# THE RELATIONSHIP BETWEEN INVESTMENT STRATEGIES AND PROFITABILITY IN THE INSURANCE INDUSTRY IN KENYA

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## Abstract

*Purpose:* The Study sought to find the relationship between investment strategies and profitability in the insurance industry in Kenya

*Methodology:* The study adopted a descriptive survey research design. This study used both primary data from the respondents of the research instruments and the secondary data available from the financial statements. The study took 50% of the population as the sample size. This yielded 22 insurance companies. Both qualitative and quantitative data was collected using a questionnaire that consisted of both open ended and close ended questions. Data was analyzed using Statistical Package for Social Sciences (SPSS) and results presented in frequency tables to show how the responses for the various questions posed to the respondents.

*Results:* Results indicated that there is a positive and significant relationship between investment strategies and profitability, ROA and ROE of insurance companies. Specifically, it was revealed that passive strategies are more superior to active strategies as they enhance profitability. The results imply that insurance firms invest in local stocks, international equity, cash equivalents, bonds and investment in associates and subsidiaries in an effort to diversify.

*Unique contribution to theory, practice and policy:* The study recommends that insurance firms should continue investing in local stocks, international equity, cash equivalents, bonds and investment in associates and subsidiaries in an effort to diversify their portfolio. It is also recommended that insurance firms should reduce their holdings in real estate to safeguard their liquidity. The study recommends that insurance firms should use passive strategies as opposed to active strategies as this would enhance their profitability. Passive strategies are less costly compared to the active strategies.

*Keywords: Investment, insurance industry, investment strategies, profit income, profitability,*

## 1.0 INTRODUCTION

### 1.1 Background of the Study

The chapter discusses the background of the study by focusing on concepts such as investments, investment strategies, profitability, and insurance industry. It also discusses the problem statement by highlighting the knowledge gap. Furthermore, the chapter describes the purpose of the study, the study objectives, research questions, assumptions and significance of the study. The chapter then defines key terms after which a summary of the whole chapter is given.

In the 21$^{st}$ Century economy, successful firms must be strategically positioned to handle and take advantage of the ever changing markets. They must be prepared to handle issues such as global competition to maintain a sustainable competitive advantage. One of the more popular and significant strategic decisions is making sound Investments (Olawale, Olumuyiwa, & George, 2010). Murad (1964), defines the term investment as the purchase of any income-yielding asset, such as securities or real estate. Investment can also be defined as the addition to the value of the capital equipment which has resulted from the productive activity of the period. In their study "Investment decisions in a developing economy: A case study of insurance business in Nigeria", Akitoye and Felix (2008), argue that the behaviour of insurance companies and investment decisions are postively related to the total premium ratio and profitability but inversely and significantly related to the growth of the economy".

Jones, (2009) defines investment strategy as a set of rules or procedures that guide an investor's selection of an investment portfolio. The strategy is designed around the investor's risk-return trade off. A well planned investment strategy is essential before having any investment decisions. Investment strategies are ways by which an investor can acquire the expected return, given a specific risk tolerance level. Investment strategies are adopted at organizational, industry and market level and serve as a guide for entering and selecting investment portfolios (Fama & French, 1992).According to Damodaran (2009), insurance companies make their income in two ways. One is through the premiums they receive from those who buy insurance protection from them and the other is income from the investment portfolios that they maintain to service the claims. Nissim (2010) further states that the financial factors such as availability of internal finance, ease of access to debt of new equity finance of the functioning of the borrower's investment project affect the investment behavior of most firms.Premiums received by the companies are invested and earn investment income in the form of dividends and interest from the shares and other investments owned by the company. Additional profit may result from eventual disposal of the shares at a higher price than they originally cost. Invested assets constitute the majority of Insurers' assets.

Investment decision-making is the process whereby resources are allocated in organizations in anticipation of future gains (Butler, Davies, Pike, & Sharp, 1993).The value of any firm can be viewed as the sum of the value of its investment projects. Thus, making the correct strategic investment decisions is of critical importance to maximizing the value of the firm (Hammer, 2009).The global competition for any business is becoming intense and rigorous by the day. For the insurance industry to survive and develop, they must make investments that enable them to offset the possible underwriting losses and make considerable profit (Jia & Hao, 2009).They further observe that,

*"Unlike in the developing markets, the Capital utilization rate of insurance companies in developed markets usually can reach 90%, and the investment involves stocks, bonds, funds, futures, foreign exchange trading, real estate, and mortgage loan. The developing markets investment channels still need to be expanded to improve the financial environment. Efficient and diversified insurance investments in developed countries have brought the insurance companies huge profits. According to Swiss Re's statistics, during a range of 20 years, the average rate of return on insurance funds in developed countries is more than 8%. That high investment return helped the insurance companies to consolidate their profit, although they may have an underwriting loss…"*

The Insurance Industry is the second largest financial services industry after banking in terms of market capitalization. The financial services sector accounted for 6% of all full time employees in the United States in the 2002 economic census. Given the importance of financial service companies to the economy, the crisis of 2008 acted as a wakeup call for investors. As stock prices at established firms like AIG, Citigroup and Bank of America collapsed; the fragility of the system came to the fore. At the same time, the failure of the banking system made people more aware of how dependent the entire economy is on the health of financial service firms. Without banks lending money and insurance companies pooling risk, the rest of the real economy came to a standstill (Damodaran, 2009).

In Kenya, the insurance industry seemed so far to have escaped the worst ravages of the financial crisis. Apart from a handful of high profile casualties like BlueShield, Stallion, Kenya National, United, Lakestar ,Liberty, Access, Invesco and Standard  who all went through a period of financial difficulties and eventually became insolvent. Mainstream business operations are holding up well. Problems only arise from exposures to risky financial instruments such as capital market stocks and losses on investment portfolios. Profitability is more likely to have been impacted than underlying solvency (KPMG, 2009).

This study aimed at finding out how the firms in the insurance industry in Kenya have done their investments, assess their profitability and evaluate the relationship between investments strategies and profitability.

