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Effect of Board Diversity on the Financial Performance of Insurance Companies in Kenya

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Abstract

Good corporate governance practices enhance the ethical behavior of those yielding corporate powers by monitoring managers to ensure that they behave in accordance with the aspirations of the wider stakeholders of entities. This culminates in overall firm financial performance and health business dealings. The insurance companies in Kenya have been reporting poor financial performance results as evidence by the collapse of several insurance companies in the recent past, such as the Invesco insurance company. The collapse of these insurance companies can be attributed to poor corporate governance practices. The main objective of the study was to investigate the effect of board diversity on the financial performance of insurance companies in Kenya. The stakeholders' theory, was used in supporting this study. This research study adopted the descriptive research design. The stratified random sampling technique was employed in determining the sample size for this study, thus resulting into having a sample size of 211 employees. The primary data for this study was collected using questionnaires whereas the secondary data was collected using data observation schedules/collection sheets. The p values of .001from the regression model which was less than 0.05, confirmed that board diversity has a significant positive effect on the financial performance of insurance companies in Kenya. The research therefore recommends that the insurance companies in Kenya should embrace board diversity, because it has a positive significant effect on their financial performance.

Keywords: *Bard Diversity, Financial Performance, Insurance Companies, Corporate governance practices*

1.0 Introduction

Corporate governance (CG) is an internal system with regard to guidelines, procedures, and individuals who attend to the needs of stakeholders as well as shareholders through guiding and monitoring managerial undertakings with noble business knowledge, impartiality, accountability, and honesty (Kipruto & Minja, 2020). It is a trade whereby money suppliers guarantee themselves a return on their venture (Okeyo, Olokoyo, Okoh, & Uzohue, 2020). It precisely deals with issues of conflict of interest, plans avenues to mitigate corporate misbehavior, and brings into line the aspirations of stakeholders through motivation avenues (Owiredu & Kwakye, 2020). Corporate governance is regarded as the integrity of entities (Kipruto & Minja, 2020). An assortment of corporate governance practices has been established and implemented around the globe, and they may include the institution of a board of directors, ensuring company auditing is conducted, as well as spelling out the roles and responsibilities of the company's officers, such as the chief executive officer (CEO) (Aswathy & Chandramohan, 2018)

Corporate governance has become an up-to-date issue due to its enormous impact on the economic development of entities (Okeyo, Olokoyo, Okoh, & Uzohue, 2020). The presence of good corporate governance is the chief basis for the success of numerous positive-performing firms (Owiredu & Kwakye, 2020) . A noble corporate governance practice has a constructive impact on an entity's performance. The fiscal health of an economy is reflected in the performance of its' firms (Wondem & Batra, 2019). Henceforth, the poor development records of developing nations can be attributed to poor corporate governance practices. Okeyo, Olokoyo, Okoh, and Uzohue, (2020) emphasized comprehending corporate governance through critically looking into and understanding the major characteristics of corporations. Corporate governance advocates that stockholders possess minimal obligations and, consequently, are not managers (Owiredu & Kwakye, 2020). This helps in avoiding conflicts of interest among proprietors and managers (Habib, Rafique, & Akbar, 2020). Thus, good corporate governance practices are fundamental in ensuring that entities are run well to warrant attainment of corporate-wide goals (Aswathy & Chandramohan, 2018).

Several studies have been conducted around the globe with reference to corporate governance practices and financial performance. In the United Kingdom (UK), Ananzeh, Al Amosh, and Albitar (2022) studied the effect of corporate governance quality and its mechanisms on firm philanthropic donations. The researchers found that board size and gender diversity positively influence the amount and intensity of firms' donations. In Nepal, Maharjan (2019) examined the effect of corporate governance practices on the financial performance of insurance entities in Nepal. The research established an inverse relationship among board meetings, audit committees, firm size, age, CEO duality, and board meetings against return on equity. In another study, Hamud and Opuodho (2019) researched the effect of corporate governance on the financial performance of commercial banks in Kenya. The study established that board size, board diversity, and separation of the roles of the CEO and the chairman of the board positively influenced the performance of commercial banks in Kenya. This current research study, therefore sought to venture into corporate governance practices by focusing on board diversity and its effect on the financial performance of insurance companies in Kenya.

