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The Relationship between Corporate Governance and Performance of Insurance Companies in Kenya

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Abstract

The environment in which insurance companies operate has been fraught with various corporate governance challenges that have hindered their progress. Thus, a deliberate effort has to be made to avoid future corporate mismanagement and company failures given the important role insurance plays in the economy of Kenya, especially towards the development of the small and large scale firms through ensuring financial security. This study sought to establish the relationship between corporate governance and performance of insurance companies in Kenya. This study was anchored on Agency theory. Positivism philosophical foundation was adopted with a cross-sectional survey. The study population comprised of 52 insurance companies in Kenya licensed by the Insurance Regulatory Authority (IRA) as at December 2017. The insurance companies constituted the unit of analysis. The respondents were the Senior Managers and the general employees. This study utilized primary data collected using questionnaires. The influence of corporate governance was evaluated based on dimensions of three constructs namely transparency, board responsibility and ownership structure. The results indicated that corporate governance was positively and significantly associated to performance. This was an indication that corporate governance portrayed a strong connection with performance. The null hypothesis of the study was that corporate governance has no significant relationship with performance of insurance companies in Kenya was rejected. The study concluded that corporate governance influences performance. Subsequently, insurance firms need to maintain good corporate governance practices by having appropriate board structures and composition that takes into consideration diversification of expertise. The study recommends that policy and decision makers need to ensure that appropriate corporate governance mechanisms are implemented in insurance companies. This constructs of corporate governance play a key role in effective

governance of insurance companies. Policy and decision makers can use the findings in developing codes of governance that govern the practice.

Keywords: *Corporate Governance, Transparency, Board Responsibility, Ownership Structure, Performance, Insurance Companies & Kenya.*

1.1 Introduction

Corporate governance encompasses developing accountability, transparency and disclosure mechanisms in order to protect the interests of investors and the various stakeholders in a relationship (Padgett, 2012). Khan (2019) defines corporate governance as the collection of laws, policies and processes that provide direction on how organizations are managed and controlled. The aim of corporate governance is to manage the connection among stakeholders such as that of the shareholder, and board of directors while also aiming to achieve the goal of the organisation. Effective corporate governance systems contribute towards proper functioning of organizations and the economy as a whole. Firms that embrace good governance are able to attract capital, maximize on their resources hence spur growth (OECD, 2015).

Meckling (1976) theorized that for managers to act in the best interest of the shareholders and maximize returns, appropriate governance structures must be put in place in organizations. This study was anchored on agency theory as the theoretical underpinning of good governance. The need for good corporate governance has gained attention both locally and globally due to the corporate crisis and collapses experienced in the recent past across the globe. The financial giants like Enrol, Pamalat and Worldcom that collapsed due to serious malpractices elicited the need to review corporate governance laws for adoption by firms (Ferguson, 2008). Africa and Kenya in particular has had its share of the fiscal crisis. The collapse of several institutions in the financial and insurance sector experienced in Kenya in the recent past were also attributed to corporate malpractices (Barako & Tower, 2007).

Widiatmika and Darma (2018) study established that corporate governance is crucial in companies as it enables organizations to achieve their goals, control risks and assuring compliance. Further, the study by Paniagua, Rivelles and Sapena (2018) posits that good corporate governance incorporates set of rules that define the relationship between stakeholders, management and the board of directors of a company and influence how the company is operating thus aligning them to perform better. The existence of corporate governance mechanisms enables a balance between the goals and objectives of the organization and the various stakeholders (Supango, 2012). Excellent corporate governance makes the institutions credible, accountable and transparent while guaranteeing sufficient disclosure of information that impels corporate performance. Good governance sustains firm's performance, excellence and financial growth. According to Mohammed (2011) organizations that embrace good governance report higher firm valuation, superior profits and lesser expenditure. Various scholars have theorized how adoption of the governance principles of transparency and accountability enhances business success and sustainability (Mwanzia, 2010).

In Kenya, there were 52 licensed insurance companies by 2017 (IRA, 2019). Of this twenty-seven underwrite general insurance business, thirteen life insurance business and twelve are composite companies. The insurance industry has various players namely; insurance companies, reinsurance companies, insurance brokers, intermediaries and other service providers such as investigators, motor vehicle assessors, insurance risk assessors, surveyors, claims and loss adjusters and insurance agents (IRA, 2019). This study focused on only the insurance companies in Kenya. In Kenya insurance business is regulated by the Insurance Regulatory Authority under the statutes of the Insurance Act, Chapter 487 Laws of Kenya.