## 1.1.1 Profitability

Soto (2006),in his study notes that profitability is, in general, the efficiency of a company or industry at generating earnings. It is necessary to invest to make a business profitable no matter what kind of business. It also seems reasonable that current profitability is related to future investment and that current investment is related to future profitability. Profitability is variously interpreted as net income, equity value and return on investment and it is a result focused indicator watched more carefully than any other performance measurement category (Robert & Robin, 1998).According to Brainard (2008), performance in the insurance industry can either be financial or non financial performance. Financial performance is profit performance and investment performance. Non-financial performance can be evaluated by looking at the internal and external factors. The net result of a well functioning insurance market should be better pricing of risk,greater efficiency in the overall allocation of capital and mix of economic activities and higher productivity.The performance of an organization is the outcome of activities of individuals and units of the organization (Kasturi, 2006). Bertoneche and Rory (2001) argue that the financial performance of an institution is usually measured using a combination of analyses and review of the financial statements, financial ratios analysis, benchmarking against the best performing institutions in the industry, measuring the performance against a budget or a mix of all these methodologies.

In his paper on the comparison of financial performance in the banking sector,Taranneth(2006), argues that the common assumption under which much of the financial performance research and discussions revolve around, is that increasing financial performance will lead to improved functions and activities of the organization. He further observes that there are three principal factors to improve financial performance for financial institutions; the institution size, its asset management, and the operational efficiency. The insurance firms make money by investing the difference between the premiums collected and the claims paid out and management expenses. The firms use the difference to build the investment portfolios and other assets.

Ratios used to evaluate profitability include Return on Equity and return on Investment. These ratios are relevant in all firms but they are particularly important when analyzing the insurance and other financial services companies. In addition, ratios specifically used in analyzing insurers include the combined and operating ratios and their components, underwriting leverage, investment yield and investment return. These measures are important for evaluating profitability and primary net asset turnover (Nissim, 2010).

### 1.1.2 Insurance Industry

Scott and Gregory(2004), observe that insurance is the most important form of risk management. It is basically the transfer of risk from one person (or party) to another for a specified premium. It plays an important role in social and economic development of a society by offering diverse benefits to individuals, groups, countries, and the world in general.

According to Geneva (2009),insurance plays a major role for the efficient and sustainable development of modern economies harboring expertise that is unavailable elsewhere. It is a consideration to make for any economic action, facilitates new ventures and is intertwined with the most basic human needs and aspirations. In the world over, insurance is essential for any viable economy since it assumes risks that could potentially result in financial ruin for an individual or enterprise.Statitics have shown that the insurance industry is a strong lever for implementing sustainability due to its size,the extent of its reach into the community and the significant role it plays in the economy.In 2005,the worldwide premium volume exceeded USD 3.4 trillion,making insurance the largest industry in the global economy,while its global assets under management stood at USD 16.6 trillion Geneva (2009).

The insurance industry is awakening to the fact that acting sustainability,as in the cases of internal resource efficiency and money saving are concrete ways of leading by example.Beyond their principle existence of managing and carrying risks,insurers are major institutional investors and increasingly recognise that responsible investment is a critical component of the overall sustainable insurance agenda (Bacani, 2007).Brainard (2008) argues that insurance contributes materially to economic growth by improving the investment climate and promoting a more efficient mix of activites than would be undertaken in the absence of risk management instruments. The insurance industry contribute to the social development of a nation through its contribution of insurance to poverty alleviation and welfare of the poor through micro insurance.Recently there  has been new and innovative insurance covers in Kenya like last expense and funeral expenses cover that are meant to meet the costs of burial incase of a policyholder's demise.

In Europe,the insurance firms faired better than banks during the global financial crisis and resulting recession in 2008. However,they were shaken by investment losses,as were their

customers with market-linked products.They also suffered from capital base erosion. The insurers are responding to 2008 investment losses by focusing on ways to restore,replenish and protect their capital Ernst & Young(2010). The insurance firms in Kenya face the challenge of simultaneously building up the capital to meet the new share capital requirements and growing revenues by evaluating their existing business models.

The insurance industry in Kenya has played a vital role in the contribution into the social and economic grid. The sole function of insurance is to protect the policyholder from unforeseen losses due to certain insured for events. The premiums paid by all policy holders are put in a pool. The insurance companies invest the money in the pool to get a return. The insurance companies also have an insurer who insures the company against huge claims they are called the reinsurers. They protect insurance companies from large claims due to major calamity. The insurance industry is a capital intensive one. Unlike other financial institutions, the insurance industry in Kenya has been struggling with losses and low profits. This has led to situations where some insurance companies are unable to compensate the policyholder when a claim falls due.

## 1.2 Statement of the problem

Investments are an important factor in the profitability of the Insurance industry. The industry collects premiums from individuals and corporate firms. In exchange, the insurance firms undertake the risks on their behalf. The insurance firms are expected to invest the pooled monies to be able to pay the claims obligations as they fall due.In the recent past,several insurance companies in Kenya have been put under receivership or collapsed due to their inablity to meet the claims obligations falling due. One of the things that stand out in each of these companies is the low profitability of such companies in the years preceeding the collapse or the receivership (IRA,2011). This could mean that they did not make strategic investments and hence the study reviewed if there is any relationship between investment strategies and profitability of the insurance industry firms in Kenya. This also implies that the choice of investment strategy may have had an impact on their profitability.

In their study, Akitoye & Felix, (2008) concluded that the behaviour of insurance companies and investment decisions are postively related to the total premium ratio and profitability. In their study, Jia & Hao (2009) concluded that China insurance Companies have to increase investment return to meet rapid growth of total assets and consequently improve the profitability of the firms. Study on the area of investment strategy and return concetrate on market timing ability and its role in delivering superior returns. Studies by Christensen (2005), Chen and Liang (2005, Treynor and Mazuy (1966), Merton and Henriksson (1981) have mixed conclusions on the ability of market timing to deliver superior or above market returns. While Chen and Liang (2005) find evidence of a positive relationship between market timing and returns, Christensen (2005) does not. This implies that the area of study is riddled by inconclusiveness.

The closest study to the current one was by Mulindu (2007) who analyzed the impact of investment strategies on the performance of managed funds in Kenya. He took a case study of Fedha Management Limited and concluded that the poor performance of the managed funds could be attributed to the inconsistent use of strategies by managers and the emotional approach to investment management. The author asserted that pressure from emotional clients made investment managers change their investment strategies frequently which led to losses. There has

not been an attempt to assess the relationship between investment strategies and profitability on the insurance industry in Kenya. Therefore, the researcher does not know of any study that has been conducted on the insurance industry.

This study is a maiden attempt to tackle the relationship between investment strategies and the profitability of the Insurance sector in Kenya. The main focus of this study was a rigorous approach to investments strategies in the insurance sector and evaluating the profitability of the insurance sector so as to determine the relationship between investment strategies and the profitability of the industry.

