisational experiences and research suggest that the business environment affects the organisation's growth and profitability. Conditions within the business environment create threats to and opportunities for organisations which could have a major impact on strategic options as well as the decisions made in light of them (Carpenter and Sanders, 2009).

The business or external environment consists of all the factors inside and outside the organisation which require understanding to form strategic intent, to develop its strategic mission, and allow it to take actions that result in strategic competitiveness and above-average

returns. Strategic Analysis as a process by which the enterprise examines its own internal or corporate characteristics and capabilities; and identifies the most important features of the external environment within which it must operate. The process is used by organisations to identify and understand variables such as (Morden, 2007).

Strategic analysis is used to inform the process of strategy formulation, strategic decision-making, and strategic choice. Organisations often face external business environments that are highly turbulent, complex, and global which make interpreting them extremely difficult. To cope with the ambiguous and incomplete environment data that is often collected, and to increase their understanding of the business environment, organisations often engage in a process called external environmental analysis (Robbins and Coulter, 2009).

Financial Prudence

The financial prudence indicators are concerned with the financial strength and liquidity of the insurance programme. Often, these are not tracked at product level but rather at the level of the organisation that bears the insurance risk. Larger companies may, however, allocate specific assets to cover reserves and expenses for each product and to maintain a good asset-liability match; doing this enables them to track solvency and liquidity by product. These companies may, however, have some additional assets to fall back on if solvency or liquidity of the product were threatened. Liquidity and solvency do affect the other performance areas of an insurance programme, for example, excessive liquidity reduces investment income which in turn lowers overall net income. Too little liquidity on the other hand may cause a delay in claims payment (Akotey, 2013).

The solvency ratio is defined as the ratio of admitted assets to liabilities. A programme (or a risk-bearing organisation) with 130 percent solvency ratio owns 130 in admitted assets for every 100 of its liabilities. The liquidity ratio as an indicator measures the amount of available cash to meet short-term obligations. Here, short-term liabilities mean projected payables within the next three months. To evaluate it, tally the available cash and short-term investments that can be immediately converted to cash (government securities, commercial paper, money market funds). Second, project expenses, claims, surrender payouts and other payables for the next three months; this is the denominator of the ratio (Ghimire, 2013).

Research Gaps

A critical review of past literature show that several conceptual and contextual research gaps existed in the effects of financial management practices on organizational performance of insurance companies in Kenya. For instance, the studies by Butt, Hunjra and Rehman (2010) studied the relationship between organizational performance and financial management practices like capital structure decision, dividend policy, investment appraisal techniques, working capital management and organizational performance assessment in Pakistani corporate sector. The results show a positive and significant relationship between financial management practices and organizational performance in Pakistani corporate sector.

In Kenya, only a few studies have been done on strategic intelligence and the majority of them have focused on the banking and telecommunication sector. Mugo, Wanjau, Ayodo (2012) researched on an investigation into competitive intelligence practices and their effect on profitability of firms in the banking industry: A case of Equity Bank. Mutua (2010) did a

research on competitive intelligence practices by EssarTelcom (YU) (K) Ltd. Muiva, (2001) conducted a survey on the use of competitive intelligence systems in the Kenyan Pharmaceutical Industry while Kipkorir, (2001) researched on competitive intelligence practices by FM radio stations operating in Kenya. These studies were however done on different sectors other than the insurance industry in Kenya. This is despite the fact that the insurance sector in Kenya is facing many challenges posed by the competitive environment and the nature of service offered. Despite the adoption of this competitive intelligence there is no study that has been done on the Kenyan insurance industry to date. This study therefore sought to fill the existing knowledge gap by carrying out an investigation of competitive intelligence practices for greater profitability in the insurance industry in Kenya.

