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DETERMINANTS OF FINANCIAL PERFORMANCE OF INSURANCE FIRMS: A SURVEY OF SELECTED INSURANCE FIRMS IN NAIROBI COUNTY

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ABSTRACT

The study investigated the determinants of financial performance of selected insurance firms in Nairobi County. The target population was 55 licensed insurance firms (42 locally owned insurance firms and 13 Foreign owned insurance firms). The study used two respondents in each insurance firm who were Finance Managers and Corporate Affairs Managers and all these had total of 96 respondents. The study used both primary and secondary data. The main primary data source was semi structured questionnaire. The data from the study was analyzed qualitatively and quantitatively using percentages, means and frequency distribution with the aid of Statistical Package for Social Sciences (SPSS) version17. Since data was descriptive, variants such as means, frequencies and percentages were used to describe the findings of the study. Bivariate – ANOVA statistical data analytical technique was used to find the determinants of financial performance of selected insurance firms in Nairobi County. The study concluded that insurance firms had liquid investments which helped them to settle claims especially if their underwriting income cannot cover claims. The firms would sell off their investments if they lacked money to settle claims. Majority of insurance firms relied on cash flow from operations in liquidity management. This implied that all firms had certain source of funds for liquidity management. The study recommended that insurance firms should establish a well matched portfolio of their assets and liability in terms of cash flows or rather they should ensure that they create additional reserve so that it can assist them to cover the interest rate since low interest may create a discrepancy on the earnings.

Key Terms: Equity Returns, Financial performance, Liquidity, Premium Rate, Resources, Retention Ratio, Stakeholders

INTRODUCTION

Financial performance is one of many different measures to evaluate how well a firm is using its resources to generate income. Good examples of financial performance include operating income, earnings before interest and taxes, and net asset value (Ngui, 2010). Business executives use financial statements to draft a comprehensive financial plan that will maximize shareholders wealth and minimize possible risks that may preexist. Financial statements evaluate the financial position and performance of a firm. These statements are prepared and produced for external stakeholders for example: shareholders, government agencies and lenders (Ramadhan, 2010).Assessment of a firm's performance should take into account many different measures as there are several factors that determine the performance of economic organization including asset base, leverage, performance of the loan book, corporate governance and the quality of staff and regulations in the industry. The essence of financial performance measurement is to provide the organization with the maximum return on the capital employed in the business (Ngui, 2010).

The financial performance measures the financial soundness and health of the organization in monetary terms and thus, can be used to compare the performance of different corporations within any particular industry or between the industries. The financial performance of the insurance firms plays a pivotal role in the growth of the industry as a whole, which ultimately contributes to the success of an economy (Iswatia, & Anshoria, 2007).Insurers' profitability is influenced by both internal and external factors. Whereas internal factors focus on an insurer's-specific characteristics, the external factors concern both industry features and macroeconomic variables. The profitability of insurance firms can also be appraised at the micro, meso and macro levels of the economy. The micro level refers to how firm-specific factors such as size, capital, efficiency, age, and ownership structure affect profitability. The meso and macro levels refer to the influence of support-institutions and macroeconomic factors respectively. At the micro level, profit is the essential pre-requisite for the survival, growth and competitiveness of insurance firms and the cheapest source of funds (Buyinza et al., 2010).The financial performance of a general insurance underwriter would be affected by how much of the available funds are deployed in assets that earn a return and also how big that rate of return is (Chen and Wong, 2004).Losses incurred or total claims expense to premiums earned denotes the underwriting results or essentially the quality of business underwritten. The lower the loss ratio, the better the financial performance. Expense ratio is the total expenses (excluding claims) to premiums written and basically indicates the operational efficiency in managing the general insurance firm. The higher the expense ratio, the worse the financial performance. The sum of the loss and expense ratios is referred to as the combined ratio, and the lower it is the better the financial performance (Leverty and Grace, 2010; Chen and Wong, 2004; and Hirao and Inoue, 2004).

Sigma (2001) contends that the largest insurance sectors are to be found in the United States and Japan, which together generate more than 50 percent of global premium income, followed by the United Kingdom, Germany, France, and Italy. Furthermore, during the last four decades the global insurance sector has on average outpaced global economic growth. Between 1984 and 2001, the global insurance industry grew with an annual growth rate of 9.7 percent (roughly comprised of 11.8 percent from the life insurance sector, and 7.5 percent from the property casualty sector). Over the last few years, growth in the global property casualty market has significantly slowed down and has only grown in line with general economic growth (Sigma, 2001).The Ghanaian insurance industry has undergone significant changes such as:

the transformation of the industry from state-led to a market-driven one due to the privatization2 of state-owned insurance firms; the legal separation of insurance firms into life and non-life entities; and the massive influx of foreign insurers onto the market. All of these changes have resulted in a keener competition in the industry (Buyinza et al., 2010).

According to an IRA annual report released in the year (2012), the Kenyan general insurance industry comprises of 23 firms. According to the Association of Kenya Insurers, general insurance penetration as at 2012 stood at 2.08%, this was represented by gross written premium of Kshs 71.46 billion. The general insurers' profitability was Kshs 11.82 billion for the year.