## 1.3 Objective of the Study

I. To assess the types of investment done by the firms in the insurance industry in Kenya.
II. To establish the investment strategies of the firms in the insurance industry in Kenya.
III. To assess the profit income of the firms in the insurance industry in Kenya.
IV. To determine the relationship between the investment strategies and the profitability of the insurance companies in Kenya.

## 2.0 LITERATURE REVIEW

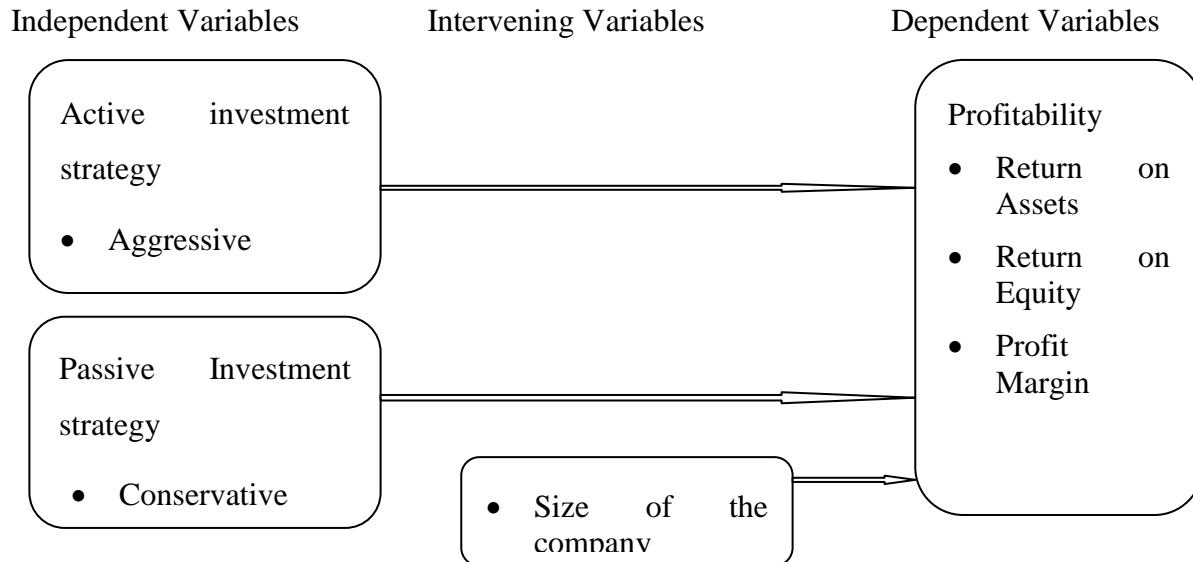### 2.1. Theoretical framework

### 2.1.1 The Neo-Classical theory

According to Davidson (1993), the core assumption of neo-classical investments theory is that in the objectives function of the enterprise, there is no separation of ownership and management in the modern corporation. All neo-classical models of the enterprise investment decisions begin with the assertion that the firm's objective is in pursuit of owners' objectives and thus the firms maximize the market value. The management concerns itself only with expected value of the distribution of expected future returns on prospective investment projects. The discount rate it applies to these expected returns does reflect perceived risk, but it is risk as evaluated from the investors' point of view.In his paper, Crotty, (1985) points out several problems with the neo-classical approach. He says that three points about value maximization are worthy of noting. Firstly, there is a great deal of empirical and institutional evidence that the agency problem exists which classical approach fails to recognize. Secondly, neo-classical have not generally agreed a method of choosing an enterprise objective function, for specifying the constraint set or even for identifying the cost of financial capital. Lastly, if the firms are independent from the owners and can make investment decisions that run counter to shareholders, perceived interests, there is no wealth holder control of, or sovereignty over the capital accumulation process and no mechanism to assure optimal coordination between the real and financial sectors of the economy, Thus when the management is independent, the real sector becomes semi-autonomous as well, a result that is inconsistent with the neoclassical vision.

The neo-classical model of investment is based on an explicit model of optimization that assumes efficient capital markets and perfect information. All firms have equal access to capital markets regardless of risk, therefore the cost of capital will only differ because of investment in demand. The neo-classical rests on assumptions that individuals maximize utility, firms maximize profits and people act independently on the basis of full and relevant knowledge (Jorgenson, 1996).

In a nut-shell, the neo classical investment theory demonstrate a well-coordinated and efficient system of market and assumes that long-lived capital assets have perfect or near perfect resale markets. Hence, with a perfect resale markets, the neo-classical investment decision is a riskless and reversible decision.

## 2.2 Conceptual Framework

Independent Variables        Intervening Variables        Dependent Variables

Active investment strategy
- Aggressive

Passive Investment strategy
- Conservative

- Size of the company

Profitability
- Return on Assets
- Return on Equity
- Profit Margin

**Source: Researcher (2012)**

**Figure 1: Conceptual Framework**

## 3.0 RESEARCH METHODOLOGY

The study adopted a descriptive survey research design. This study used both primary data from the respondents of the research instruments and the secondary data available from the financial statements. The study took 50% of the population as the sample size. This yielded 22 insurance companies. The target respondents were Finance and Investment managers, Underwriting manager and claims managers The target population of this study was all the insurance companies in Kenya. According to IRA (2011), there are 44 licensed insurance firms in Kenya. Both qualitative and quantitative data was collected using a questionnaire that consisted of both open ended and close ended questions. Data was analyzed using Statistical Package for Social Sciences (SPSS) and results presented in frequency tables to show how the responses for the various questions posed to the respondents. The data was then analyzed in terms of descriptive statistics like the researcher used bar charts, tables, and histogram and frequency polygons for displaying categorical data.

