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Risk Transfer Strategy And The Performance Of Insurance Companies In Nyeri County, Kenya

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***Abstract:** The combined effects of technological, globalization and economic forces have resulted to not only insurance companies struggling to grow but also remaining profitable. Risk transfer strategy has been used to reduce risk exposures in insurance market. This study sought to examine the effects of risk transfer strategy on the performance of insurance companies in Nyeri County. The study's target population consists of 66 managerial level employees of 22 insurance companies who are directly involved in risk management process. The study adopted a census study. Both descriptive and explanatory research design were utilized. Self-administered questionnaires were used to collect primary data. Data was analyzed using Statistical Package for Social Sciences computer software. Content validity and face validity was ensured through empirical reviews and concepts deduced from appropriate literature. Reliability of the research instrument was ensured through Cronbach Alpha Value of 0.8 Descriptive and inferential statistics were computed to describe the characteristics of the study variable while multiple regression analysis was used to establish the nature and degree of relationship between the independent and dependent variable. The researcher concludes that risk transfer strategy positively and significantly affect performance of insurance companies in Nyeri County. The study recommend that insurers should focus on use of insurance derivatives, reinsurance, partnerships with other insurance companies on high risks and broaden coverage of group insurance products to derive greater performance benefits.*

***Keywords:** Risk Management Strategies, Performance of Insurance Companies*

I. INTRODUCTION

A. BACKGROUND OF THE STUDY

Risk taking is at the heart of all insurance companies' as they cover risks from individuals, companies and businesses and therefore, risk management is critical in minimizing their exposure to risks. Enterprise risk management requires a proactive approach designed to address risks in a manner that enhances value to an organization's core function as well as business model (Meiryani,2018). The pooling of risks by insurance companies enables the distribution of risks across different clients (Olowabi et al, 2017). For every risk undertaken, a corresponding risk management strategy is required in place. World-over, insurers have had to rethink innovative and cost-effective ways to not only survive but to grow their business as well which has seen an increase in the focus on risk management strategies.

According to Pricewaterhouse Coopers 2018 report noted that flawed strategy was noted as one of the causes insurance company's failure. The potential consequences of failure to recognize and manage risks by insurance companies have been witnessed by the collapse of a number of insurance companies worldwide. The assessment of significant risks, development and implementation of suitable risk strategies are critical to achieve superior performance in the rapidly changing environment.

William (1998) posits that risk transfer entails sharing of risks through third parties. Risk transfer can be between organizations, organizations to insurance companies, insurance companies to insured and insurance companies to reinsurance companies. Risk transfer strategies include: use of insurance derivatives that transfer risks faced by insurance to capital market investors, reinsurance where insurance companies insure their risks with reinsurance companies, multiple insurance coverages where multiple insurances come together to cover very high risk under one contract, and finally group life insurance that covers an entire homogenous group under one contract. Transfer of risks enables insurance companies diversify risk exposures, reduce costs of capital thereby expanding the availability of insurance (Vladimir & Maksimovic,2009). This study examines the impact of risk transfer strategy on performance of insurance companies.

B. RESEARCH PROBLEM

The insurance industry in Kenya is one of the crucial drivers' financial services sector and thus plays a fundamental role in the realization of Vision 2030 financial services goals which proposes financial reforms to increase savings from 17% to 40% of GDP. Insurance companies are facing a myriad of challenges key among them being; income-sensitive population, cultural mindset, large informal economy, insurance being viewed as a discretionary spending, level of distrust and insurance being more of a push rather than a pull product. Further compounding these challenges are regulatory changes key among them being interest rate capping, risk-based supervision as well as proposed adoption of International Financial Reporting Standards (IFRS) 9 and 17 which have impacted on their profitability (Insurance Regulatory Authority, 2017).