Insurance in Kenya is widely grouped as general (non-life) insurance and life insurance. General insurance includes motor-commercial, motor-private, fire-domestic, aviation, fire-industrial and engineering, theft, workmen's compensation, marine. Any insurance policy that is undertaken and does not cover against the life of an individual is referred to as non – life insurance or general insurance. Nairobi controls 79.77% in terms of premiums (IRA, 2014). In Nairobi there are a total of 50 insurance firms, 3 reinsurance firms, 198 insurance brokers, 4 reinsurance brokers and 5,155 insurance agents. Kenya's insurance penetration stands at 3.0% compared to its peer-countries in the Sub-Saharan Africa region as at 31st December 2014. The country has remained under-tapped in insurance, particularly within the middle to low-income bracket, which still remains informal. The industry is regulated by Insurance Regulatory Authority (IRA), a body formed under the Insurance Act Cap 487 of the Laws of Kenya. The Association of Kenya Insurers (AKI) was established in 1987 as a consultative and advisory body to insurance firms and registered under the society act Cap 108. Insurance Institute of Kenya (IIK) has dealt with training and professional education of insurance in the country.

According to Insurance Industry Annual Report 2012, the insurance industry recorded a gross written premium of Kshs 108.54 billion in 2012 compared to Kshs 91.60 billion in 2011 representing an increase of 18.49%. Gross earned premium increased by 19% to stand at Kshs 84.38 billion in 2012 compared to 70.92 billion in 2011(IRA, 2012). Some of the achievements in insurance industry in 2012 according to the Kenya Insurance Industry Outlook 2013 include growth as indicated by increased premium income, investment income, business network expansion as well as increased market share. Product development is also another key development which involved new product launch resulting in enhanced product mix. There were also improved claims settlement, claims reduction and minimization of claims management costs. (IRA, 2013)

The Kenya Insurance Outlook 2013 identified Key drivers of insurance industry in 2012.Among them is marketing strength which comprised of reaching new market segments,expanded branch networks, using alternative distribution channels and improved intermediary network. Staffing is another key driver of insurance industry in Kenya in 2012 and involved staff retention and setting of a staff quality assurance and development strategy. (IRA, 2013).With proposals in the 2015/2016 National Budget Statement to increase the paid-up capital to KES 400 million for long term insurers, KES 600 million for general insurers and KES 1 billion for reinsurers, it is expected that this will further enhance industry stability especially as the Authority implements risk based supervision(IRA Annual Report,2014)

Insurance firms are in the business of taking risks. Worldwide these firms underwrite policies that deal with specific risks, and in many cases, even

underwrite exotic risks. In carrying its core activities, i.e., pricing, underwriting, claims handling and reinsurance management, an insurer will face a wide range of risks which are often interlinked and if not properly managed, could threaten the ability of the institution to achieve and sustain its viability (Adams and Buckle, 2008).

Objectives of the Study

- To determine the effect of firm size on the financial performance of selected insurance firms in Nairobi County.
- To examine the effect of liquidity on the financial performance of selected insurance firms in Nairobi County.
- To evaluate the effect of equity returns on the financial performance of selected insurance firms in Nairobi County.
- To establish the effect of premium rate on the financial performance of selected insurance firms in Nairobi County.

RELATED LITERATURE

Theoretical framework

Stake Holders Theory

Laplume (2008) notes that most scholarly works on stakeholder theory generally credit R. Edward Freeman as the "father of Stakeholder Theory." The model of man in stewardship theory is based upon the assumption that the manager will make decisions in the best interest of the organization, putting collectivist options above self-servicing options. This type of person is motivated by doing what is right for the organization, because she believes that she will ultimately benefit when the organization thrives. The steward manager maximizes the performance of the organization, working under the premise that both the steward and the principal benefit from a strong organization (Mallin, 2010).

At the heart of stakeholder theory, is the investigation of the relationship between corporate social performance (CSP) and corporate financial performance. As a "theory of organizations", stakeholder theory helps to nourish a relational model of organizations by revisiting questions about "who" is actually working with (and in) the firm and hence who should, as a cardinal principle be given priority in order to achieve the maximum value of the firm both today and in the long-run (Freeman, 2004). According to Donaldson and Davis (2004), managers are good stewards of the corporations and diligently work to attain high levels of corporate profit and shareholders returns. Those financial managers are principally motivated by achievement and responsibility needs. The finance managers will always strive to invest their resources under their custody optimally so as to maximize the shareholders' wealth.

Agency Theory

The principal-agent theory is an agency model developed by economists that deals with situations in which the principal is in position to induce the agent, to perform some task in the principal's interest, but not necessarily the agent's (Health and Norman, 2004). Firms that separate the functions of management and ownership will be susceptible to agency conflicts (Lambert, 2001). They show that regardless of who makes the monitoring expenditures, the cost is borne by stake holders. Debt holders, anticipating monitoring costs, charge higher interest. The higher the probable monitoring costs, the higher the interest rate and the lower the value of the firm to its shareholders all other things being the same. There are three types of agency costs which can help explain financial performance. Asset substitute effect: as debt to equity increases, management has an increased incentive to undertake risky projects. This is because if the

project is successful, shareholders get all the upside, where as if it is unsuccessful, debt holders get all the downside. If the projects are undertaken, there's a chance of firm value decreasing and a wealth transfer from debt holders to shareholders. Underinvestment problem: if debt is risky, the gain from the project will accrue to debt holders rather than shareholders. Thus, management has an incentive to reject positive net present value projects, even though they have the potential to increase firm value. Free cash flow: unless free cash flow is given back to investors, management has an incentive to destroy firm value through empire building and perks etc. Increasing leverage imposes financial discipline on management. (Soundry , 2007)

