EFFECT OF FINANCIAL ANALYSIS ON ORGANIZATIONAL PERFORMANCE OF INSURANCE COMPANIES IN KENYA

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ABSTRACT

The purpose of the study was to establish the effects of financial management practices on organizational performance of insurance companies in Kenya. The study adopted descriptive research design. The population of the research consisted of the 49 licensed insurance companies in Kenya as at 2013 which constituted the units of analysis. The study used both secondary and primary data. Secondary data was for the organizational performance of the companies while primary data was for the information on the financial management practices used by insurance companies in Kenya. Statistical Package for Social Sciences (SPSS) was used in the analysis of data and results were presented on frequency tables to show how the responses for the various variables and indicators posed to the respondents. Reliability and validity tests were conducted to determine the internal consistencies of the variables under investigation. Analysis of Variance (ANOVA), multiple regression and correlation analysis was carried out to test the hypothesis. The data was analyzed by use of descriptive and inferential statistics. Descriptive statistics produced

frequencies, trends, means and percentages while inferential statistics produced regression and correlation results which show the relationship among the variables. The study findings indicated that the company management was particular about monthly targets for each department as guided by departmental targets, management in their company conduct monthly and yearly budget variance analysis and management in their company does produce daily, weekly, monthly, quarterly and yearly financial reports. Regression and correlation results indicated that there was a positive and significant relationship between financial analysis and organization performance of insurance companies in Kenya. The study concludes that the firms have embraced the budgeting process which involves all the parties to ensure that all departments are well financed. The study findings also led to the conclusion that indeed budget was used in decision making and it is really management tool. It is therefore recommended that the management of insurance companies to consider putting in place the recommended steps seen as probable ways of ensuring that their financial management practices are improved for better return on assets. For instance they should enhance the process of preparation and publication of the company's financial statements, improve the company's capital structure and ensure that the companies fully utilize their debt facility according to their capabilities.

Key Words: ***Financial Analysis, Organization Performance, Insurance Companies, Financial Management Practices***

1. INTRODUCTION

The performance of any firm not only plays the role to increase the market value of that specific firm but also leads towards the growth of the whole industry which ultimately leads towards the overall prosperity of the economy. Assessing the determinants of performance of insurers has gained the importance in the corporate finance literature because as intermediaries, these companies not only provide the mechanism of risk transfer, but also helps to channelize the funds in an appropriate way to support the business activities in the economy. However, it has received little attention particularly in developing economies (Ahmed et al., 2011).

The subject of organizational performance has received significant attention from scholars in the various areas of business and strategic management. It has also been the primary concern of business practitioners in all types of organizations since organizational performance has implications to organization's health and ultimately its survival. High performance reflects management effectiveness and efficiency in making use of company's resources and this in turn contributes to the country's economy at large (Naser & Mokhtar, 2004).

Insurance companies provide unique financial services to the growth and development of every economy. Such specialized financial services range from the underwriting of risks inherent in economic entities and the mobilization of large amount of funds through premiums for long term

investments. The risk absorption role of insurers promotes financial stability in the financial markets and provides a "sense of peace" to economic entities. The business world without insurance is unsustainable since risky business may not have the capacity to retain all kinds of risks in this ever changing and uncertain global economy (Ahmed, 2010).

Firer et al. (2004) and Gitman (2007), describe financial management practices as to include five constructs namely; working capital management which is also subdivided into cash management, receivables management and inventory management. Other constructs under financial management include; investment, financing, accounting information systems, financial reporting and analysis.

Maseko and Manyani (2011) aver that accounting systems provide a source of information to owners and managers of small businesses operating in any industry for use in the measurement of financial performance. It is crucial therefore that the accounting practices of insurance companies supply complete and relevant financial information needed to improve economic decisions made by entrepreneurs.

The ability of insurance companies to continue to cover risk in the economy hinges on their capacity to create profit or value for their shareholders. Indeed, a well-developed and evolved insurance industry is a boon for economic development as it provides long- term funds for infrastructure development of every economy (Charumathi, 2012).

2. STATEMENT OF THE PROBLEM

The focus on the determinants of organizational performance and profitability measures for the insurance sector of a specific country is underscored by virtue of the fact that most countries have an intermediation-based financial system that have individual or firms such as agents that link customers with the organizations (Insurance Regulatory Authority, 2013). The relation between financial management practices and performance becomes extremely important when considering the fundamental role in value generation and distribution. Insurance companies today find themselves juggling a variety of challenges as they work to improve profitability, growth, and compete (Insurance Regulatory Authority, 2013).

