

Influence of Product Value on the performance of the Insurance Industry in Kenya

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Abstract

In view of firms financial prudence, firms see how best or poor they have achieved the set goals that existed in their Strategic reasoning. Financial prudence 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. A review on financial 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. Insurance company Performance rating on the other hand 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 this is important especially in making financial related decisions.

Key words; Product, Value, Performance, Insurance, Inputs

Introduction

Every organization or group that can separate its goals and objectives into the two streams of upper and lower decision making needs a strategy to reach success. All organizations, big and small, deserve such a service. In sum, strategic intelligence serves the needs of all those groups who want to plan carefully for mainstream achievement in the foreseeable future, whether they are corporate, regional, familial, or social. In the nineteenth and twentieth century's, intelligence practice evolved toward the form that is now recognizable in the context of current practice. To its detriment, the intelligence milieu is somewhat misunderstood by many observers (Rausch et al, 2013).

Performance measures in the Insurance Industry

In analyzing insurance firms, this study will measure the performance relative to other firms in the industry. The financial ratios to be used include such return on equity, return on assets, expense to premium ratios, net income ratio, average cost per claim. Non-financial measures will include agent performance, customer's satisfaction, and average time to settle a claim and customer retention.

The study will also use efficiency analyses in insurance and elsewhere focusing on production and cost efficiency with a focus on revenue and profit. Perhaps the most basic frontier is the

production, which is estimated based on the assumption that the firm is minimizing input use conditional on output levels. Production frontiers can be estimated even if data on input and output prices are unavailable. If data on input prices are available, it is possible to estimate the cost frontier, usually based on the assumption that the firm is minimizing costs conditional on output levels and input prices. Ultimately, of course, the firm also can optimize by choosing its level of output and/or output mix. The revenue and profit functions allow the firm to do this by maximizing revenues or profits, respectively, contingent only on input and output prices (Brealey R, 2009).

Performance measurement systems play a key role in developing strategy, evaluating the achievement of organizational objectives and compensating managers. Inadequacies in financial performance measures have led to innovations ranging from non-financial indicators of intangible assets and intellectual capital to balanced scorecards of integrated financial and non-financial measures. This article discusses the advantages and disadvantages of non-financial performance measures and offers suggestions for implementation (Trigeorgis, 2010).

The study will adopt both financial and non-financial measures to ensure a closer link to long-term organizational strategies. Financial evaluation systems generally focus on annual or short-term performance against accounting yardsticks. They do not deal with progress relative to customer requirements or competitors, nor other non-financial objectives that may be important in achieving profitability, competitive strength and longer-term strategic goals. For example, new product development or expanding organizational capabilities may be important strategic goals, but may hinder short-term accounting performance. By supplementing accounting measures with

non-financial data about strategic performance and implementation of strategic plans, companies can communicate objectives and provide incentives for managers to address long-term strategy.

Further, the drivers of success in many industries including insurance industry are intangible assets such as intellectual capital and customer loyalty, rather than the tangible assets allowed on to balance sheets. Although it is difficult to quantify intangible assets in financial terms, non-financial data can provide indirect, quantitative indicators of a firm's intangible assets. In addition, non-financial measures can be better indicators of future financial performance. Even when the ultimate goal is maximizing financial performance, current financial measures may not capture long-term benefits from decisions made now.

Similarly, investments in customer satisfaction can improve subsequent economic performance by increasing revenues and loyalty of existing customers, attracting new customers and reducing transaction costs. Non-financial data can provide the missing link between these beneficial activities and financial results by providing forward-looking information on accounting or stock performance.

The global perspective of insurance industry

In 2011, global economic activity continued to be uneven. While growth in developed countries surprised on the upside, emerging and developing economies grew slower than anticipated. Positives were stronger than expected consumption in the United States, declining and eventually stable oil prices, and resilience in the face of supply-chain disruptions caused by the earthquake in Japan. The slowdown in emerging and developing countries was likely a result of early monetary policy action in reaction to rising headline inflation (Ayele, 2013).

Financial markets remained volatile. At the beginning of 2012, the International Monetary Fund (IMF) diagnosed increased risks to financial stability. Developed and emerging economies were susceptible to spillovers from a potential intensification of the euro area crisis. Policy measures to contain potential adverse impacts included low interest rates in advanced economies. These rates continued to feed into low investment yields that now have prevailed for an extended number of years. The insurance sector appears to have weathered the challenges of 2011 well. Despite losses caused by an exceptional series of natural catastrophes in the Asia and Pacific region, non-life insurers and reinsurers appear to have recovered most of their capital over the course of the year. At the same time, declining interest rates and a widespread recovery of equity markets benefited the year-end valuation of financial assets held by life and non-life insurers. Later sections in this report will examine in more detail the operating and financial performance of life and non-life insurers in 2011 as well as their capital position at the end of the year (International, 2013).

According to preliminary estimates, in 2010 total insured losses for the global re-insurance industry from natural catastrophes and man-made disasters were US\$ 108 bn. This is more than double the losses registered in the previous year and close to the record of 2005, when hurricanes Katrina, Wilma and Rita caused claims of more than US\$ 100 bn in the United States alone. The table below shows the Insurance volumes, density and penetration in the world (Nena, 2013).