The corporate governance constructs that have been defined in literature include transparency, board responsibility and ownership structure (Darma, 2018; Naciti, 2019; Paniagua, Rivelles & Sapena, 2018; Utama, & Amarullah, 2017). Ramírez and Tejada (2018) defines transparency as the access and proper disclosure of financial information, such as a company's audited financial reports. It enables others to see and understand how they operate in an honest way. Widiatmika and Darma (2018) defines transparency as having full disclosure in public companies. Transparency allows its processes and transactions observable to outsiders. It also makes necessary disclosures, informs everyone affected about its decisions. Transparency is a critical component of corporate governance because it ensures that an entity’s actions can be checked at any given time by an outside observer (Azeez, 2015). Transparency ensures that all company’s actions can be checked at any given time by an outside observer. According to Alabdullah, Ahmed and Muneerali (2019), board’s responsibilities entails determining the long term aims of the company, providing leadership to achieve these aims. Ownership structure concerns the internal organization of a business entity and the rights and duties of the individual holding the equitable or legal interest in that company (Utama, & Amarullah, 2017).

The environment in which insurance companies operate has been fraught with various corporate governance challenges that have hindered its progress. The collapse and placement of several insurance companies under statutory management in the 1990’s due to financial misappropriation, poor leadership and high risk taking created the need to entrench good governance practices in organizations (Wanyama & Olweny, 2018). Therefore, a deliberate effort has to be made to avoid future corporate mismanagement and company failures given the important role insurance plays in the economy of Kenya especially towards the development of the small and large scale firms through ensuring financial security. The challenges call for effective corporate governance in insurance companies in Kenya in order to spur performance.

1.2 Statement of the Problem

The insurance penetration level in Kenya stands at only 2.75 % to GDP which is quite low compared to the world average of 6.28% (Swiss Re Sigma, 2020). The insurance penetration declined in the last five years from 2.79 % in 2015 to 2.37 % in 2019 (AKI, 2020). Low insurance penetration in the region and increased claims and losses due to fraud, particularly in the motor and health businesses, have strained the industry’s performance (Deloite, 2020). The decline being mainly attributed to reduced insurance uptake and malpractices coupled with poor corporate governance practices (Swiss Re Sigma, 2020). This is despite the fact that insurance is a critical factor to the development of the financial sector in Kenya and contributes to the achievement of Vision 2030 goals under the economic pillar (IRA, 2020). The low penetration hinders the achievement of goals and contribution to the Gross domestic product. Insurance companies in Kenya therefore presents a sub–optimal performance. Efforts require to be undertaken towards avoiding future corporate mismanagement and company failures. This is because insurance plays an important role in the economy of Kenya towards the development of the small and large scale firms through ensuring financial security. To overcome the problem of nonperformance in the insurance sector thus requires effective corporate governance structures to be put in place.

Scholars have reported mixed findings on the effect of corporate governance on performance. Several studies find a positive relationship (Mwanja *et al*., 2014; Akshita and Chandan, 2016; Mokaya and Jagongo, 2015; Mangunyi, 2011). Other studies find a negative relationship (Waithaka *et al*., 2012). Some studies find no significant relationship (Ekadah & Mboya, 2012). Therefore, the relationship between corporate governance and performance is inconclusive. From the literature, majority of studies done are based on different contexts other than the insurance companies in Kenya (Mwanja *et al*., 2014; Muriuki *et al*., 2017). Therefore, this study addressed the gap by conducting a study on the relationship between corporate governance and performance of insurance companies in Kenya.

1.3 Objective of the Study

To establish the relationship between corporate governance and performance of insurance companies in Kenya.

2. Literature review

2.1 Theoretical Literature Review

Agency Theory

The concept of agency was first conceptualized by the proposition of Modigliani and Miller (1958) on capital structure theory. The theory proposed that in a fully efficient market there are no transaction nor agency costs hence investment decisions are independent of capital structure. Jensen and Meckling (1976) built on the Modigliani and Miller theory model by theorizing the relationship between the principal (shareholder) and the agent (manager). The agency concept arose out of the need for separation of ownership and control, whereby the principal (shareholder) appoints an agent (manager) to act on their behalf. This contractual relationship involves the principal (s) engaging the agent to perform some service with delegated decision-making authority. Agents are engaged in the daily operation of organizations thus have undue information advantages. This results in information asymmetry in the agency relationship. The principal- agent relationship results in monitoring costs employed by principals to reduce the opportunistic behavior and expropriation by managers (Jensen & Meckling, 1976).