Methodology

Polit et al (2001) define a research design as the researcher's overall for answering the research question or testing the research hypothesis. In this descriptive study, qualitative and quantitative data collection techniques was used including; semi-structured interviews, and pre and post-test questionnaires. This study adopted positivism more than phenomenological perspective because the influence of Strategic Intelligence on the organisation performance constructs as pertaining in Kenya's insurance industry can be examined objectively through the use of established theoretical frameworks and structured instruments to assess and analyse it, upon which generalizations can be made from the findings. The population of this comprised of 46 units of analysis which are the licensed insurance companies in Kenya (IRA, 2013) from which the target and accessible population was drawn. The study population comprised of 316 senior management employees and 749 middle management employees.

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The study population comprise of 1065 employees from senior and middle management. According to Mugenda and Mugenda (2003), a population of less than ten thousand elements is defined as a small population. They recommend a formula for determining appropriate sample from a small population as demonstrated by equation 1 below.

Equation 1

$n=Z^2*p*(1-p)/d^2$ where;

n   desired sample size of a big population i.e. more than 10,000

Z   standard normal deviate at the required confidence level, Z value score, (1.96)

p   Proportion of units in the target population estimated to have characteristics being measured. For this study it is set at 50% (0.5)

d   Precision level desired for the study (0.05)

N   1017 subjects

Based on the equation 1, the sample of a big population size can be established as;

$$n= \frac{1.96^2 \times 0.5(1-0.5)}{0.05^2} = 384$$

According to Mugenda and Muganda (2003), with a small population of less than 10,000, the required sample size will be smaller. The study calculated the final sample estimate n_0 using equation 2 below;

Equation 2

$$n_0 = \frac{n}{1+ \frac{(n-1)}{}}$$

N

Where: $n_0 =$ the desired sample size (when the population is less than 10,000)

n =the desired sample size (when the population is more than 10,000)

N = the estimate of the population size

Based on the equation 2, the reduced sample size can be established as;

384/(1+((384-1)/1017) = 278

The sample size was distributed within the 46 licensed insurance companies in the two strata using the study population ratio representation. This ensured that sample distribution was unbiased and balanced. The study used both primary and secondary data. Data was collected using interview guide, questionnaires and secondary data collection sheet.

A multiple regression model was used to test the significance of the effect of the independent variables on the dependent variable. The multiple regression model was as below

$$Y = \beta_0+\beta_1X_1+\beta_2X_2+\beta_3X_3+\beta_4X_4+\beta_5X_5+\beta_6X_6 + e$$

Where:

Y = the value of the dependent variable (organizational performance)

$\{\beta_i; i=1,2,3,4,5,6\}$ = The coefficients representing the various independent variables.

B_0 = the Y intercept

$\{X_i; i=1,2,3,4, 5,6\}$ = Values of the various independent (covariates) variables.

e = the error term which is assumed to be normally distributed with mean zero and constant variance.

Y = organizational performance of insurance companies

X_1 = Working capital management

X_2 = Fixed assets management

X_3 = Financial analysis

X_4 =Claims settlement policies

X_5 =Internal controls

Study Findings and Discussion

According to the findings, the regression model indicated that the relationship between Financial Prudence and Insurance Industry Performance (IIP) was significant since the coefficient of determination R- square was 0.466, at 0.05 significance level. The findings further indicated that 46.6% of the variation of Insurance Industry Performance is influenced by Financial Prudence individually. The findings also show that there was a linear relationship between Financial Prudence and Insurance Industry Performance.

Table 1: Regression model summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
Financial Prudence	.682[a]	.466	.454	.10972

According to Table 2 below, the significance values were all less than 0.05 implying that there is a positive significant relationship between Financial Prudence and Insurance Industry Performance.