According to Jensen and Meckling (2006), complete protection would require the specification of extremely detailed protective covenants and extra ordinary enforcement costs. As residual owners of the firm, the stock holders have an incentive to see that monitoring costs are minimized up to a point. Monitoring costs may limit the amount of debt that's optimal for a firm to issue. It's likely that beyond a point the amount of monitoring required by debt holders increases with the amount of debt outstanding. When there's little or no debt, lenders may engage in only limited monitoring. Costs associated with protective covenants are substantial and rise with the amount of debt financing. Shareholders incur monitoring costs to ensure manager's actions are based on maximizing the firm's value. Jensen and Meckling (2006) further noted that with increasing costs associated with higher levels of debt and equity an optimal combination of debt and equity might exist that minimizes total agency costs.

Conceptual Framework

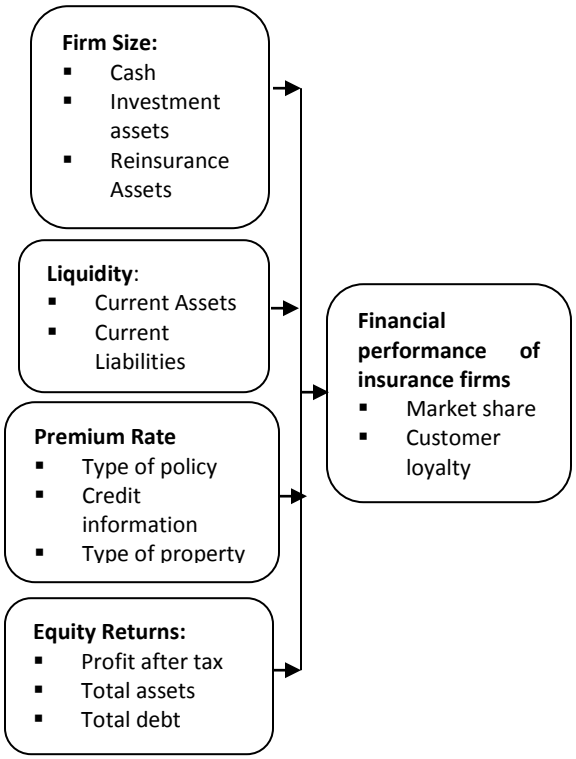

Figure 1: Conceptual Framework

Firm Size and Financial Performance

The size of the firm affects its financial performance in many ways. Large firms can exploit economies of scale and scope and thus being more efficient compared to small firms. Size can be determined by net premium which is the premium earned by an insurance firm after deducting the reinsurance ceded. The premium base of insurers dictates the quantum of policy liabilities to be borne by them (Ahmed, 2010; and Teece, 2009).Brown, Carson and Hoyt (2011), identified important economic and market factors and insurer specific characteristics related to the life insurer performance. In the study financial performance was positively related to the size and liquidity band portfolio returns whereas negatively related to anticipate inflation. Large insurance firms normally have greater capacity for dealing with adverse market fluctuations than small insurance firms. Hardwick (2009) suggested that

large insurers are likely to perform better than small insurers because they can achieve operating cost efficiencies through increasing output and economizing on the unit cost of innovations in products and process development. A positive linkage between firm size and its financial performance is expected, since large firms have more resources, a better risk diversification and better expenses management. Scherer (2010) have argued that large firms possess monopoly power which allows them to set prices above the economic costs involved in the production of the products resulting in additional profit for the larger firms.

Adams (2009) believes that large firms are able to diversify their investment portfolios and this could reduce their business risks. Grace and Timme (2012) suggest that large firms generally outperform smaller ones because they manage to utilize economies of scale and have the resources to attract and retain managerial talent. Swiss (2008) research on the relationship among firm characteristics including size, age, profitability and growth indicated that large firms are found to grow faster than small smaller and younger firms found to grow faster than older firms. Hence, most of the researchers in insurance have found a positive relationship between size and profitability.

Liquidity and Financial Performance

Chen and Wong (2004) revealed that size, investment and liquidity are significant determinants of the profitability of insurers. However, Ahmed et al., (2011) in a similar study of the Pakistani life insurance industry, claimed that liquidity is not a significant determinant of insurers' profitability. They posited that, whereas size and risk (loss ratio) are significant and positively related to the profitability of insurance firms, leverage is negative and hence decreases the profitability of insurers significantly. Adams and Buckle (2013) argued that highly geared and low liquid Bermuda insurers perform better and that their underwriting risk is directly related to a resilient financial performance. This seems to suggest that actuarial risk and operational risks are properly managed by Bermuda insurers. Adams and Buckle further posited that insurers' size and scope of business do not have significant influence on financial performance.

Mazlan & Mohamad (2009) stated that, due to the limited literature and empirical evidence on this topic, it is believed that related studies on insurance firms would be able to provide useful insight and information on factors affecting the financial performance of the takaful firms in Malaysia. According to Shiu (2007), firms with more liquid assets are likely to perform better as they are able to realize cash at any point of time to meet its obligation and are less exposed to liquidity risks. By not having sufficient cash or liquid assets, insurance firms may be forced to sell investment securities at a substantial loss in order to settle claims promptly. However, there are contrasting views with regard to performance and liquidity in relation to the agency theory. According to Pottier (2008), high liquidity could increase agency costs for owners by providing managers with incentives to misuse excess cash-flows by investing in projects with negative net present values and engaging in excessive perquisite consumption.