1.1 Problem Statement

Over the years, the insurance industry in Kenya has witnessed fraud, the exit of subscribers, and eventually the collapse of some of the insurance companies (Kiptoo, Kariuki, & Ocharo, 2021). In

2015, the Insurance Regulatory Authority (IRA) reported an increase in fraud cases in the insurance industry. For instance, fraud cases increased from 88 cases involving 102 million Kenya to 93 cases involving 324 million Kenya shillings (IRA, 2022). Out of these cases reported, six cases worth 14.5 million shillings involved employees, and 21 cases worth 17.8 million involved agents of the insurance companies (IRA, 2022). On the other hand, as revealed in the 2019 IRA report, the retention ratio of the insurance companies dropped from 73.5% in 2015 to 70.2% in 2019, while the net earned premium ratio plunged from 71.0% in 2015 to 69.5% in 2019 (IRA, 2022). These cases were attributed to several factors, among them poor corporate governance practices, which is the focus of this current study.

These events, among others, contributed to the collapse of some of the insurance companies, including Invesco Assurance, Standard Assurance, Blue Shield, and Access Insurance Company, among others (IRA, 2022). The collapse of these insurance companies can be attributed to poor governance practices and malpractices within the industry (Kiptoo, Kariuki, & Ocharo, 2021). For instance, one of the factors that led to the collapse of Invesco Assurance Company in 2009 was an escalated loss ratio, which can easily be linked to poor corporate governance practices (Osedo, Mwanza, & Ogendo, 2020). It is with this awareness in mind (the insufficiency of the research studies by the reviewed researchers, the limited awareness of corporate governance structural issues, and the current failures in the insurance industry) that this study strived to bridge the research gap by researching on the "effect of board diversity on the financial performance of insurance companies in Kenya".

1.2 Research Objective

To determine the effect of board diversity on the financial performance of insurance companies in Kenya.

1.3 Research Hypothesis

H_0: Board diversity has no significant effect on the financial performance of insurance companies in Kenya

2.0 Literature Review

This section presented a review of literature which supported this research study.

2.1 Theoretical Framework

2.1.1 The Stakeholders' Theory

The stakeholder's theory was first put forward by Edward Freeman in the 1984s (Bashir & Muzzafar, 2018). This concept was extracted from an amalgamation of the sociological and organizational disciplines, it denotes to a section or characters mutually affecting the attainment of organization's goals (Afif & Onsumo, 2019). Scholars in this field postulates that executives in entities serve a network of relationships including merchants, personnel as well as business associates. The Anglo-American model of corporate governance champions on board comprising of executive and non-executive members as a monitoring avenue while the German model gives stake-holders constitutional rights to actively participate in board meetings (Omware, Atheru, & Jagongo, 2020)

Unlike agency theory, stakeholder theory emphasizes not on the viewpoint of individuality, but somewhat on top management role of being overseers, assimilating their objectives as fragments of the entities thus endorsing CEO-duality as practices and an essential component of corporate governance (Hamud & Opuodho, 2019). This theory is in juxtaposition to the agency theory; where as in agency theory, the focus is on shareholders' wealth maximization, in this theory the focus is on the wider stakeholders' interests (Osedo, Mwanza, & Ogendo, 2020)

This theory has been reviewed by recent scholars who researched on corporate governance and its effect on various sectors of the economy. For instance, (Omware, Atheru, & Jagongo, 2020) studied the stakeholder's theory in his research on corporate governance and financial performance of selected commercial banks listed at the Nairobi Securities exchange in Kenya. Hence solidifying its close study in this current research so as to give a theoretical background and underpinning the study variables of this present study. Specifically, this theory supported the board diversity and the board independency variables.

2.2 Conceptual Framework

A conceptual framework is a pictorial presentation of the independent and the dependent variables under investigation (Cooper & Schindler, Business Research Methods, 2019) It depicts in pictorial form the relationship amid variables (Kothari & Garg, 2019). The conceptual framework guiding this research was developed as shown in figure 1.