Proponents of the agency theory believe that a firm's top management becomes more powerful when the firm' stock is widely held and the board of directors is composed of people who know little of the firm. The theory suggests that a firm's top management should have a significant ownership of the firm in order to secure a positive relationship between governance and the amount of stock owned by the top management (Mallin, 2004). Wheelen and Hunger (2002) argue that problems arise in corporations because agents (top management) are not willing to bear responsibility for their decisions unless they own a substantial amount of stock in the corporation. The agency theory also advocates for the setting up of rules and incentives to align the behaviour of managers to the desires of owners (Hawley & Williams, 1996). However, it is difficult to write a set of rules for every scenario encountered by employees. Consequently, the

Australian Stock Exchange Governance Council (2003) associates good governance with people of integrity.

This study is anchored on Agency as the dominant theory underpinning the need to entrench corporate governance practices as an essential monitoring device to ensure principal agent conflict is minimized and profits maximized. The theory finds that the effective control held by managers empowers them to maximize firm performance and corporate profits through autonomous behavior and not necessary control mechanisms put in place as in the case of the agency theory.

2.2 Empirical Literature review

Delima (2017) examined whether corporate governance has impact on performance in financial institutions in Sri Lanka. The research was carried out with the objective of measuring the association between corporate governance and financial institution's performance in Batticaloa district. Board size, corporate governance mechanism, communication strategies, and code of conduct were considered as the measurement variables of corporate governance and customer satisfaction, employee commitment and corporate reputation were considered as the measurement variable of performance. Questionnaires were used to collect data for this study. 115 management respondents and 115 customers from whole financial institutions in Batticaloa district were selected for this study. Data was analyzed and evaluated using univariate analysis. The study found that there was a strong positive relationship between corporate governance and performance of financial institutions. 72.7% of variation in Performance was explained by the dimension, Corporate Governance. This model implied that Corporate Governance had a 72.7% explanatory power on Performance in financial institutions which was a significant proportion as denoted by Najjar (2019) thus inclonclusive findings. The study was conducted in Sri Lanka whose context is different from Kenya and covered financial institutions. The current study focused on insurance firms and was conducted in Kenya.

Oghoghomeh and Ogbeta (2016) conducted a study on the influence of corporate governance and performance in Nigerian banks. The study adopted a survey research design which was conducted using a selected bank in Asaba, Delta State. Data was collected through questionnaires that were administered to the selected (cross section of 100) respondents which was judged to be adequate for this study. Data collected was analyzed using the statistical package for social sciences (SPSS Vs.20) to establish the level of relationship between corporate governance, ethical behaviour/code of conduct, corporate social responsibility, managers and board members relationship and banking performance in Nigeria. The results showed that there is a statistical significant relationship between corporate governance and banking performance (β=.573, p=0.000) and the null hypothesis was rejected. The study revealed that weak corporate governance had accounted for some recent corporate failures in Nigeria and has heightened poor corporate governance, large scale misappropriation of funds, financial crises, excessive executive remuneration, conflict of interest, bankruptcy and eventual collapse. However, corporate governance alone might not depict the true picture of organization perfomance in organizations as stipulated by Petrovic, Saridakis and Johnstone (2018) and thus inconclusive findings.

Kimaite (2017) investigated the influence that corporate governance has on performance in Stanbic Bank in Uganda. The study adopted a case study design and a sample size of 97

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respondents comprising staff was selected using simple random sampling. Data was collected using structured questionnaires and in-depth interviews. The data was analyzed using Microsoft excel and SSPS version 20. The findings of the study revealed that there was a significant relationship between transparency and performance and transparency was a key predictor of bank performance. Similarly, a significant relationship was observed between accountability and performance where accountability was seen to be a predictor of bank performance. Further, the relationship between board composition and performance showed a significant relationship. Transparency and accountability accounted for 58% explanatory power on organization performance. As per Darma (2018) and Naciti (2019), this study added board responsibility and ownership structure in assessing corporate governance. Further, the study focused on one firm only and therefore its findings could not be generalizable. This current study focused on the entire insurance industry for representativeness.