## 4.0 RESULTS AND DISCUSSIONS

### 4.1 Type of Product

The study sought to assess the type of insurance product. Information on type of product is important because it illustrates the composition of the firms under study. Results on type of product were given in figure 2.
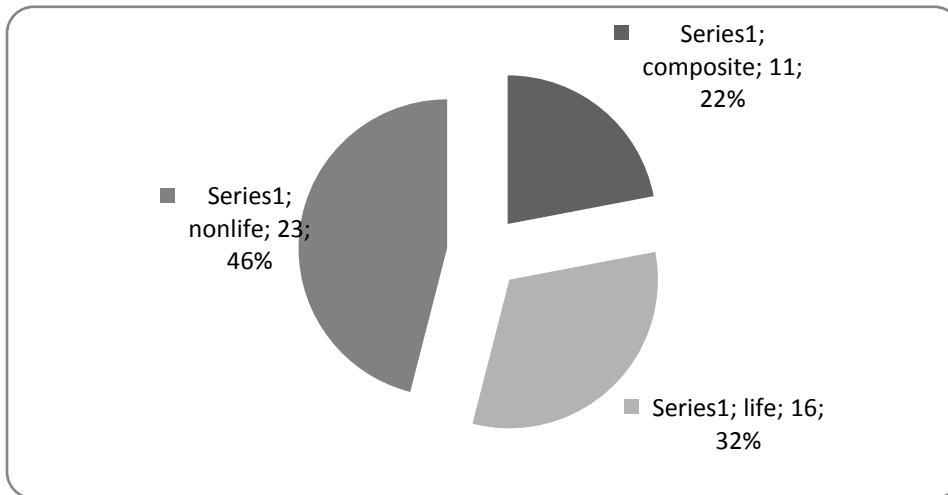
www.carijournals.org



**Figure 2: Type of Product**

Findings in figure 2 revealed that a majority (46%) of the respondents came from firms with non life products, 32% were from life products while 22% were from composite insurance products. The findings are in line with the composition and structure of the insurance industry as given by the Insurance regulatory Authority (IRA, 2011).

**4.2 Period of Existence**

The study sought to assess the period of existence of the firms under study. Information on period of existence is important because it illustrates whether the firms have been in existence long enough for them to observe a profit trend when executing different investment strategies. Results on period of existence were given in figure 3.
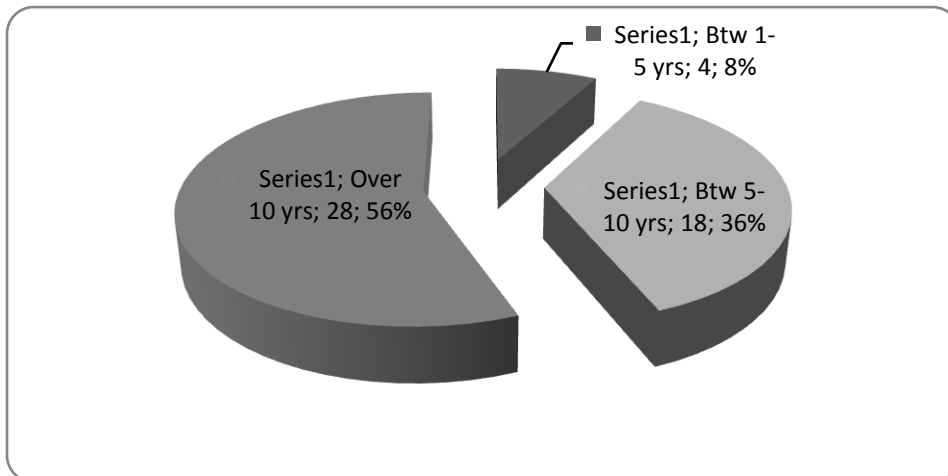


**Figure 3. Period of Existence**

Findings in figure 3 revealed that a majority (56%) of firms under study had been in existence for a period of over 10 years. A further 36% had been in existence for 5 to 10 years and 8% had been in existence for 1 to 5 years. The findings imply that the firms had been in existence long enough for them to observe a profit trend when executing different investment strategies.

### 4.3 Types of Investments

The study sought to assess the type of investments that insurance firms undertake. Such results would be crucial in understanding the preferred types of investments and the reasons underlying the preference. In addition, such information would facilitate the answering of the first research question or achieving the first research objective. One of the objectives of the study was to assess the type of investments that insurance firms undertake. Results on type of investment were presented in figure table 1 below.

### Table 1: Types of Investments

| | Strongly disagree | Disagree | Neither agree nor disagree | Agree | Strongly agree |
|---|---|---|---|---|---|
| Local stocks | 2% | 0% | 4% | 42% | 52% |
| International equity | 0% | 6% | 16% | 36% | 42% |
| Cash equivalents | 0% | 0% | 2% | 42% | 56% |
| Bonds | 0% | 4% | 16% | 34% | 46% |
| Real estate properties | 14% | 50% | 18% | 10% | 8% |
| Futures and options | 38% | 28% | 12% | 22% | 0% |
| Investment in associates and subsidiaries | 0% | 4% | 8% | 78% | 10% |

Results in table 1 revealed that a majority (52%) strongly agreed while a further (42%) agreed with the statement that local stocks form a significant proportion of the firm's investment portfolio. This brought to a total of (94%) of those respondents who generally agreed with the statement. Results in table 1 revealed that a majority (42%) strongly agreed while a further 36% agreed with the statement that international equity forms a significant proportion of the firm's investment portfolio. This brought to a total of (78%) of those respondents who generally agreed with the statement. Results in table 1 revealed that a majority (56%) strongly agreed while a further (42%) agreed with the statement that cash equivalents form a significant proportion of the firm's investment portfolio. This brought to a total of (98%) of those respondents who generally agreed with the statement. Results in table 1 revealed that a majority (46%) strongly agreed while a further 34% agreed with the statement that bonds forms a significant proportion of the firm's investment portfolio. This brought to a total of (80%) of those respondents who generally agreed with the statement. Results in table1 revealed that a majority (50%) disagreed while a further (14%) strongly disagreed with the statement that real estate forms a significant proportion of the firm's investment portfolio. This brought to a total of (64%) of those respondents who generally disagreed with the statement. Results in table 1 revealed that a majority (38%) strongly disagreed while a further (28%) disagreed with the statement that futures and options form a significant proportion of the firm's investment portfolio. This brought to a total of (66%) of those respondents who generally disagreed with the statement.Results in table 1 revealed that a majority (78%) agreed while a further (10%) strongly agreed with the statement that investment in associates and subsidiaries forms a significant proportion of the firm's investment portfolio. This brought to a total of (88%) of those respondents who generally agreed with the statement.The results imply that insurance firms invest in local stocks, international equity, cash