Table 1: Premium Insurance Density and Penetration

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Region	Country	Life Premiums USD Billion	Non-Life Premiums USD Billion	Total Premiums USD Billion	Insurance Density (USD)	Insurance Penetration %
Advanced Markets.	USA	567756	703128	1270884	4047	8.18
	Japan	524372	129740	654112	5167	11.44
	UK	205918	105500	311418	4350	11.27
	France	149346	93112	242459	3543	8.92
	Germany	106411	125497	231908	2804	6.74
	Italy	93273	50945	144218	2221	6.73
	Hong Kong	28979	3738	32717	4543	12.44
Emerging Markets	Brazil	44784	37483	82267	414	3.65
	Mexico	10844	13138	23982	206	2.04
	Russia	1732	24296	26027	182	1.33
	China	141208	104302	245511	178	2.96
	India	53300	13142	66441	53	3.96
Africa	Africa	49888	22002	71891	67	3.6

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The insurance industry just like many other organisations engage in hundreds, even thousands, of activities in the process of converting inputs to outputs. These activities can be classified generally as either primary or support activities that all businesses must undertake in some form. To ensure efficient operation and delivery of insurance services to customers, several players are involved in the value chain (Ayele, 2013). Products sold by insurers are divided into two main categories. Short Term or General insurance products provide protection for one year and below. Examples of short term products are medical, funeral and motor insurance. Long Term or Life insurance products provide protection for more than one year. Examples include whole life assurance, annuities and endowment insurance. Buyers of insurance can be divided into three main categories. Individual clients include you and me. Corporate clients include registered companies and the Government. The other categories are the foreign clients. Foreign clients buy Kenyan insurance services by buying cover from Kenyan insurers.

The main role of insurance companies is taking away risks or fears from you and promising to pay you for any losses or damage that may affect your property or life. Presently there are 46 registered direct insurance companies in Kenya, some offering general insurance, some life insurance while composite insurers sell both life and general. The products offered by insurance companies are generally the same although each company has a set of value added services for consumers. It is important that you seek advice before buying a policy as this will enable you buy a policy that will meet your needs (Insurers, 2013).

The way you are afraid of losses arising and adversely affecting your daily life, possessions or business is the same way insurers fear receiving claims that they may not be able to pay alone. They also buy insurance protection, this time from reinsurers. There are three locally incorporated reinsurers in Kenya include Kenya Reinsurance Corporation, East Africa Reinsurance Company and Continental Reinsurance. There are also two regional reinsurers including Africa Reinsurance Corporation and PTA Reinsurance (Zep Re) (International, 2013).

Ordinarily, insurance companies do not sell their products directly to consumers but often use intermediaries. Intermediaries are insurance agents, insurance brokers and medical insurance providers. The three are called intermediaries because they do not have products of their own to sell but only sell products of and on behalf of insurance companies. All intermediaries must be registered with the IRA and are issued with licenses every year. The difference between agents and brokers is that while agents only sell products of insurers they are authorized to represent, brokers are professionals who offer professional advice on insurance to their clients. Others may

include the medical insurance providers (MIP) are brokers who specialize in medical insurance business (Bakos, 2009).

Loss adjusters are specialized in adjusting loss amounts on behalf of insurers. Insurance Surveyors are appointed by insurers to survey, mostly properties to be insured against fire in order to advise insurers about the exact risk characteristics. This helps insurers to underwrite the risks appropriately. Motor Assessors are appointed also by insurers to assess your motor vehicle before the insurer can underwrite and insure it. Risk Managers are appointed by insurers to provide advice on loss prevention mechanisms. Their advice enables insurers to set terms, conditions and warranties in the policy that must be observed by the insured to minimize loss. Insurance investigators investigate losses on behalf of insurers after they have occurred (Akotey, 2013).

Product Development Theory

The majority of top insurance carriers are cultivating skills and leveraging partners focused on accelerating product development in order to compete with industry peers. They also are launching entire new marketing brands as a means of competition. Small, nimble carriers traditionally are able to respond more quickly to emerging market segments, getting the early jump on opportunities. Larger carriers are held back by their inability to centralize information and modify master product catalogs. They need those abilities to quickly respond to competitive pressures and implement new marketing strategies and products (Van de Ven and Rogers, 1988; Wolfe, 1994; and Slappendel, 1996).

High-performance product design and development (PD&D) technology, coupled with business process automation, can help insurers improve financial ratios and the non-financial aspects of their businesses, positioning their organizations for future success. It can help them improve three key areas: increase sales by significantly reducing PD&D cycle time up to 65 percent, specifically across product research, validation, design, development, maintenance and deployment, increase customer value by dramatically improving product quality perception and increase personnel productivity and improve organizational alignment for both captive and independent producer networks (Edvardsson, 2005).