According to Adam and Buckle (2013), liquidity measures the ability of managers in insurance and reinsurance firms to fulfill their immediate commitments to policyholders and other creditors without having to increase profit from underwriting and investment activities and/or liquidate financial assets. Therefore, having high liquidity obviates the need for the management of the insurance firms to improve their financial performance. Consequently, there is no prior expectation on the direction of the relationship between performance and liquidity. A Study by Adams and Buckle (2009) also indicates limitations due to concentration on one segment that is relatively small, highly concentrated and

largely unregulated. It is also observed that the previous studies focus mainly on insurers operating in the United States, United Kingdom and other developed countries. Chen (2004) revealed that liquidity has a significant statistical impact on financial performance of insurance firms. In contrast, Adams & Buckle (2010) found a negative relationship between liquidity and profitability. Ahmed, Ahmed, & Usman, (2011) in there study in Pakistan found that ROA has statistically insignificant relationship with liquidity. On the other hand, Hakim and Neaime (2005) observed that liquidity and investment are the important determinants of bank's profitability, which also applies to insurance.

Equity Returns and Financial Performance

According to Lee(2008) , equity capital which is the capital raised from owners in the firm, is the residual claimant or interest of the most junior class of investors in assets, after all liabilities are paid; if liability exceeds assets, negative equity exists. In an accounting context, shareholders' equity represents the remaining interest in the assets of a company, spread among individual shareholders of common or preferred stock; a negative shareholders' equity is often referred to as a positive shareholders' deficit. More capital influx enables the firm to expand and open new branches, which in turn may lead to growth and possibly would be accompanied by economies of scale and hence improved financial performance (Hansen, 2009).

According to Athanasoglo (2005) the effect of a growing size of a bank on profitability has been proved to be positive to a certain extent. Consequently, a positive relationship is expected between size and profitability by many insurance area researchers. However, for firms that become extremely large, the effect of size could be negative due to bureaucratic and other reasons Yuqi (2007). Hence, the size-profitability relationship may be expected to be non-linear. Therefore most studies use the real assets in logarithm and their square in order to capture the possible non-linear relationship. Booth, Cooper, Haberman and James (2009) are of the view that equities have the benefit of providing inflation hedge and over the long term, the investment would be expected to give higher real returns than fixed interest investments. However, a higher proportion of investment in equities could lead to a higher risk of insolvency if the values of the assets dropped. Curak, Pervan and Marijanovic (2011) indicated that firm size, underwriting risk; inflation and equity returns have significant association with composite insurers‟ financial performance. General financial institutions tend to hold a relatively low proportion of their investment portfolios in equities because a high proportion of the portfolios in equities could increase insolvency risk.

Premium rate and Financial Performance

In Poland, a panel study of 25 non-life insurance firms by Kozak (2011) revealed that the value of gross premiums is positive and a significant parameter of the profitability and efficiency of insurance firms. He, however, identified a negative relationship between profitability and lack of specialization or expertise in few cost-effective products. Premium growth measures the rate of market penetration. Empirical results showed that the rapid growth of premium volume is one of the causal factors of insurers' insolvency (Kim et al. 2005). Being too obsessed with growth can lead to self-destruction of the firm as other important objectives may be neglected.Ahmed et al., (2011) also investigated the impact of firm level characteristics on the performance of the life insurance sector of Pakistan over the period of seven years from 2001 to 2007. The results revealed that growth of written premium and age of a firm has also negative relation to performance of life insurance firms but they are statistically insignificant.

Measurement of Financial Performance

Financial performance is a measure of an organization's earnings, profits, appreciations in value as evidenced by the rise in the entity's share price (Asimakopoulos, Samitas, and Papadogonas, 2009). Insurer's profitability is influenced by both internal and external factors. Whereas internal factors focus on an insurer's specific characteristics, the external factors concern both industry features and macroeconomic variables. The profitability of insurance firms can also be appraised at the micro, meso, and macro levels of the economy. The micro level refers to how firm-specific factors such as size, capital, efficiency, age, and ownership structure affect profitability.

The meso and macro levels refer to the influence of support-institutions and macroeconomic factors respectively. These factors include; Debt leverage which is measured by the ratio of total debt to equity (debt/equity ratio). This ratio shows the degree to which a business is utilizing borrowed money. It reflects insurance firms' ability to manage their economic exposure to unexpected losses. This ratio represents the potential impact on capital and surplus of deficiencies in reserves due to financial claims (Adams and Buckle, 2000). Another determinant of financial performance is the level of liquidity. Liquidity refers to the degree to which debt obligations coming due in the next twelve months can be paid from cash or assets that will be turned into cash. Insurance liquidity is the ability of the insurer to fulfil their immediate commitments to policyholders without having to increase profits on underwriting and investment activities and/or liquidate financial assets (Chaharbaghi and Lynch, 2009). The cash and bank balances are to be kept sufficient to meet the immediate liabilities towards claims due for payment but not paid.