Luyima (2015) did a study to find out if corporate governance structures, practices, principles and pillars have an effect on the performance of the Insurance companies in Kenya. The research design for the study was cross sectional descriptive research design. Data was gathered using structured questionnaires and analyzed using descriptive and inferential statistics. The results indicate that the insurance companies in Kenya have in place corporate governance practices and structures and their activities are anchored on corporate governance pillars and principles. Independently, corporate governance structures have a positive relationship with performance of Insurance companies; it contributes greatly in the learning and growth performance and the financial performance of the insurance companies respectively. The results further indicate that there is no relationship between financial performance and the corporate governance principles; however there is a positive relationship between the principles and customer performance, internal business performance and learning and growth performance measurements. The pillars of corporate governance have a positive relationship with financial performance, customer performance, internal business process performance and learning and growth performance.

Kiratu (2016) conducted a study on the influence of corporate governance on performance in Kenya with a case of agricultural state corporations. The study adopted a descriptive survey and a sample of 80 respondents was used for this study. The primary data was collected by use of questionnaires. The secondary data was obtained from published documents. A pilot study was conducted to pre-test the validity and reliability of instruments for data collection. The data was analyzed with the help of SPSS version 21 and Excel. The study adopted correlation and regression analysis at 5% level of significance to determine strength and direction of the relationship of the variables under study. The analysis showed that managerial skills had the strongest positive (Pearson correlation coefficient =0.755) influence on performance. In addition, board structure, culture and customer relation management were positively correlated to performance. The study established that board managerial skills were the most significant factor. The study creates a methodological gap by use of a descriptive survey while the current study adopted a cross sectional survey design.

Akshita and Chandan (2016) found mixed results in their study on corporate governance and performance of Indian manufacturing companies. The study findings indicated that larger boards have greater access to information which enhances making of informed decisions and performance the results indicated that return on equity and profitability was not related to corporate governance indicators. The study found mixed results for different constructs of corporate governance such as CEO duality which had no effect on firm performance while large boards had a positive influence on performance. The study results were inconclusive and open to further research. The study was conducted in Sri Lanka whose context is different from Kenya and covered manufacturing companies. This study thus created a contextual gap. The current study focused on insurance firms and was conducted in Kenya.

2.3 Hypothesis of the Study

H_0: Corporate governance has no significant relationship with performance of insurance companies in Kenya.

2.4 Conceptual Framework

The study's conceptual framework indicates a relationship between corporate governance as the independent variable and organization performance as the dependent variable. The conceptual model is illustrated in Figure 1.

Independent Variable **Dependent Variable**

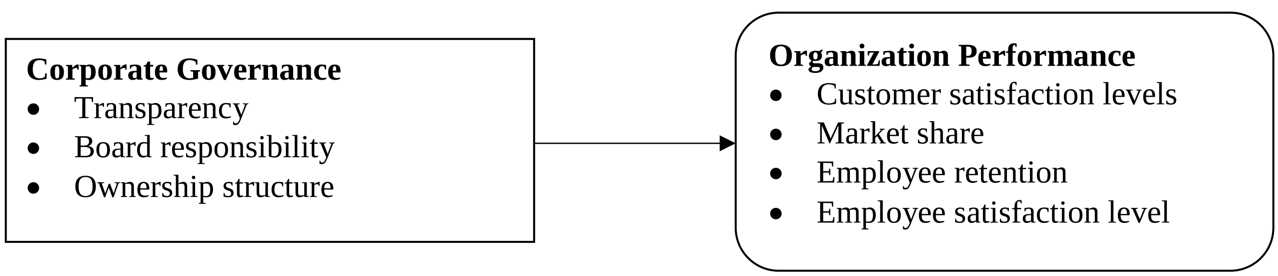

Figure 1: Conceptual Model

3. Research Methodology

The philosophical foundation of this study was positivism, where quantitative data was used. This study thus adopts the positivist philosophy which is founded on objectivity, precision and scientific rigor to develop knowledge as opposed to the phenomenological approach which focusses on personal knowledge and subjectivity (Van Manen, 1997). The cross-sectional survey design was adopted for this study in order to provide relevant information of the extent to which corporate governance influences performance of insurance companies in Kenya. The study population comprised of fifty two (52) insurance companies in Kenya licensed by the Insurance Regulatory Authority (IRA) as at December 2017. These insurance companies constituted the unit of analysis.