equivalents, bonds and investment in associates and subsidiaries in an effort to diversify. However, the insurances firms do not put a significant proportion of the investments portfolio in real estate, futures and options perhaps because they of compliance with the regulatory framework governing the insurance sector. The regulatory framework stipulates that only a small proportion of the investment portfolio should be put in real estate to safeguard liquidity. The findings concur with those of Shefrin (2006) who argues that overall, there are three different kinds of investments. These include stocks, bonds and Cash. The results also agree with Niehaus and Harrington (2003) who asserted that insurance companies usually invest in mortgages and real estate, cash and short term, corporate bonds and government bonds and Common and preffered stocks. The results also agree with those of Sornette (2003) who asserts that it is important for an organization to have a mix in the investments to caution against bad economic times for a certain type of investment. The results also agree with Pandey (2008) who says that there are many ways to classify investments. Some of the classifications are expansion of existing business, expansion of new business, replacement and modernization of equipments. Investment Strategies of the Firms in the Insurance Industry in Kenya.The study sought to establish the investment strategies of the firms in the insurance industry in Kenya. The findings on investment strategies are crucial in achieving the second objective of the study which was to establish the investment strategies of the firms in the insurance industry in Kenya.

## 4.4 Aggressive strategy

The study sought to establish whether insurance firms used aggressive investment strategies. The results were presented in Table 2 below.

**Table 2 Aggressive strategy**

|  | Strongly disagree | Disagree | Neither agree nor disagree | Agree | Strongly agree |
|---|---|---|---|---|---|
| The firm aims at outperforming the market with its investment portfolio through quick adjustments | 8% | 26% | 12% | 24% | 30% |
| The firms focus on high risk high return investments in the short to medium term | 10% | 16% | 20% | 10% | 44% |

Findings in table 2 revealed that a majority (30%) strongly agreed while a further 24% agreed with the statement that the firm aims at outperforming the market with its investment portfolio through quick adjustments. This brought to a total of (54%) those respondents who generally agreed with the statement. Findings in table 2 also revealed that a majority (44%) strongly agreed while a further 10% agreed with the statement that the firm focus on high risk high return investments in the short to medium term. This brought to a total of (54%) those respondents who generally agreed with the statement. The findings imply that insurance firms use an aggressive investment strategy. The findings concur with those of Schoenfeld and Steven (2004) who asserted that these investors who pursue an aggressive investment strategy focus on high return investments in the short to medium term and to achieve these high returns, they are willing to take higher risk.

## 4.5 Value Strategy

The study sought to establish whether insurance firms used value investment strategies. The results were presented in table 3 below.

### Table 3: Value Strategy

| | Strongly disagree | Disagree | Neither agree nor disagree | Agree | Strongly agree |
|---|---|---|---|---|---|
| The firm conducts market research and invests in undervalued stocks | 6% | 16% | 14% | 28% | 36% |
| The firm assumes that the market is yet to realize the potential of various stock it has identified and once it does, the price will go up significantly. | 6% | 20% | 14% | 32% | 28% |

Results in table 3 revealed that a majority (36%) strongly agreed while a further (28%) agreed with the statement that the firm conducts market research and invests in undervalued stocks. This brought to a total (64%) those respondents who generally agreed with the statement. Table 3 also revealed that a majority (32%) agreed while a further (28%) strongly agreed with the statement that the firm conducts market research and invests in undervalued stocks. This brought to a total (60%) those respondents who generally agreed with the statement. The findings imply that insurance firms pursue a value investment strategy. The findings concur with those in Jones (2009) who asserted that a value investment strategy consists of investing after detailed research and analysis of the company and the industry, and this is done with the assumption that the market is yet to realize the potential of the stock and once it does, the price will go up significantly.

## 4.6 Moderate Risk Investment Strategy

The study sought to establish whether insurance firms used moderate risk investment strategies. The results were presented in table 4 below.

### Table4: Moderate Risk Investment Strategy

| | Strongly disagree | Disagree | Neither agree nor disagree | Agree | Strongly agree |
|---|---|---|---|---|---|
| The Firm attempts to minimize the risk in their portfolio by adding a few stable stocks | 8% | 20% | 8% | 48% | 16% |
| The firm balances out the high risk stocks in their portfolio and keep their investment from being wiped out in case the markets go into a nosedive | 12% | 14% | 18% | 30% | 16% |

Table 4 reveals that a majority of respondents 48% agreed while a further 16% strongly agreed with the statement that the firm attempts to minimize the risk in their portfolio by adding a few stable stocks. This brought to a total of 64% those respondents who generally agreed with the statement. In addition, table4 also reveals that a majority (30%) agreed while a further 26% strongly agreed with the statement that the firm balances out the high risk stocks in their portfolio and keeps their investment from being wiped out in case the markets go into a nose dive. This brought to a total of 56% those who generally agreed. The finding implies that

insurance firms use a moderate risk investment strategy. The findings concur with those of Ferri (2009) who argued that in moderate risk investing, the investor attempts to minimize the risk in your portfolio by adding a few stable stocks.

### 4.7 Passive Strategies

The study sought to establish whether insurance firms used passive investment strategies. The results were presented in table 5 below.

### Table. 5: Passive Strategies

|  | Strongly disagree | Disagree | Neither agree nor disagree | Agree | Strongly agree |
|---|---|---|---|---|---|
| The firm seeks outs a consistent and dependable income rather than huge profits that come through higher risks. | 6% | 20% | 20% | 30% | 24% |
| The firm clientele is mainly composed of retirees who adopt a conservative investment approach to make sure they do not lose their savings and who prefer to invest in blue chip companies | 8% | 14% | 26% | 30% | 22% |
| The firm hesitate to make purchases even in market conditions show definite bullish tendencies | 6% | 14% | 18% | 32% | 30% |
| The firm holds back because of fear of losing money and thus fails to make the most of the stock market movements. | 6% | 28% | 8% | 30% | 28% |

Table 5 reveals that a majority (30%) of respondents agreed while a further (24%) strongly agreed with the statement that the firm seeks out a consistent and dependable income rather than huge profits that come through higher risks. This brought to a total of (54%) those respondents who generally agreed with the statement. Table 5 also revealed that a majority (30%) agreed while a further (22%) strongly agreed with the statement that the firm clientele is mainly composed of retires who adopt a conservative investment approach to make sure they do not lose their savings. This brought to a total of (52%) of those respondents who generally agreed with the statement. The findings imply that insurance firms use a conservative investment strategy which is one of the passive investment strategies. The findings also concur with Fama & French (1992) who asserted that a conservative investment strategy is carried out by investors who seek a consistent and dependable income rather than huge profits that come through higher risks. Results in table 5 revealed that a majority (32%) agreed while a further (30%) strongly agreed with the statement that the firm hesitates to make purchases even in market conditions which show definite bullish tendencies. This brought to a total of (62%) those who generally agreed with the statement. Table 5 also revealed that the majority of respondents (30%) agreed while another (28%) strongly agreed with the statement that the firm holds back because of fear of losing money and thus fails to make most of the stock market movements. This brought to a total of (58%) those who generally agreed with the statement. The findings imply that insurance firms use a highly risk averse investment strategy. The findings concur with those of Ferri (2009) who

assert that high risk averse investors hesitate to make purchases even when the market shows definite bullish tendencies.