The size of the firm is another factor that determines an insurance firm's financial performance. The size of the firm affects its financial performance in many ways. Large firms can exploit economies of scale and scope and thus being more efficient compared to small firms (Ahmed, Ahmed, and Ahmed, 2010). The size is determined by net premium which is the premium earned by an insurance firm after deducting the reinsurance ceded. The premium base of insurers decides the quantum of policy liabilities to be borne by them (Teece, 2009). Net Premium is expressed as the Total Premium earned less Reinsurance ceded. Another factor is the age of a firm. Evidently, older firms are more experienced, have enjoyed the benefits of learning, are not prone to the liabilities of newness, and can therefore; enjoy superior performance (Shiu, 2004). Older firms may also benefit from reputation effects, which allow them to earn a higher margin on sales. On the other hand, older firms are prone to inertia, and the bureaucratic ossification that goes along with age; they might have developed routines, which are out of touch with changes in market conditions, in which case an inverse relationship between age and profitability or growth could be observed (Demirgüç-Kunt and Maksimovic, 2008).

The other factor determining financial performance is underwriting risk which reflects the adequacy, or otherwise, of insurers' underwriting performance (Adams and Buckle, 2000). Sound underwriting guidelines are pivotal to an insurer's financial performance. The underwriting risk depends on the risk appetite of the insurers (Hansen, 2009). In an accounting context, shareholders' equity (or stockholders' equity, shareholders' funds, shareholders' capital) represents the remaining interest in the assets of a firm, spread among individual shareholders of common or preferred stock; a negative shareholders' equity is often referred to as a positive shareholders' deficit (Lee, 2008). More capital influx will enable the players to expand and open new branches, which in turn will incur more operating expenses.

Retention ratio is the percentage of the underwritten business which is not transferred to reinsurers. A higher retention ratio with lower claims ratio is likely to impact on the performance of insurers' positively. A more efficient insurance firm should have growth in profits since it is able to maximize on its net premiums and net underwriting incomes (Charumathi, 2012). Another factor that impacts the financial performance of an insurance firm is the ownership. There are two main dimensions of the ownership structure: Ownership concentration that is., the distribution of shares owned by majority shareholders and identity of owners especially, foreign investors and institutional investors. Ownership structure influences the management of the firm to either pay dividends or interest, or decide whether to retain much of its profits for further use in the firm (Agiobenebo and Ezirim, 2002).

METHODOLOGY

This study used descriptive research design which is a method or process of collecting data in order to answer questions concerning current status of the subjects in the study (Gay & Airasian, 2007). The sample size was determined by using the simplified Taro Yamane (1967) which is recommended for a population of below 10,000;

$$n = \frac{N}{1 + N(e^2)}$$

Where n = Sample size

N = Population size

e = level of precision and for this case at 95% confidence level (Yamane, 1967).

$$n = \frac{55}{1 + 55(0.05^2)} = \mathbf{48}$$

Therefore 48 insurance firms were selected for the study.

The study used the following model to determine the relationship between variables.

$$\mathbf{Y = ß0 + ß_1X_1 + ß_2X_2 + ß_3X_3 + ß_4X_4 + \varepsilon}$$

Where by

Y Financial Performance (value of dependent variable)

$ß_0$ Constant Variable (The value of dependent valuable when all the independent variables are Zero)

$ß_i$ Coefficient for X_i (i=1,2,3,4)

X_1 Firm Size

X_2 Liquidity

X_3 Equity Returns

X_4 Premium Rate

β1..β4 The corresponding coefficients for the respective independent variables

ε An error term

RESEARCH FINDINGS

Financial Performance

Table 1: Financial Performance Dimension

Financial Performance Dimension	N	Mean	Std. Deviation
Interest rates affect the financial performance of insurance firms	76	4.8289	.37906
Profitability affect its financial performance of insurance firm's	76	4.9079	.29110
Competition affects financial performance of insurance firms	76	4.8026	.40066
Market share affects the financial performance of insurance firms	76	4.6316	.64997

As shown in the Table 1 above, the researcher sought respondent's views on the extent of determinants of financial performance of selected insurance firms in Nairobi County: whether interest

rates affected the financial performance of insurance firms had a mean of 4.8289 and a standard deviation of 0.37906. Profitability effects in financial performance of insurance firm's had a mean of 4.9079 and a standard deviation of 0.29110. Competition effects in financial performance of insurance firms had a mean of 4.8026 with a standard deviation of 0.40066. Market share effects in the financial performance of insurance firms had a mean of 4.6316 with a standard deviation of 0.64997.

Firm Size Dimension

The respondents were asked to give out their opinion on the effect of firm size on the financial performance of selected insurance firms in Nairobi County. The responses were put in percentage form and presented in the table below;

Table 2: Firm Size Dimension

Firm Size Dimension	N	Mean	Std. Deviation
The size of the firm affects the financial performance of an organization	76	4.9474	.22478
The firms resources, accounting staffs and sophisticated information systems result in more profitability	76	4.1184	.61029
Large insurers are likely to perform better than small insurers because they can achieve operating cost efficiencies	76	5.5263	.76073
The level of Reinsurance Assets affects the financial performance of an organization	76	4.2763	.94655