The respondents were the Senior Managers and the general employees. Census method was used to obtain the number of senior management employees where a CEO and Human Resource Manager were selected from each insurance company (52*2=104). According to IRA (2017) report the total number of employees in the registered insurance companies was 7,411. Of this, 7,307 were general employees. These general employees were selected using Kothari's sampling formulae where a sample of 365 was realized. From the total of 365 general employees, 2 were

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selected from each of the 52 insurance company totaling to 104. This was done since the general employees work in the same organization and their responses were likely to be the same. Stratified random sampling was used to obtain the 104 general employees from the insurance companies. 20 participants were used for piloting and therefore, the total sample size was 188 made of 94 respondents in senior management and 94 from general employees. Table 1 shows the distribution of the respondents.

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Table 1: Distribution of the Respondents

Category	Position	No. of Insurance Firms	Number	Pilot	Total
Senior Managers	CEO	52	1*52	5	47
	HRM	52	1*52	5	47
General Employees	Junior	52	2*52	10	94
Total				**20**	**188**

The study used primary data that was collected using questionnaires. Prior to running a regression model pre-estimation and post estimation tests were conducted. The diagnostic tests conducted were; normality test, multicollinearity, heteroscedasticity and linearity tests. The diagnostic analysis results met the requirements for conducting Classical Linear Regression Model.

An empirical model was used to test the statistical significance of the independent variable (corporate governance) on the dependent variable (performance) in insurance companies in Kenya.

The model for the study:

$P = \beta_0 + \beta_1 CL + \varepsilon$

Where:

P = Performance

CG= Corporate Governance

β_0 = Constant

β_1= Beta coefficients

ε = Error term

4. Results and Findings

The study realized a success rate of 85.11%. According to Mugenda and Mugenda (2003) and Kothari (2004), a response rate of above 50% is adequate for a descriptive study. Babbie (2004) also asserted that return rates of above 50% are acceptable to analyze and publish, 60% is good and 70% is very good. Thus, 85.11% was considered very good for the study.

4.1 Correlation Analysis

Correlation analysis was carried out to determine the association between corporate governance, and organization performance. The correlation results are presented in Table 2.

Table 2: Correlation Matrix

Variables		Performance	Corporate Governance
Performance	Pearson Correlation	1.000	
	Sig. (2-tailed)		
Corporate Governance	Pearson Correlation	0.718**	1.000
	Sig. (2-tailed)	0.000	

The results in Table 2 indicated that corporate governance was positively and significantly associated to performance (r=0.718, p=0.00<0.05). This was an indication that corporate governance portrayed a strong connection with performance. Similar study by Saeed *et al*., (2015) found a positive relationship between corporate governance, intellectual capital and corporate performance.

4.2 Hypothesis Testing

The objective of the study was to establish the relationship between corporate governance and performance of insurance companies in Kenya. Regression model was used to test the statistical significance of the independent variable (corporate governance) on the dependent variable (performance) in insurance companies in Kenya. To facilitate the application of the regression model, weighted averages of the three constructs (transparency, board responsibility and ownership structure) for independent variable was computed to obtain a composite index of corporate governance. The hypothesis stated in the null form is as follows:

H_{01}: Corporate governance has no significant relationship with performance of insurance companies in Kenya.

This hypothesis was tested by regressing CG and performance guided by the equation $P = \beta_0 + \beta_1 CG + \varepsilon$

Where P = Performance, CG= Corporate Governance. The results of the regression are presented in Tables 3, 4 and 5.

As presented in the Table 3, the coefficient of determination R Square is 0.515. The model indicates that Corporate Governance explains 51.5% of the variation in performance. This means 51.5% of the performance is influenced by corporate governance. This implies that there exist a positive significant relationship between corporate governance and performance.

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Table 3: Model Fitness for Corporate Governance

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
	.718a	0.515	0.509	2.76695

a Predictors: (Constant), Corporate Governance

The Analysis of Variance (ANOVA) results are shown in Table 4. The findings further confirm that the regression model of performance on corporate governance is significant and supported by F=82.935, p<0.05.