Independent variables **Dependent variable**

Board Diversity
- Board size,
- Gender composition
- Chief Executive Officer Duality

Financial Performance
- Tobin's Q
- Return On Assets
- Return on Equity

Figure 1: Conceptual Framework

2.3 Empirical Literature Review

In Siwalankerto Surabaya, Tarigan, Hervindra and Hatane (2018) studied the influence of board diversity on financial performance, the authors found that board diversity positively and significantly influence financial performance. Kiptoo, Kariuki and Ocharo (2021) used board size, board independence, board diversity, board composition as the independent variables representing corporate governance while ROA represented financial performance in their study. The researchers employed the multiple linear regression analysis model and established an inverse association amid board size and financial performance (Kiptoo, Kariuki, & Ocharo, 2021). The authors also established that, board independence and board diversity positively affected financial performance (Kiptoo, Kariuki, & Ocharo, 2021).

3.0 Research Methodology

The study adopted the descriptive research design. The target population for the study comprised of 448 employees drawn from 56 insurance companies which are regulated by the Insurance Regulatory Authority (IRA, 2022). The sample size for the study was determined using the stratified random sampling technique, this is because the population was constructed from different cadre employees of the insurance companies in Kenya. The resultant sample size for the study was 211 units of analysis. Data for the study was collected suing questionnaires and data collection sheets. Data for the study analyzed via the Statistical Package for Social Sciences. The descriptive statistics, correlation statistics and the regression statistics were used in data analysis. The regression coefficients generated from the model were used in testing the research hypothesis at 0.05 level of significance and decision made on whether to reject or fail to reject the null hypothesis. The regression model used in this study was formulated in the following manner.

$Y = \beta_0 + \beta_1X_1 + \varepsilon$

Where: Y = financial performance, X_1 = board diversity, β = Beta coefficient and ε = the error term.

4.0 Research Findings and Discussion

This section was used in presenting the findings of this study.

4.1 Diagnostic Test Results

The test for normality and the test for linearity were carried out as prerequisites for running the simple linear regression model used in this study.

4.1.1 Test for Normality

This study used the probability to probability (P-P) plot in testing for normality. Kothari and Garg (2019) confirmed that when the p-p plots depicts a linear pattern, then the data set is said to be normal distributed. Figure 2 was used in presenting the test for normality results in this study.

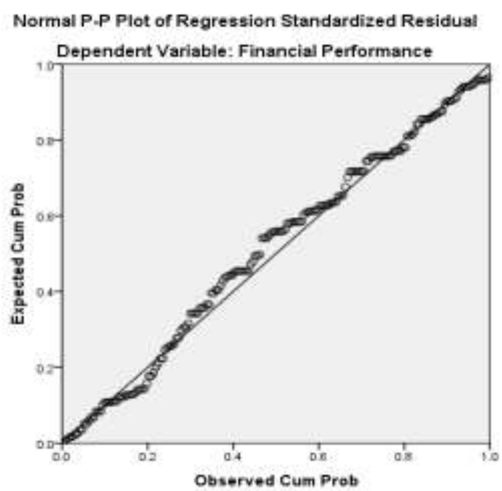

Figure 2: P-P plot

The data points in Figure 2, which followed a linear distribution pattern, confirmed that the data set for this study was normally distributed.

4.1.2 Test for Linearity

Linear relationship in a data set is confirmed when the data points depict an oval shaper distribution in the scatter plots (Holmes, 2019). Figure 3 was used in presenting the test for linear results in this study.

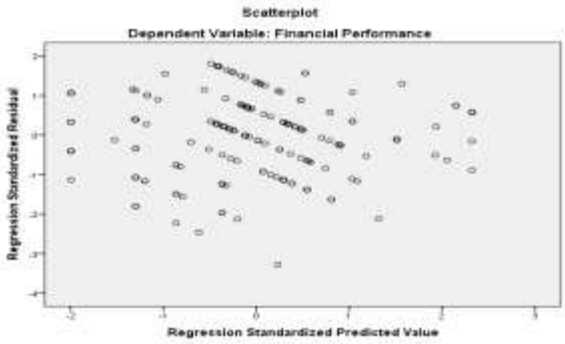

Figure 3: Scatter plot

4.2 Descriptive Test Results

Descriptive statistics were generated so as to determine the general distribution of the data around the central tendency and its dispersion. Table 1 was used in presenting the descriptive statistics for this study

Table 1: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Board diversity	185	3.00	4.83	3.9784	.41319
Financial Performance	185	3.67	5.00	4.2622	.31385
Valid N (listwise)	185				

Table 1 reported an overall mean of 3.9784 for the board diversity variable. The mean score statistic of 3.9784 indicated the general agreement by the respondents that the insurance companies in Kenya are practicing board diversity. The standard deviation statistics value of .41319 which was less than the mean statistics indicated that the data for the board diversity variable was well dispersed around the central tendency. The overall mean statistics of 4.2622 and the standard deviation of .31385 for the financial performance variable showed that its data was well dispersed around the mean.