As shown in the Table 2 above, the researcher sought respondent's views on the effect of firm size on the financial performance of selected insurance firms in Nairobi County: whether size of the firm affecte the financial performance of an organization had a mean of 4.9474 and a standard deviation of 0.22478. The firm's resources, accounting staff and sophisticated information systems result in more profitability the firm's resources, accounting staff and sophisticated information systems result in more profitability had a mean of 4.1184 and a standard deviation of 0.61029. Large insurers were likely to perform better than small insurers because they could achieve operating cost efficiencies had a mean of 5.5263 with a standard deviation of 0.76073. The level of Reinsurance Assets affects the financial performance of an organisation was supported by a mean of 4.2763 with a standard deviation of 0.94655. The findings above concurred with the study by Hardwick (2009) who suggested that large insurers were likely to perform better than small insurers because they could achieve operating cost efficiencies through increasing output and economizing on the unit cost of innovations in products and process development. The also concur with Adams (2009) who believes that large firms are able to diversify their investment portfolios and this could reduce their business risks. Grace and Timme (2012) suggest that large firms generally outperform smaller ones because they manage to utilize economies of scale and have the resources to attract and retain managerial talent.

On the extent of firm size on the financial performance of an organization, the respondents were asked to give out their opinion on the extent of firm size affect the financial performance of an organisation. The responses were put in percentage form and presented in the table and chart below;

Table 3: Extent of firm size on the financial performance of an organisation

Responses	Frequency	Percentage (%)
Moderate Extent	17	22%
To a Great Extent	24	33%
To a Very Great Extent	25	45%
Total	**76**	**100**

Further the researcher wanted to determine the extent to which firm size affect the financial performance of the insurance firm: the results showed that 45% of the respondents maintained it affects to a very great extent, 33% respondents indicated it affects to a great extent and 22% of the respondents held that it affects at moderate extent. Majority 78% of the respondents (i.e. 45%+33%) argued that it does affect to a great extent. The implications are that firm size is an essential factor for the performance of the insurance firm, thus should not be compromised at all costs.

Liquidity Dimension

The respondents were asked to give out their opinion on the effect of liquidity on the financial performance of selected insurance firms in Nairobi County. The responses were put in percentage form and presented in the table below;

Table 4: Liquidity Dimension

Liquidity Dimension	N	Mean	Std. Deviation
High liquidity hinders the need for management to improve annual operational performance	76	4.5395	.68197
The firm can sell off their investments if it does not have enough money to settle claims	76	2.6184	1.36594
The firm's financial strength can meet the policyholders' obligations	76	3.9474	.89286
The firm used portfolio's level of cash and short-term investments during liquidity management	76	4.7237	.45015
The firm used cash flow from operations during liquidity management	76	4.5132	.87168

As shown in the Table 4 above, the researcher sought respondent's views on the effect of liquidity on the financial performance of selected insurance firms in Nairobi County: whether High liquidity hinders the need for management to improve annual operational performance a mean of 4.5395 and a standard deviation of 0.68197. The firm can sell off their investments if it does not have enough money to settle claims had a mean of 2.6184 and a standard deviation of 1.36594. The firm's financial strength can meet the policyholders' obligations a mean of 3.9474 with a standard deviation of 0.89286.

The firm used portfolio's level of cash and short-term investments during liquidity management had a mean of 4.7237 with a standard deviation of 0.45015 and finally whether the firm used cash flow from operations during liquidity management was supported by a mean of 4.5132 with a standard deviation of 0.87168.These findings are in line with the study by According to Shiu (2007) who indicated that firms with more liquid assets are likely to

perform better as they are able to realize cash at any point of time to meet its obligation and are less exposed to liquidity risks. By not having sufficient cash or liquid assets, insurance firms may be forced to sell investment securities at a substantial loss in order to settle claims promptly.

On extent of liquidity on the financial performance of an organization, the respondents were asked to give out their opinion on whether the tasks were automated or non-automated. The responses were put in percentage form and presented in the table below;

Table 5: Extent of liquidity on the financial performance of an organization

Responses	Frequency	Percentage (%)
Moderate Extent	11	14%
To a Great Extent	23	30%
To a Very Great Extent	42	56%
Total	**76**	**100**

Further the researcher wanted to determine the extent to which liquidity affected the performance of the organization: the results showed that 56% of the respondents maintained it affected to a very great extent, 30% respondents indicated it affected to a great extent and 14% of the respondents held that it affected at moderate extent. The implications were that liquidity was an essential factor for the performance of the insurance firm, thus should not be compromised at all costs.

Equity Returns Dimension

The respondents were asked to give out their opinion on the effect of equity returns on the financial performance of selected insurance firms in Nairobi County. The responses were put in percentage form and presented in the table and chart below;

Table 6: Equity Returns Dimension

Equity Returns Dimension	N	Mean	Std. Deviation
The level of equity returns affects the financial performance of an organization	76	4.8816	.32525
The volume of capital is a major pull factor for the financial performance	76	4.9342	.24956
Taking an excessive underwriting risk can affect the firm's stability through higher expense	76	4.8553	.35417
Capital influx enables the firm to expand hence improved financial performance	76	4.9079	.29110
A higher proportion of investment in equities could lead to a higher risk of insolvency	76	4.6316	.62912