Table 4: ANOVA for Corporate Governance

	Sum of Squares	df	Mean Square	F	Sig.
Regression	734.864	1	734.864	82.935	.000
Residual	691.136	78	8.861		
Total	1426	79			

Table 5 shows the coefficient for corporate governance.

Table 5: Corporate Governance and Performance

	Unstandardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	t	Sig.
(Constant)	-4.669	1.355		-3.444	0.001
Corporate Governance	3.622	0.398	0.718	9.107	0.000

The fitted model from the result is

$OP = -4.669 + 3.622CG$

The results indicated a constant value of -4.669, which implied that holding all other factors constant, performance would remain at 4.669 units. Further, the results indicated that a unit change in Corporate Governance would increase performance by the rate of 3.622. The null hypothesis of the study was stated that corporate governance has no significant relationship with performance of insurance companies in Kenya. Since, the p value 0.000<0.05 was less than the critical value 0.05, the study rejected the null hypotheses. Therefore, corporate governance has a significant relationship with performance of insurance companies in Kenya.

4.3 Discussion

The objective of the study was to establish the relationship between corporate governance and performance of insurance companies in Kenya. The influence of corporate governance was evaluated based on dimensions of three constructs namely transparency, board responsibility and ownership structure. These were evaluated against the indicators of performance in order to test the influence on dimensions, regression analysis was done to find out if the model was sufficient or not to support the hypothesis. The influence of corporate governance on performance was measured against performance.

The findings indicated that when transparency, board responsibility and ownership structure are held constant, performance would remain at -4.669. An increase in Corporate governance by one unit would lead to an increase in performance of insurance companies by 3.622 units with a p-value of 0.000 <0.05. The null hypothesis of the study was corporate governance has no significant relationship with performance of insurance companies in Kenya. Since, the p value<0.05, the study rejects the null hypotheses and thus Corporate governance has a significant relationship with performance of insurance companies in Kenya.

The results indicated that corporate governance influences performance, therefore it can be concluded that higher profitability for the insurance firms is due to better corporate governance practice. The results were supported by prior research on the relationship between corporate governance and performance. The results were consistent with the study conducted by Shleifer and Vishny (2017) who reported that there is a positive relation between ownership concentration and firm performance. It is confirmed further by Davidson *et al*., 2016 who found a positive relationship between corporate governance and performance. The findings also agree with those of Zaman *et al*., (2018) who established that financial performance was positively related to transparency and disclosure among the banks in Pakistan. Further, the findings are consistent with Amba (2018) who established and finds a positive correlation between financial performance and proportion of institution ownership among firms trading in Buhrain house, Newyork. The study looked at the influence of corporate governance variables namely ownership structure, non – executive directors, CEO duality, audit committee, institutional investors on financial performance and multiple regression analysis was used to analyse the financial performance measured by return on assets on corporate governance variables.

However, other scholars have different views on the relationship between corporate governance and firm performance. Chen *et al,* (2016) on the other hand evaluated the effects of board composition and effects of direct incentives on performance and found no relationship. Daily and Dalton (2019) used both accounting based measures and market based performance measures and they found no association between corporate governance and performance.

5. Conclusion

The study investigated the relationship between corporate governance and performance and indicated that good corporate governance enhances performance and therefore supports the existing literature. The results indicated that good corporate governance influences performance, therefore, it can be concluded that higher profitability for the insurance firms is as a result of better corporate governance practices. Subsequently, insurance firms need to maintain good corporate governance practices by having appropriate board structures and composition that

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takes into consideration diversification of expertise. The constructive outcome of corporate governance on financial performance is driven by a well-working corporate governance framework that helps a firm attract investors, raise finances and fortify the establishment for performance. Further, a firm with suitable corporate governance structure has more significant access to financing can bring down the cost of capital and consequently have better performance.

6 Recommendations

The study emphasizes the importance of how corporate governance influences performance of organizations positively. Policy and decision makers need to ensure that appropriate corporate governance mechanisms are implemented in organizations. The results of the study augment earlier literature on the effect of corporate governance on performance; hence policy makers can utilize the findings of this study in developing policies on corporate governance mechanisms of ownership structure, board responsibility and transparency. This constructs of corporate governance play a key role in effective governance of organizations. Policy and decision makers can use the findings in developing codes of governance that govern the practice. The experts can utilize the findings to enrich codes of governance to include people management and leadership making them more effective especially against the backdrop of several corporate collapses that have been linked to the people factor in organizations.

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