The 2007 financial crisis led to collapse of large financial institutions which served as a wakeup call on the effects of unexpected risk exposures and poor management of risks. According to Magezi 2003, the poor management of risks resulted in the accumulation of risk which negatively impacted the financial performance of insurance companies. Over the last decade, a total of 9 insurance companies in Kenya have collapsed. The collapse of several insurance companies in Kenya prompted the Insurance Regulatory Authority launched risk management framework for insurance companies in 2013 to ensure risks are prudently managed. In a rapidly changing business environment, there has been a need to critically address and continually enhance and appraise risk management strategies (Delloite, 2015)

A universal approach towards the implementation of various risk management strategies does not apply due to differences in business environment hence organizations have to adopt different types of risk management strategies depending on the type risks faced. Researchers have observed that reinsurance (Aduloju and Ajemunigbohun (2017), outsourcing (Wabomba, 2015), joint ventures (Lambiano ,2019) had an effect on organizational performance. The studies conducted have mainly focused on different risk transfer strategies in different context. This study therefore sought to fill the knowledge gap on effect of risk management strategies adopted by insurance companies in Nyeri County on their performance.

C. RESEARCH OBJECTIVES

a. *GENERAL OBJECTIVE*

The objective of the study was to examine the effects of risk transfer strategy on the organizational performance of insurance companies in Nyeri County.

II. LITERATURE REVIEW

A. THEORETICAL REVIEW

a. *ENTERPRISE RISK MANAGEMENT THEORY*

This theory was formalized in 2004 by Committee of Sponsoring Organization of the Treadway Commission (COSO) through a framework that seeks to equip managers at all levels in the organization planning and decision making on organizational risks (COSO,2004). According to Deloach (2000), ERM is a logic process that is holistic in nature and utilizes a top-down approach that converges risk management to strategy in an effective manner that enhances organizational value.

Ondiek (2017), opine that ERM is a pro-active approach that whose purpose is to align the corporate strategy, processes, technology and people as a tool to effectively manage the risks in a manner that generates value to the organization. Managers are therefore required to identify, evaluate, manage and keep track of all risks that might interfere with achievement of the overall objectives. Wanjohi (2013) contends that ERM is crucial in attaining the balance between managers requirement to grow value to the shareholders and management of risks in a commercially viable manner. By keeping a close eye on events that are happening both internally and externally, managers are able to strategically analyses the opportunities and threats that the risks bring forth to the organization. Managers therefore need to continually be conscious of the risks that their organizations are faced to facilitate proper monitoring so as to inform on how effective the strategies in place are faring.

In relation to risk management, this theory was relevant to the study since insurance companies deal with many and different risks, there is need to have a pro-active approach in risk management so as to come up with risk management strategies that effectively address risk in a commercially viable manner. The managers have to develop and appraise sound risk management strategies in order for them to not only remain competitive and realize growth in their industry.

b. *BALANCED SCORE CARD*

The Balanced Score Card (BSC) theory was developed by Kaplan & Norton in 1996. The BCS is a strategic management tool that organizations use to manage various stakeholder demands and translate strategies into actions. It is anchored on four measurement perspectives, namely; financial perspective. customer, internal process and innovation and growth. These perspectives link performance to strategic goals and enable organizations manage stakeholders' expectations through

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translation of strategies into actions thus creating ripple effect on the drivers and the outcomes. Each perspective has applicable strategic goals, indicators and ways to achieve them (Kaplan & Norton,1997).

According to Kaplan & Norton (1997), the BCS's focus is used by organizations to aid in the following management processes. First, make clear and translate organizations vision and strategy. Second, connect and link strategic objectives to measures. Third, planning, target setting and alignment of the strategic initiatives and fourth, strengthening strategic feedback and organizational learning. In practice, the theory not only helps organizations translate strategies into actions but also facilitates employees focus their efforts on important business drivers. Through this framework, strategies are developed and monitored to evaluate their effectiveness with deviations being noted responded to ensure attainment of set goals.