## 4.8 Profit Income of the Firms in the Insurance Industry in Kenya.

The study sought to establish to establish the profit incomes accruing to firms in the insurance industry. The purpose of this was to fulfill the third objective of the study. The results were presented in figure 4.
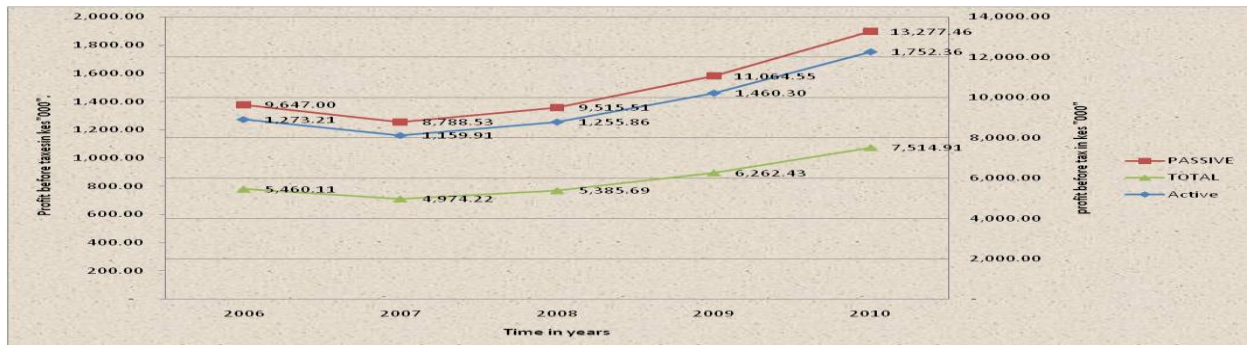


**Figure 4: Profit Income of the Firms in the Insurance Industry in Kenya**.

A trend analysis in figure 4 indicates that on average, the profitability of the selected sample of insurance firms who used a passive and active investment strategy in the year 2006 was kes 9.647 millions and kes 1.273 respectively.  Overall, the selected insurance firms posted an average profitability of kes 5.460 millions. However, the profitability for both categories of insurance firms declined in the year 2007 to kes 8.788 million for "passive" firms and to 1.159.91 for "active" firms. The overall profitability dropped to kes 4.974 million.  The drop in profitability coincided with the post election violence in Kenya as many insurance firms witnessed a drop in the premiums and an escalation in the operating costs. The findings are consistent with those in Insurance Regulatory Authority (2007) which asserted that the industry profit after tax decreased by 7.47% during the year 2007. Figure 6 also revealed that the profitability of the insurance sector has been on an upward trend since the year 2008. The relationship between Investment Strategies and the Profitability of the Insurance Companies in Kenya The study sought to establish the relationship between the investment strategies and the profitability of the insurance companies in Kenya. Firstly, the selected firms were grouped in accordance with how they had rated the use of passive and active strategies. A firm with a high likert score on passive strategies compared to active strategies was categorized as "passive" while a firm that scored highly on active strategies compared to passive strategies was classified as "active". An "active" firm was represented by a dummy of 1 while a "passive" was represented by a dummy of 2 to facilitate regression analysis. The results were presented in tables 6,7 and 8 below.

## Table 6: Model Summary

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|---|---|---|---|---|
| 1 | .985[a] | .971 | .969 | 995.59168 |

a. Predictors: (Constant), Gearing Ratio, Asset Base, Type of strategy

## Table 7: ANOVA

| Model | | Sum of Squares | Df | Mean Square | F | Sig. |
|---|---|---|---|---|---|---|
| 1 | Regression | 1.514E9 | 3 | 5.046E8 | 509.070 | .000[a] |
| | Residual | 4.560E7 | 46 | 991202.803 | | |
| | Total | 1.559E9 | 49 | | | |

a. Predictors: (Constant), Gearing Ratio, Asset Base, Type of strategy

b. Dependent Variable: PBT

## Table 8: Coefficients

| Model | | Unstandardized Coefficients | | Standardized Coefficients | | |
|---|---|---|---|---|---|---|
| | | B | Std. Error | Beta | T | Sig. |
| 1 | (Constant) | -10173.642 | 1467.394 | | -6.933 | .000 |
| | Type of strategy | 6496.257 | 1452.931 | .570 | 4.471 | .000 |
| | Asset Base | .111 | .004 | .886 | 25.551 | .000 |
| | Gearing Ratio | 16494.221 | 2773.542 | .727 | 5.947 | .000 |

a. Dependent Variable: PBT

PBT=-10173.642+6496.257Type of strategy+0.111Asset Base+16494.221Gearing Ratio

Results in table 6 revealed that the goodness of fit as demonstrated by an R squared of 0.971 was satisfactory. This indicated that 97.1% of the movements in the dependent variable (PBT) could

be explained by the movements in the independent variables namely Type of strategy, Gearing ratio and the asset base. Results in table 7 revealed that the independent variables (Type of strategy, Gearing ratio and the asset base) were good joint explanatory variables for the dependent variable (PBT) as shown by an F statistic of 509.07 and value of 0.000. Results in table 8 revealed that there exists a positive and significant relationship between the type of investment strategy and Profit before Tax (PBT). This was supported by a regression coefficient of 6496.257 (t=4.471, p value=0.00). The findings imply that the study reject the null hypothesis that "Ho.; There is no relationship between the investment strategies and profitability of the insurance firms in Kenya. The study therefore accepts the alternative hypothesis that "Ha; There is a relationship between the investments strategies and profitability of the insurance firms in Kenya. The findings concur with those in Jones(2009) who asserted that the main advantage of the passive investment strategy it has lower operating costs. In addition, active investment may be advantageous in its possibility that the managers of the portfolio may be able to outperform the index due to their superior skills. However, in line with the Efficient Market Hypothesis (EMH), this is rarely the case as market is efficient. A market is said to be "efficient" if prices adjust quickly and, on average, without bias, to new information. As a result, the current prices of securities reflect all available information at any given point in time. Consequently, there is no reason to believe that prices are too high or too low and one cannot consistently use an active strategy to outperform the market. The findings also agree with Ferri (2009) who argued that active strategies may be disadvantageous as they are more costly because of the high fees and operating expenses resulting from regular monitoring.