As shown in the Table 6 above, the researcher sought respondent's views on the effect of equity returns on the financial performance of selected insurance firms in Nairobi County: whether the level of equity returns affects the financial performance of an organization had a mean of 4.8816 and a standard deviation of 0.32525. The volume of capital is a major pull factor for the financial

performance had a mean of 4.9342 and a standard deviation of 0.24956. Taking an excessive underwriting risk can affect the firm's stability through higher expense had a mean of 4.8553 with a standard deviation of 0.35417 and finally whether the A higher proportion of investment in equities could lead to a higher risk of insolvency had a mean of 4.6316 with a standard deviation of 0.62912. These findings are in line with those of Curak, Pervan and Marijanovic (2011) who indicated that equity returns have significant association with composite insurers' financial performance. Insurance firms institutions tend to hold a relatively low proportion of their investment portfolios in equities because a high proportion of the portfolios in equities could increase insolvency risk. Booth, Cooper, Haberman and James (2009) are of the view that equities have the benefit of providing inflation hedge and over the long term, the investment would be expected to give higher real returns than fixed interest investments. However, a higher proportion of investment in equities could lead to a higher risk of insolvency if the values of the assets dropped.

On extent of equity returns on the financial performance of an organization, the respondents were asked to give out their opinion on the extent of equity returns affect the financial performance of an organisation. The responses were put in percentage form and presented in the table below;

Table 7: Extent of equity returns on the financial performance of an organisation

Responses	Frequency	Percentage (%)
Moderate Extent	13	17%
To a Great Extent	21	28%
To a Very Great Extent	37	49%
Total	**76**	**100**

Further the researcher wanted to determine the extent to which equity returns affected the performance of insurance firm: the results showed that 49% of the respondents maintained it affected to a very great extent, 28% respondents indicated it affected to a great extent and 17% of the respondents held that it affected at moderate extent. Majority 77% of the respondents (i.e. 49%+28%) argued that it did affect to a great extent. The implications were that equity returns was an essential factor.

Premium Rate Dimension

The respondents were asked to give out their opinion on the effect of premium rate on the financial performance of selected insurance firms in Nairobi County. The responses were put in percentage form and presented in the table below;

Table 8: Premium Rate Dimension

Premium Rate Dimension	N	Mean	Std. Deviation
Premium rates affects the financial performance of an organization	76	4.8158	.39023
The type of policy offered by the firm greatly affects its performance	76	4.8684	.34028
The Credit information of an insurance firm greatly affects its performance	76	4.8026	.40066
Rapid growth of premium volume can lead to self-destruction of the firm	76	4.5789	.69787

As shown in the Table 8 above, the researcher sought respondent's views the effect of premium rate on the financial performance of selected insurance firms in Nairobi County: whether Premium rates affected the financial performance of an organization had a mean of 4.8158 and a standard deviation of 0.39023. The type of policy offered by the firm greatly affected its performance

had a mean of 4.8684 and a standard deviation of 0.34028. The Credit information of an insurance firm greatly affects its performance was supported by a mean of 4.8026 with a standard deviation of 0.40066 and finally rapid growth of premium volume can lead to self-destruction of the firm as supported by a mean of 4.5789 with a standard deviation of 0.69787.

On extent of premium rate on the financial performance of an organization, the respondents were asked to give out their opinion on the extent of premium rate on the financial performance of an organisation. The responses were put in percentage form and presented in the table below;

Table 9: Extent of premium rate on the financial performance of an organisation

Responses	Frequency	Percentage (%)
To a Great Extent	18	24%
To a Very Great Extent	58	76%
Total	**76**	**100**

Further the researcher wanted to determine the extent to which premium rate on the financial performance of selected insurance firms in Nairobi County. : The results showed that 79% of the respondents maintained it affected to a very great extent, 24% respondents indicated it affected to a great extent. The implications were that premium rate was an essential factor for the performance of the insurance firms in Nairobi County, thus should not be compromised at all costs.

Regression Analysis

Model Summary

The model summary gives of the total variability in the dependent variable explained by the model. This then indicated the percentage of the variability in the dependent variable explained by factors not included in the study.

Table 10: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.986[a]	.973	.972	24.50381

a. Predictors: (Constant), Premium rate, Liquidity, Firm size, Equity returns

b. Dependent Variable: Financial performance

Table 10 illustrated that the multiple correlation coefficient R = 0.986 indicated there was a strong positive correlation between (Premium rate, Liquidity, Firm size, Equity returns) and financial performance. Also, the value of R^2 = 0.972, meaning that financial performance can account for 97.2% of the variation of financial performance in the insurance companies. The adjusted R^2= 0.972 concerns the generalizability of the model, allowing the results to be taken from the sample and generalized for the whole population. It was noticed that the value of the adjusted R^2 is very close to the value of R^2. If the adjusted R^2 is excluded from R^2 (0.986-0.972) = 0.074. This minor decrease (0.074) means that if the model had been fitted when the whole population participates in the study, the higher variance in the outcome was 0.074.

ANOVA

The study sought to establish Analysis of variance (**ANOVA**) which was collection of statistical models used to analyze the differences among group means and their associated.

Table 11: ANOVA

ANOVA

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	1539577.240	4	384894.310	641.024	.000[a]
	Residual	42631.010	71	600.437		
	Total	1582208.250	75			

a. Predictors: (Constant), Premium rate, Liquidity, Firm size, Equity returns

b. Dependent Variable: Financial performance

The ANOVA statistics presented was used to present the regression model significance. An F-significance value of $p<0.001$ was established showing that there is a probability of 0.1% of the regression model presenting a false information.