The theory endeavors to explain the need for organizations to measure performance using both financial and non-financial metrics; a proposition supported by Gituma, Kimencu & Muchemi (2018). The insurance industry is a service industry hence the BSC sets of performance measures are important. The study measured financial perspective using profitability, customer perspective using customer repeat purchases and market penetration metrics and finally learning perspective through employee satisfaction.

c. AGENCY THEORY

Originated from risk sharing among individuals explored by economists in 1960's and 1970's.The theory attempts to describe agency problem using a metaphor of a contract where the principal delegates work to an agent (Jensen & Meckling, 1976).The theory contends that the asymmetrical distribution of earnings amongst the shareholders, management and debt holders results in mismatched interests consequently resulting to an organization either failing to engage in projects whose net value is positive or taking too much risks than it should. According to Stulz (1984) since managers are agents of the shareholders, they aim at profit maximization hence will avoid risks which invariably saves on agency costs. Agency costs are made up of cost of having a board of directors, bonding costs to align their interest to their actions by the agent and residual loss and are present in all levels of management in every organization. In managing the agency problem, the managers are given incentives through stock or stock options coupled with management behavior monitoring mechanisms to induce value maximizing decisions which results in positive performance of the organization (Mayers & Smith, 1987). Shareholders desire high risk investments that yield high return while managers favor low risk investments that offer low return. Risk management according to shareholders is therefore perceived as a tool that managers use to align wealth maximization goal to the management interests (Osiemo, 2016).

The agency theory emphasizes on managing the conflicting interest of the principal and shareholder. Through risk management, managers are aware about the organization's risk appetite as set by the board. In so doing, managers can come up with effective risk mitigation strategies appropriate for the opportunities identified as wealth maximization avenues. The theory was therefore relevant to this study since it provides balance of shareholders and principal in the pursuit of organizational performance.

B. EMPIRICAL REVIEWS

a. RISK TRANSFER STRATEGY AND PERFORMANCE

Wabomba (2015) surveyed particular international developmental organizations domiciled in Nairobi to determine the value of risk transfer strategies on the project achievements. The study employed outsourcing, insurance premiums and binding contractual agreements as risk sharing strategies to evaluate performance of the projects. The respondents were project managers with predictive research design being adopted. The study found out the risk transfer strategy had significant effect on the project's duration.

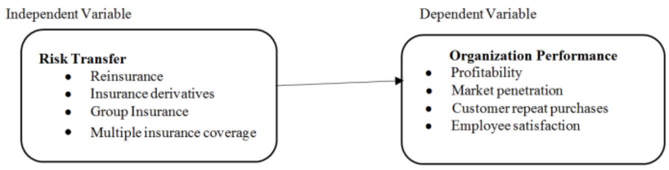
In a study undertaken by Sing'ombe (2016), the research sought to determine how risk transfer through reinsurance programmes affected the fiscal performance of Kenya's insurance companies. The study adopted analytical survey and correlation research design. The population included all insurance companies in existence in the period covering 2013-2015 and the source of data was secondary. The study concluded that reinsurance programmes had a positive but insignificant relationship to insurance firms' performance.

Lambaino (2019) sought to find out how risk transfer strategies applied in Kenya's petroleum sector impacts on supply chain resilience. The target population was made up of 87 oil marketing companies licensed by Energy Regulatory Commission (ERC). Depot managers and logistics managers provided primary data which concluded that transfer of risks to third parties through outsourcing, insurance and partnerships greatly contributed to performance.

Macharia and Kirui (2018) in a study assessed risk transfer strategy influence on the completion of construction projects in public high schools in Muranga county, Kenya. The strategies assessed included; purchase of insurance premiums, legal agreements and outsourcing. The study's population was made up of principals, board of management chairpersons and accountants where purposive sampling was applied and sample size was 136. The authors concluded that transfer strategies had some value on the projects in stages used.

Aduloju and Ajemunigbohun (2017) examined reinsurance as a risk transfer strategy and performance of insurance firms in Nigeria that transfer all risk to reinsurance businesses. Return of equity, ceded ratio, return on asset and ratio of reinsurance recoverables to policyholders' surplus were used to measure performance. The study adopted descriptive research and purposive sampling technique. The population was 56 insurance companies with primary data obtained from 248 respondents as well as information obtained from published fiscal annual reports covering 2014 and 2015 years. The study revealed that insolvency risk faced by insurance companies is reduced by purchasing reinsurance which stabilizes loss experience.