Table 2: ANOVA Regression results

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.327	1	.327	21.627	.000[b]
	Residual	.665	44	.015		
	Total	.991	45			
2	Regression	.385	1	.385	27.982	.000[b]
	Residual	.606	44	.014		
	Total	.991	45			
3	Regression	.469	1	.469	39.554	.000[b]
	Residual	.522	44	.012		
	Total	.991	45			
4	Regression	.444	1	.444	35.718	.000[b]
	Residual	.547	44	.012		
	Total	.991	45			
5	Regression	.462	1	.462	38.346	.000[b]
	Residual	.530	44	.012		

	Total	.991	45

a. Dependent Variable: Organization Performance Predictors: (Constant), x1, x2, x3, x4, x5

The study further determined the beta coefficients of Product Value , Product awareness, Product Satisfaction, Service Quality , Financial Prudence talent on organization performance. From the table 4.17, the regression models were as follows: $Y = 3.406 + 0.002x_1$ $Y = 3.44 + 0.012x_2$ $Y = 3.493 + 0.018x_3$ and $Y = 3.406 + 0.302x_4$ The models shows that the relationship between Product Value, Product awareness, Product Satisfaction, Service Quality, Financial Prudence and organization performance were all positive since their coefficients were: 0.002, 0.012, 0.018, 0.302, and 0.402 respectively. The significance values (p-values) were all 0.000 which were also less than 0.05.

Table 3: Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	3.406	.106		32.214	.000
	Product Value	.002	.000	.574	4.650	.000
2	(Constant)	3.440	.087		39.596	.000
	Product Awareness	.012	.000	.623	5.290	.000
3	(Constant)	3.493	.065		53.560	.000
	Product satisfaction	.018	.000	.688	6.289	.000
4	(Constant)	3.398	.084		40.477	.000
	Service Quality	.302	.000	.669	5.976	.000
5	(Constant)	3.429	.076		44.998	.000
	Financial Prudence	.402	.000	.682	6.192	.000

a. Dependent Variable: Organization performance

In terms of significant associations, study concludes that there is significant association between Financial Prudence and Insurance Industry Performance

Conclusion

The good response rate of (69.6%) provides the study with a clear and candid picture of how the insurance industry looks like in relation to strategic intelligence, strategic information Systems and Performance of the insurance industry. The duration of organization existence spanning from less than five years to more than 10 years indicate that for the organizations to be sustainable and constantly improve performance which ensures that they do not go out of business, then, to strategic intelligence plays a crucial role in achievement of this goal. An organization can be deemed as strategically sound in relation to the number of branches it has in existence and how far in geographical location they are spread thus the more the number of branches, the better placed a company is while also the number of employees is a key determinants of what an organization requires to meet the needs of its clients; the more the number of employees the broader and more dynamic a strategic plan should be. The coverage period of a strategic capacity suggest how focused an organization is and how best it has positioned itself to keep on growing, a review of the same self-awareness affect the manner in which an organization can adapt itself to the market as time goes by. A strategic capacity for logic that is reviewed on a needs basis serves an organization right as compared to strategic plans that are reviewed at a set time or period. Strategic intelligence was considered by the respondents as being very important to the various organizations including all it aspects and among them the key ones included the marching of the objectives and goals of the organization with the day to day activities in the concerned organizations. With regards to performance rating, the effectiveness of solvency and liquidity ratio is a key determinant in the generation of profits while market share was also suggested to be a determinant of performance. The growth of customer service has led to the increase in customer loyalty.

Strategic Intelligence is key and primary for any insurance organization that wants to grow and maintain its market share. A review of the same strategic creativity and problem solving plays a major role in determining how best a strategic plan has achieved the goals and objectives of an organization. On the other hand strategic information systems and performance is a review tool which helps

Firms see how best or poor they have achieved the set goals that existed in their Strategic reasoning. Strategic thinking should be one of the fundamental factors taken into consideration by insurance companies before they venture either into any market or the launch of new products or services; through strategic planning, an analysis can be done on both the in and out factors that will affect management decisions to be adopted by insurance companies. A review on strategic intelligence plays a crucial role in the determination of whether a strategic plan is achieving the goals for which it was intended for and on whether programmes that were set to be accomplished are on track in terms of period and resource distribution. A review period should also be set to the best interest of the organization to ascertain that bottle neck problems are mitigated before things get to peak level what cannot be reworked without adverse effect to the companies. Performance rating on the other had provides a simplistic tool through which companies can strategically troubleshoot their position in terms of performance and how best they can work on their drawbacks as well as continue improving on what they are doing best.

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