Coefficients

Table 12: Coefficients

Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	T	Sig.
1	(Constant)	20.155	12.719		1.585	.118
	Firm size	.127	.061	.108	2.079	.041
	Liquidity	.002	.006	.013	.434	.666
	Equity returns	.061	.013	.297	4.779	.000
	Premium rate	.555	.078	.588	7.083	.000

a. Dependent Variable: Financial Performance

After the computation of the determinants of financial performance of selected insurance firms in Nairobi County.; the findings indicated that firm size had a P=.041, less than the significance level of 0.05. This showed a strong relationship between firm sizes as a factor affecting financial performance of selected insurance firms. These findings were in line with the study by Hardwick (2009) who suggested that large insurers are likely to perform better than small insurers because they can achieve operating cost efficiencies through increasing output and economizing on the unit cost of innovations in products and process development. A positive linkage between company size and its financial performance is expected, since large firms have more resources, a better risk diversification and better expenses management. Liquidity had a P>.666, more than the significance level of 0.05. This shows a weak relationship between liquidity as a factor affecting financial performance of insurance firms. These findings concur with those of Ahmed et al., (2011) in a study of the Pakistani life insurance industry, claimed that liquidity is not a significant determinant of insurers' profitability. They posited that, whereas size and risk (loss ratio) are significant and positively related to the profitability of insurance firms, leverage is negative and hence decreases the profitability of insurers significantly.

Equity returns had a p<0.001 connoting a strong relationship between it and financial performance of insurance firms. These findings concur with a study by Curak, Pervan and Marijanovic (2011) which indicated that equity returns have significant association with composite insurers" financial performance. General financial institutions tend to hold a relatively low proportion of their investment portfolios in equities because a high proportion of the portfolios in equities could increase insolvency risk. Premium rates as a factor affecting financial performance of insurance firms scored a p<0.001 connoting a strong relationship between it and financial performance of insurance firms. The findings clear indication that premium rates strongly affects financial performance of insurance firms. These findings are related to a panel study of 25 non-life insurance companies in Poland by Kozak (2011) which revealed that the value of gross premiums is positive and a significant parameter of the profitability and efficiency of insurance companies.

CONCLUSIONS

The study concluded that the size of the firm was a significant factor affecting the profitability of insurance firms in the Kenyan insurance markets. Moreover, the positive relationship which had been established between the size of the firm and profitability can be interpreted as the existence of the effected of economies of scale and scope in the activities of insurance firms operating in Nairobi. Large firms had more resources, more accounting staff and sophisticated information systems that result in more profitability which in turn results in high performance.

The study concluded that good performance of the insurance firm's benefited the stockholders more than it did debt holders. As the firm moved towards bankruptcy, equity holders face the risk of losing only their shareholdings, passing the burden of such bankruptcy to the debt holders. Taken together, these outcomes encouraged managers working to protect the interest of equity holders to embark on risky, high-return projects.

The study also concluded that insurance firms had liquid investments which helped them to settle claims especially if their underwriting income cannot cover claims. The firm would sell off their investments if they lacked money to settle claims. Majority of insurance firms relied on cash flow from operations in liquidity management. This implied that all firms had a certain source of funds for liquidity management.

The study further concluded that the value of gross premiums was a significant parameter of the profitability and efficiency of insurance firms. An excessive attention on marketing to grow premiums without a proportionate allocation of resources towards the management of their investment portfolios led to a negative effect on investment income of an insurance firm.

Deficiencies in the management of credit risk associated with lending resulted in high premiums outstanding and this can negatively gnaw at the profit maximizing force of an insurer.

RECOMMENDATIONS

The study recommends that:

- Insurance firms should establish a well matched portfolio of their assets and liability in terms of cash flows or rather they should ensure that they create additional reserve so that it can assist them to cover the interest rate since low interest may create a discrepancy on the earnings.
- Insurers should invest in financial analysts so that they can gauge when interest rates can work in their favor in increasing their income.

This would enhance their financial performance hence they would be able to settle all claims irrespective of the amount of money involved.

- The government through the insurance regulatory authority should ensure that the insurance firms follow the doctrine of interest rates set by Central Bank of Kenya (CBK) when pricing their products so as to ensure to protect consumers from unfair, deceptive, and abusive practices of overpriced policies.
- Stronger regulations should be set to improve the transparency, fairness, and appropriateness of consumer and investor products and services.
- The Central bank as a regulator should monitor general interest rates, because the likelihood of very low interest rate is one reason insurers have redesigned and re-priced some products, offering less-generous features to individuals. These include long-term care insurance and retirement-income products with minimum-income levels. Insurers stand to lose from persistently low interest rates.
- Insurance firms should have separate departments with requisite personnel for their investment operations and underwriting activities. And that the activities of these departments must be managed closely together in a complementary manner. In particular their underwriting/actuary departments must insist on the validation of all policies in order to prevent price undercutting and overtrading by insurance marketing agents.
- All insurers should find an area they excel and capitalize on it to get a competitive edge while trying to upgrade on the areas in which they are weak. This would place them ahead of competition.
- The insurers should work towards increasing their cash flow to avoid sale of investments in case of settling huge claims. This would make them financially healthier.

AREAS FOR FURTHER STUDIES

The researcher suggested that a similar study should be conducted in other sectors of the economy in order to see if the same results will be achieved.

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