b. CONCEPTUAL FRAMEWORK



Source: Researcher, 2021

III. RESEARCH METHODOLOGY

The study used descriptive research design. The study population was sixty-six (66) respondents who consisted of branch managers, unit managers and underwriters of 22 insurance companies with branches within Nyeri County. Owing to the reasonably small size of the target population, a census survey was adopted. The study adopted questionnaire to obtain primary data. Data collection instrument was subjected to a pilot test to ensure it was free of errors and ambiguity. The study considered three types of validity of research tool. Namely, construct validity was ensured by operationalization of the study's variables, content validity was ensured in two ways. First, through expert judgment by asking similar questions to a target group and based on their views, unclear statements were amended. Second, through empirical literature review to ensure focus areas of study were captured. The researcher ensured face validity relied on instruments used in related studies and concepts deduced from appropriate literature. This study ensured reliability using Cronbach alpha test for in the questionnaire.

A multiple regression analysis was used to determine the effect of risks transfer strategies on performance of insurance companies.

The regression model adopted was as follows:

$\mathbf{Y} = \beta_0 + \beta_1\mathbf{X_1} + \beta_2\mathbf{X_2} + \beta_3\mathbf{X_3} + \beta_4\mathbf{X_4} + \varepsilon$

Where

Y = Performance of Insurance Companies

β0= Constant Term

β_1, β_2, β_3 and β_4 = Beta coefficients

$\mathbf{X_1}$ = Insurance derivatives

$\mathbf{X_2}$ = Reinsurance

$\mathbf{X_3}$ = Multiple Insurance coverage

$\mathbf{X_4}$ = Group insurance

ε_i = error term

IV. RESULTS, FINDINGS AND DISCUSSION

Questionnaires were administered to a sample size of 66, 63 questionnaires were received from the field representing a response rate of 95% which was adequate for this study.

A. DESCRIPTIVE STATISTICS

The research sought to establish the respondents' gender and the findings as well as analysis reveals that 73.33% were males whereas 26.67% were females implying men held majority of management positions in the companies under study.

The research sought to establish the age bracket and the findings revealed that 15%, were aged 35 years and below whereas another 33.3% were aged between 35 to 40 years of age. Additionally, 31.67% of the total respondents were within the age group of 41-45 years. The respondents aged above 45 years were 20%. These results propose that, most of the respondents fall between 35 – 45 aged group which means they are efficient, productive as well as energetic.

The research sought to establish the position held by the respondents and the findings indicated that 31.67%, 35% and 33.33% of the respondents were branch managers, unit managers and underwriting managers respectively. This indicates that there was balanced representation of the respondents in the insurance companies that were targeted therefore the respondents had a greater understanding of the insurance company in various sections to provide reliable data relevant for this study.

The study sought to find out the highest level of education of the respondents and the findings show that, majority of the respondents, 68.33% had bachelor's degree while 31.67% had attained post graduate qualification. The holders of these managerial positions are required to a minimum of college certificate. This analysis implies that, all insurance companies under the study hire highly qualified personnel due to competitive market forces who have the prerequisite knowledge in management positions.

This study sought to establish the total number of years the respondents had worked with the insurance company. This study reveals that, majority of the respondents, 50 % respondents had worked for the insurance company for a period of 6 to 10 years while 38.33% respondents had worked for over 10 years and above while 11.67% respondents had worked for above 1-5 years. This analysis shows that, all the respondents had adequate work experience and they were familiar with the operations of the insurance companies they work for.

B. RISK TRANSFER STRATEGIES AND PERFORMANCE OF INSURANCE COMPANIES

The questionnaire required the respondents to rate the level to which they concur with specific statements regarding the phenomenon under study through ticking their preferred choice on a five-point Likert scale (where:1 - Strongly disagree, 2 - Disagree, 3 - Neutral, 4 - Agree, 5 - Strongly Agree.)