### 4.9 The Relationship between ROA and Investment Strategy

The study attempted to establish the relationship between ROA and Investment Strategy. The results were presented in 9, 10 and 11 below.

### Table 9: Model Summary

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|---|---|---|---|---|
| 1 | .999[a] | .998 | .998 | .00283 |

a. Predictors: (Constant), Gearing Ratio, Asset Base, Type of strategy

### Table 10: ANOVA

| Model | | Sum of Squares | Df | Mean Square | F | Sig. |
|---|---|---|---|---|---|---|
| 1 | Regression | .192 | 3 | .064 | 8020.410 | .000[a] |
| | Residual | .000 | 46 | .000 | | |
| | Total | .193 | 49 | | | |

a. Predictors: (Constant), Gearing Ratio, Asset Base, Type of strategy

b. Dependent Variable: ROA

**Table 11: Coefficients**

| Model | | Un-standardized Coefficients | | Standardized Coefficients | T | Sig. |
|---|---|---|---|---|---|---|
| | | B | Std. Error | Beta | | |
| 1 | (Constant) | -.502 | .004 | | -120.494 | .000 |
| | Type of strategy | .425 | .004 | 3.351 | 102.929 | .000 |
| | Asset Base | 8.397 | .000 | .006 | .681 | .500 |
| | Gearing Ratio | 1.006 | .008 | 3.991 | 127.772 | .000 |

a. Dependent Variable: ROA

ROA=-0.502+0.425Type_of_strategy+8.397Asset Base+1.006Gearing Ratio

Results in table 9 revealed that the goodness of fit as demonstrated by an R squared of 0.998 was satisfactory. This indicated that 99.8% of the movements in the dependent variable (ROA) could be explained by the movements in the independent variables namely Type of strategy, Gearing ratio and the asset base. Results in table 4.5 revealed that the independent variables (Type of strategy, Gearing ratio and the asset base) were good joint explanatory variables for the dependent variable (ROA) as supported by an F statistic of 8020.4 and value of 0.000. Results in table 11 revealed that there exists a positive and significant relationship between the type of investment strategy and Return on Assets (ROA). This was supported by a regression coefficient of 0.425 (t=102.929, p value=0.00).The findings imply that the study reject the null hypothesis that "Ho.; There is no relationship between the investment strategies and profitability of the insurance firms in Kenya. The study therefore accepts the alternative hypothesis that "Ha; There is a relationship between the investments strategies and profitability of the insurance firms in Kenya.

The Relationship between ROE and Investment Strategy

The study attempted to establish the relationship between ROE and Investment Strategy. The results were presented in 12, 13 and 14 below.

**Table. 12: Model Summary**

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|---|---|---|---|---|
| 1 | .999[a] | .998 | .998 | .00233 |

a. Predictors: (Constant), Gearing Ratio, Asset Base, Type of strategy

**Table. 13: ANOVA**

| Model | | Sum of Squares | df | Mean Square | F | Sig. |
|---|---|---|---|---|---|---|
| 1 | Regression | .130 | 3 | .043 | 7955.677 | .000ᵃ |
| | Residual | .000 | 46 | .000 | | |
| | Total | .130 | 49 | | | |

a. Predictors: (Constant), Gearing Ratio, Asset Base, Type of strategy

b. Dependent Variable: ROE

**Table 14: Coefficients**

| Model | | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|---|---|---|---|---|---|---|
| | | B | Std. Error | Beta | | |
| 1 | (Constant) | -.410 | .003 | | -119.239 | .000 |
| | Type of strategy | .341 | .003 | 3.276 | 100.211 | .000 |
| | Asset Base | 1.673 | .000 | .015 | 1.644 | .107 |
| | Gearing Ratio | .814 | .006 | 3.928 | 125.265 | .000 |

a. Dependent Variable: ROE

ROE=-0.410+0.341Type of strategy+1.673Asset Base+0.814Gearing Ratio

Results in table 12 revealed that the goodness of fit as demonstrated by an R squared of 0.998 was satisfactory. This indicated that 99.8% of the movements in the dependent variable (ROE) could be explained by the movements in the independent variables namely Type of strategy, Gearing ratio and the asset base. Results in table 13 revealed that the independent variables (Type of strategy, Gearing ratio and the asset base) were good joint explanatory variables for the dependent variable, ROE as supported by an F statistic of 7955.677 and pvalue of 0.000. Results in table 14 revealed that there exists a positive and significant relationship between the type of investment strategy and Return on Equity (ROE). This was supported by a regression coefficient

of 0.341 (t=100.211), p value=0.00.The findings imply that the study reject the null hypothesis that "Ho.; There is no relationship between the investment strategies and profitability of the insurance firms in Kenya. The study therefore accepts the alternative hypothesis that "Ha; There is a relationship between the investments strategies and profitability of the insurance firms in Kenya.

The findings also concur with those of Malik (2011) who pointed out that the key factors that influence profitability of the insurance industry are the age of the company, the size of the company, volume of capital, leverage ratio and the loss ratio.