An optimized PD&D process must help insurers create niche products quickly based on even the most narrowly defined market segments. Carriers in North America and Western Europe quickly are adopting PD&D to identify this niche, underserved small- and midsize-market segments that are highly profitable. Optimized PD&D also can improve an organization's capability to quickly respond to small markets where many carriers lack control over multi-national or conglomerate product catalogs that focus on geographic profitability, or provide a heightened awareness of producer product and channel performance. By creating narrower risk selections, PD&D can provide improved accuracy in product pricing by increasing the ability to accurately match risk to price. Another key benefit is an improved ability to generate reports and filings, leading to greater regulatory compliance. Insurers have many requirements for their PD&D solutions as they strive to meet ever-increasing regulatory compliance obligations, industry pricing pressures and challenging customer recruitment and retention. Many product configurators only answer part of the requirements. Product configurators traditionally focus in three areas: product design, product testing, and product management (Bose, 2008).

While this is a good start for insurers engaged in PD&D processes, insurers will require much more collaboration and interoperability as they expand their thinking about product development across the broader community. To meet their numerous obligations, insurers need to look for new PD&D vendor solutions that will better integrate people, existing legacy applications and best-of-breed providers to support these new requirements (Ibid).

Product Value

The value performance indicators focus on how much the insured, on average, receive for their money. The higher incurred claims ratio means that on average, more financial benefits are being paid back to the insured in relation to premium cost (increased value). On the other hand, high net income and high expenses have the opposite effect of reducing value since less money is available for benefits. Changes in product value drive the awareness and satisfaction indicators such as in the case of member-based schemes where members increase or decrease their participation in reaction to the changes in value (Bose, 2008).

Clearly, the three indicators also address viability (Incurred Expense Ratio, the efficiency of the delivery of insurance; Incurred Claims Ratio, the value of insurance to the insured and; Net Income Ratio, the viability of insurance product or programme). Without a positive net income the programme will not achieve viability and will become reliant on subsidies to survive. A positive net income, on the other hand, cannot be realized without a proper combination of expenses and benefits (Akotey, 2013).

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.

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

$$n = Z^2 * p * (1-p) / d^2 \quad \text{where;}$$

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)

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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

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6 + e$$

Where:

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

{ β_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

Results shows that all Product Value had a skewness and kurtosis values between -1.0 and +1.0, and it was concluded that Product Value was normally distributed since it lay with the ± 1 range recommended by Myoung (2008).

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Table 2: Normality Test

Variables	skewness	Std. Error	Kurtosis	Std. Error
Product Value	-0.345	2.011	0.534	-0.021
Organization Performance	-0.632	1.003	-0.132	0.034

Regression model indicates that the relationship between Product Value and Insurance Industry Performance (IIP) was positive given that the coefficient of determination R- square is 0.330 at 0.05 levels of significance. The findings indicated that 33%, of the variation of Insurance Industry Performance is influenced by Product Value. The findings also show that there was a linear relationship between Product Value and Insurance Industry Performance.

The overall model shown on Table 3 indicates that Product Value was highly significant with p-values less than 0.05. The finding further confirms that the entire null hypothesis were rejected hence there was significant relationship between dependant variable and independent variables. The fitted models were: $Y = 3.627 + 0.007X_1 + 0.002X_2 + 0.102X_3 + 0.011X_4 + 0.003X_5$ and $Y = 3.469 - 0.027X_1 * X_6 + 0.010X_2 * X_6 + 0.102X_3 * X_6 + 0.029X_4 * X_6 + 0.217X_5 * X_6$. However, despite the strong relationship between dependant and explanatory variables for both models, model 2 was more superior than model 1 since it was characterized by high coefficient of determination value.

Table 3: Overall Coefficient

Model		Unstandardized		Standardized	t	Sig.
		Coefficients		Coefficients		
		B	Std. Error	Beta		
1	(Constant)	3.627	.063		58.020	.000
	Product Value	.007	.001	-2.207	-8.355	.000
	Product Awareness	.002	.000	.917	6.342	.000
	Product Satisfaction	.102	.000	.868	5.407	.000
	Service Quality	.011	.000	.520	3.130	.003
	Financial Prudent	.003	.000	.857	7.036	.000
2	(Constant)	3.469	.083		41.890	.000
	Product Value*X ₆	.027	.003	-1.405	-8.170	.000
	Product Awareness*X ₆	.010	.001	.718	7.239	.000
	Product Satisfaction*X ₆	.102	.001	.715	6.251	.000
	Service Quality*X ₆	.029	.002	.392	3.527	.001
	Financial Prudent*X ₆	.217	.001	.685	7.727	.000

a. Dependent Variable: Organization performance, X₆=Strategic information system

Conclusion

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 Product Value like levels of customer satisfaction, speed of claims settlement and also quality of underwriting services. Strategic

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Intelligence is the key and road map to be followed by any insurance company that aspires to succeed in the undefined industry climate; consumers are evolving and have new preferences and options for better products thus an insurance company that wants to remain productive should be in the business of finding out why consumers would choose one product or service over the other and meet this need. The quality of customer service has proven to be the yard stick of determining whether companies will retain and get new customer or lose them. Insurance companies should ensure that their underwriting is done promptly and accurately to ensure that consumers get professional customer service. Market share being an indicator of performance, insurance companies need to be aware of their current market share, why they stand as they are and what strategies can they adopt to ensure they increase in their market share.



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