4.3 Pearson's Correlation Analysis results

The Pearson's correlation analysis tests the strength and the direction of the relationship between the variables unnder study (Cooper & Schindler, 2019). The Pearson's correlation analysis statistics were generated and presented in table 2.

Table 2: Pearson's Correlation Results

		Financial performance	Board diversity
Financial performance	Pearson Correlation	1	
	Sig. (2-tailed)		
	N	185	
Board diversity	Pearson Correlation	.568**	1
	Sig. (2-tailed)	.000	
	N	185	185

**. Correlation is significant at the 0.01 level (2-tailed).

The pearson's correaltion analysis outcomes presented in table 2 indicated a strong positive ralationship of .568 between board diversity and the financial performance of the insurance companies in Kenya. This correlation was significant at .01 level (2-tailed).

4.4 Regression Analysis Results

Table 3 was used in presenting the model summary, table 4 was used in presenting the ANOVA whereas table 5 was used in presenting the regression statistics.

Table 3: The Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.897[a]	.685	.674	.22761

a. Predictors: (Constant), Board diversity
b. Dependent Variable: Financial performance

The R-square results of .685 in table 3 indicated that over 68.5% of the variability of the dependent variable could be explained by the independent variable, thus indicating that the model was a good fit. These results paved way for the successful application of the simple linear regression model.

Table 4: The ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	8.799	1	2.200	42.462	.000[b]
	Residual	9.325	180	.052		
	Total	18.124	184			

a. Dependent Variable: Financial performance
b. Predictors: (Constant), Board diversity

The significant F test statistic of .000 in table 4 indicated that the model was fit and statistically significant, thus paving way for the successful running of the simple linear regression model.

Table 5: The Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.182	.205		10.632	.000
	Board diversity	.250	.043	.397	3.508	.001

a. Dependent Variable: Financial performance

Out of the findings in table 5, the simple linear regression model was fitted as shown in the following equation.

$Y = 2.182 + 0.250X_1$

4.5 Hypothesis testing

The p-value statistics from the regression model in table 5 were used in testing the hypothesis at .05 level of significance. The decision rule was to reject the null hypothesis if the p-value was less than 0.05 or fail to reject if the p-value was greater than 0.05. The results for the hypotheses testing were presented in table 6.

Table 6: Hypothesis Testing

Hypothesis Statement	P-value	Decision Rule
H_{01}: Board diversity has no significant effect on the financial performance of insurance companies in Kenya	.001	Reject **H_{01}**, Since P-value ≤0.05

4.6 Discussion

The objective of the study was to determine the effect of board diversity on the financial performance of insurance companies in Kenya. The Statistical Package for Social Sciences (SPSS) version 20 was used in data analysis and the findings were presented in tables, and plots of distribution. The hypothesis testing in table 6 led to the rejection of H_0, since the p value of .001 was less than .05. The rejection H_0, indicated that board diversity has a significant positive effect on the financial performance of insurance companies in Kenya. These findings were similar to the findings of Ananzeh, Al Amosh and Albitar (2022) who reported a significant positive effect of board diversity on donations in the UK.

5.0 Conclusion

Based on the findings from this study, the researcher concludes that board diversity has a significant positive effect on the financial performance of insurance companies in Kenya. This conclusion was drawn from the statistical analysis which revealed a strong correlation between board diversity and the financial performance of insurance companies in Kenya. The rejection of H_{01} further substantiated the significant positive effect of board diversity and the financial performance of insurance companies in Kenya.

6.0 Recommendations

The study therefore, recommends that the insurance companies in Kenya should embrace board diversity because it positively affects financial performance. Additionally, it is recommended that the managers in the insurance companies, should develop mechanisms which promotes corporate governance practices if they wish to witness positive financial performance results.

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