# 5.0 DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS

## 5.1 Summary of the Study

In this chapter, the researcher discuses and presents the overall findings of the study. An attempt is made to provide answers to the research questions in the light of the existing theories and within the theoretical framework derived from the literature review. The chapter also presents conclusions, recommendations drawn from the study and suggests possible areas of further research. The purpose of the study was to seek answers to the four research questions. The study findings in response to these questions were to enable the researcher to meet four research objectives. The research findings are presented in the same format that the objectives had been stated. One of the objectives of the study was to assess the types of investment of the firms in the insurance industry in Kenya. Findings indicated that a large majority (94%) of respondents generally agreed with the statement that local stocks form a significant proportion of the firm's investment portfolio. Results also reveal that a majority (78%) of respondents generally agreed with the statement that international equity forms a significant proportion of the firm's investment portfolio. Findings indicated that a majority (98%) of respondents generally agreed with the statement that cash equivalents forms a significant proportion of the firm's investment portfolio. Results further indicated that a total of (80%) of respondents generally agreed with the statement that bonds forms a significant proportion of the firm's investment portfolio. Results revealed that a majority (64%) of those respondents generally disagreed with the statement that real estate forms a significant proportion of the firm's investment portfolio. Results revealed that a majority (66%) of those respondents generally disagreed with the statement that futures and options forms a significant proportion of the firm's investment portfolio. Results revealed that a majority (88%) of those respondents generally agreed with the statement that investment in associates and subsidiaries forms a significant proportion of the firm's investment portfolio.The results imply that insurance firms invest in local stocks, international equity, cash equivalents, bonds and investment in associates and subsidiaries in an effort to diversify. However, the insurances firms do not put a significant proportion of the investments portfolio in real estate, futures and options perhaps because they of compliance with the regulatory framework governing the insurance sector. The findings concur with those of Shefrin (2006) who argues that overall, there are three different kinds of investments. These include stocks, bonds and Cash. The results also agree with Niehaus and Harrington (2003)  who asserted that insurance companies usually invest in mortgages and real estate, cash and short term, corporate bonds and government bonds and Common and preferred stocks. The second research objective was to establish the investment strategies of the firms in the insurance industry in Kenya. Findings revealed that insurance firms in Kenya use both passive and active investment strategies. The active strategies being used include; an aggressive strategy as indicated by (54%) and (54%) of

respondents who agreed to the two statements, a value Strategy as indicated by (64%) and (60%) of respondents who agreed to the two statements and a moderate risk investment strategy as indicated by (64%) and (56%) of respondents who agreed to the two statements. The passive strategies included; a conservative investment strategy as indicated by (54%) and (52%) of respondents who agreed to the two statements and a high risk averse strategy as indicated by (62%) and (58%) of respondents who agreed to the two statements. The findings concur with those of Schoenfeld and Steven (2004) who asserted that these investors who pursue an aggressive investment strategy focus on high return investments in the short to medium term and to achieve these high returns, they are willing to take higher risk. The findings concur with those in Jones (2009) who asserted that a value investment strategy consists of investing after detailed research and analysis of the company and the industry, and this is done with the assumption that the market is yet to realize the potential of the stock and once it does, the price will go up significantly. The findings concur with those of Ferri (2009) who argued that in moderate risk investing, the investor attempts to minimize the risk in your portfolio by adding a few stable stocks.The findings also concur with Fama & French (1992) who asserted that a conservative investment strategy is carried out by investors who seek a consistent and dependable income rather than huge profits that come through higher risks. The findings concur with those of Ferri (2009) who assert that high risk averse investors hesitate to make purchases even when the market shows definite bullish tendencies. The third research objective was to assess the profit income of the firms in the insurance industry in Kenya. A trend analysis in figure indicates that on average, the profitability of the selected sample of insurance firms who used a passive and active investment strategy in the year 2006 was kes 9.647 millions and kes 1.273 respectively. Overall, the selected insurance firms posted an average profitability of kes 5.460 millions. However, the profitability for both categories of insurance firms declined in the year 2007 to kes 8.788 million for "passive" firms and to 1.159.91 for "active firms". The overall profitability dropped to kes 4.974 million. The drop in profitability coincided with the post election violence in Kenya as many insurance firms witnessed a drop in the premiums and an escalation in the operating costs. The findings are consistent with those in Insurance Regulatory Authority (2007) which asserted that the industry profit after tax decreased by 7.47% during the year 2007. Figure 4.12 also revealed that the profitability of the insurance sector has been on an upward trend since the year 2008.The fourth research objective was to determine the relationship between the investment strategies on the profitability of the insurance companies in Kenya. Results indicated that there is a positive and significant relationship between investment strategies and profitability, ROA and ROE of insurance companies. Specifically, it was revealed that passive strategies are more superior to active strategies as they enhance profitability. The relationship between type of strategy and PBT was supported by a regression coefficient of 6496.257 (t=4.471, pvalue=0.00).The relationship between type of strategy and ROA was supported by a regression coefficient of 0.425 (t=102.929, p value=0.00). The relationship between type of strategy and ROE was supported by a regression coefficient of 0.341 (t=100.211, p value=0.00).The findings concur with those in Jones(2009) who asserted that the main advantage of the passive investment strategy it has lower operating costs. In addition, active investment may be advantageous in its possibility that the managers of the portfolio may be able to outperform the index due to their superior skills. The findings also agree with Ferri (2009) who argued that active strategies may be disadvantageous as they are more costly because of the high fees and operating expenses resulting from regular monitoring.

## 5.2 Conclusion

The study made the following conclusions that the local stocks, international equity, that cash equivalents, that bonds, investment in associates and subsidiaries forms a significant proportion of the firm's investment portfolio. However, the study also concludes that real estate do not form a significant proportion of the firm's investment portfolio and that futures and options do not form a significant proportion of the firm's investment portfolio. The study concludes that insurance firms invest in local stocks, international equity, cash equivalents, bonds and investment in associates and subsidiaries in an effort to diversify their portfolio. However, the insurances firms do not put a significant proportion of the investments portfolio in real estate, futures and options perhaps because they of compliance with the regulatory framework governing the insurance sector.

The study also concludes that insurance firms in Kenya use both passive and active investment strategies. The active strategies being used include; an aggressive strategy, a value strategy and moderate risk investment strategy .The passive strategies included; a conservative investment strategy and a high risk averse strategy. The study also concludes that that there is a positive and significant relationship between investment strategies and profitability ROA and ROE of insurance companies. Specifically, it was revealed that passive strategies are more superior to active strategies as they enhance profitability.

## 5.3 Recommendations

The study recommends that insurance firms should continue investing in local stocks, international equity, cash equivalents, bonds and investment in associates and subsidiaries in an effort to diversify their portfolio. It is also recommended that insurance firms should reduce their holdings in real estate to safeguard their liquidity. The study recommends that insurance firms should use passive strategies as opposed to active strategies as this would enhance their profitability. Passive strategies are less costly compared to the active strategies.

## 5.4 Recommendations for Further Research

One area of further research is the behavioral approach to choice of investments in the insurance industry. Further research can also be done on the role of the insurance industry in financial inclusion in Kenya. Further studies should be done on the level of stock market efficiency in Kenya. Such a study would test and validate the efficient market hypothesis.

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