Descriptive Statistics

	N	Minimum	Maximum	Sum	Mean	Std. Deviation
Risk Reinsurance	60	1	5	262	4.3667	0.73569
Partnerships on High Risks	60	1	5	257	4.2833	0.76117
Group Insurance Products	60	2	5	231	3.85	0.7089
Insurance derivatives	60	1	5	199	3.3167	0.79173
Aggregate score					3.9542	0.7494
Valid N (listwise)	60					

Source: Field Data, 2021

Table 1: Risk transfer strategy

From the above analysis, the total aggregate mean score of this section was found to be 3.9542 with a standard deviation of 0.7494 signifying that on average, managers confirmed that risk retention strategies affected organizational performance. The results indicate that organizational performance is highly dependent on risk reinsurance (mean score=4.3667) and partnerships on high risks (mean score=4.2833). This depicts that insurance companies are expected to spread risks with other companies to minimize incidences of great losses and enhance the sustainability of their business. Reinsurance is a requirement by the IRA and prudent managers in the insurance industry have to comply with this. Spreading of risks in the insurance industry is key to ensure that should the number of claims increase substantially, the insurance company remains a going concern.

The findings further indicate that group insurance products (mean score=3.85) and insurance derivatives (mean score=3.3167) have the lowest impact on the organizational performance. This signifies that Kenyan context and specifically in the insurance companies, group insurance products and insurance derivatives have a minimal effect on organizational. This can be attributed to the fact that derivatives market in Kenya is still at its infant stage and hence majority of insurance managers are yet to take up insurance derivatives. Group insurance product are yet to be adopted by a majority of Kenyans except for medical insurance products which are widely taken up by organizations for their employees.

C. PERFORMANCE OF INSURANCE COMPANIES

ANOVA Table							
			Sum of Squares	df	Mean Square	F	Sig.
Performance * Risk Transfer	Between Groups	(Combined)	7.292	9	.810	4.661	.000
		Linearity	5.054	1	5.054	29.072	.000
		Deviation from Linearity	2.238	8	.280	1.609	.146
	Within Groups		8.692	50	.174		
	Total		15.983	59			

Source: Field Data, 2021

Table 2: Test of Normality on Risk transfer

Based on the ANOVA output table above, value sig deviation from linearity of 0.146>0.05, it can be concluded that there is a linear relationship between risk transfer and organizational performance of insurance companies. The findings support Mucheru (2016) implementation of risk mitigation strategies enhance organizational performance.

Coefficients[a]								
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	.078	.606		.129	.898		
	Risk Transfer	.573	.147	.472	3.887	.000	.676	1.478
a. Dependent Variable: Performance								

Source: Field Data, 2021

Table 3: Coefficient of the Model

The results of regression analysis shown in Table 3 above were used to interpret the regression model as illustrated below;

$$Y = \beta_0 + \beta_1 \mathbf{X_1}$$

$$Y = 0.078 + 0.573\ X_1$$

From the output in Table 3 above, it was established that the P – value of risk transfer 0.000**,** implies that this predictor variable is statistically significant at a confidence level of 95%. The null hypothesis was rejected implying that risk transfer is statistically significant in influencing organizational performance of insurance companies in the Nyeri County. The coefficient for risk transfer was + 0.573. This means that an increase in risk transfer will result to an increase in the organizational performance. The findings support those of Aduloju and Ajemunigbohun (2017) who concluded that the risk transfer greatly reduced insolvency faced by insurance firms in Nigeria. Findings are also consistent with Macharia and Kirui (2018) findings that risk transfer strategies employed in construction projects in public schools in Murang'a County had significant influence on performance. This concurs with Wabomba (2015) findings that risk transfer strategies had the greatest impact on performance of international developmental organizations in Nairobi.

V. CONCLUSION AND POLICY RECOMMENDATIONS

Based on the findings, the study makes the following recommendations:

The study recommends insurance companies to capitalize on the use of risk transfer strategies since they have a strong and positive influence on performance. There is need for the enhancement of cooperation of insurance companies in undertaking risky insurance contracts as well as broadening scope of reinsurance portfolio undertaken with reinsurance companies. The government should strengthen the derivatives market and Insurance Regulatory Authority should encourage insurance companies to use derivatives through training as an avenue of alternative risk transfer to enhance performance.

The purpose of this was determine effect of risk management strategies on the performance of insurance companies in Nyeri County. Future studies could therefore focus on other risk management strategies not studied and how they affect performance. In addition, researchers could also study challenges faced in the implementations of risk transfer strategies by other industries within the financial sector.

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