According to Mudaki and Wanjere (2012) eight insurance companies in the last two decades had either been liquidated or placed under official receivership. The latest casualty being Concord

insurance company which was placed receivership in 2013 (IRA, 2013). Most empirical evidences on financial management practices and characteristics came from the developed economies such as the United States of America and there seems to be a lack of evidence from less developed countries like Kenya. Furthermore there has been little research examining the effect of financial management practices on profitability (McMahon, et al., 1993). This lack of empirical evidence from less developed economies and the lack of examination of the effect of financial management practices on organizational performance are major gaps in the knowledge of financial management.

Based on previous research findings and recognition of these gaps, a study of the effect of financial management on profitability is justified and the effect of financial management practices and financial characteristics should be developed and tested by using empirical data from less developed economies (Kieu, 2004). Existing Studies cover developed and emerging countries while most of the studies done in Kenya did not address the effect of financial management practices on organizational performance of insurance companies. As outlined above, it is evident that organizational performance continues to demand strategic approaches to manage financial practices. The extent empirical literature on the financial management practices and organizational performance of insurance companies appears somewhat limited for the underdeveloped countries and this study contributes to the existing literature in Kenya. So far no known study by the researcher has attempted to study the effect of financial analysis on organization performance of insurance companies in Kenya.

3. PURPOSE OF THE PAPER

The purpose of this paper was to establish the effects of financial management practices on organizational performance of insurance companies in Kenya.

3.1 Specific Objective

This study was guided by the following specific objective:

i) To determine the effect of financial analysis on organizational performance of insurance companies in Kenya.

4. LITERATURE REVIEW

Financial analysis and budgeting was explained by production of monthly financial statements which is important in monitoring profitability. Annual budgets are key in directing and monitoring financial performance, The insurance industry in Kenya should have key organizational performance indicators which should be used to gauge performance. The insurance company management should be particular about monthly targets for each department as guided by departmental targets (Wang, 2010).

In theoretical management accounting literature, some theorists (Drury, 2000 and Joshi, 2003) believe that through budgeting the process of financial decision-making and internal operation of an organization as well as its multiple functions regarding budgeting behavior can be achieved. These functions are planning, coordinating, communicating, control, and evaluating. If administered wisely , budgeting can help first in compelling management planning, secondly, providing definite expectations that are the best framework for judging subsequent performance, and finally promoting effective communication and coordination among various segments of the organization (Horngren, 1977).

A study by Yang (2010) intended to gain a deeper understanding about how budgeting affects the performance of SMEs in China. He reviewed the budgeting process in business organizations and performance measurement in SMEs and found out that more formal budgeting planning promotes higher growth of sales revenues in SMEs, clear and difficult budget goals improve budgetary performance of organizations, a higher level of budgetary sophistication results in a lower profit growth of SMEs ,more formal budgetary control leads to a higher growth of profit in the organizations and a greater budgetary participation leads to better managerial performance. Medium-sized firms achieve higher profit growth than small firms and state-owned enterprises achieve better non-financial performance than small firms.

Wijewardena and De Zoysa (2001) investigated the impact of financial planning and control on performance of SMEs in Australia. They made a clear distinction between small firms and middle sized firms in their research sample. Some 80 per cent of firms in the sample were small firms. Another 20 per cent of sample firms were medium-scale. They defined that firms employing fewer than 100 employees belong to the small industry category, while firms with 101 to 300 employees represent medium-sized firms. Based on the reasons above, firm size and ownership, these two

variables were introduced in the research model as control variables. The study examined whether they affected the budgeting of Chinese firms.

Joshi, et al. (2003), however, examines budgeting planning, control, and performance evaluation practices in a developing country. He conducted a questionnaire survey of 54 medium- and large-sized firms, including both the listed and non-listed firms located in Bahrain. His research found that most of the firms prepare long-range plans and operating budgets, and use budget variances to measure a manager's performance, for timely recognition of problems, and to improve the next period's budget.

Wijewardena and De Zoysa (2001) argue that the impact of budget planning and budgetary control on performance may vary from firm to firm depending on the extent of its use. The greater extent of the formal budgeting process should have a positive impact on the performance of SMEs. In their study, performance was measured by two financial indicators: sales growth and return on investment. Data was collected from 2,000 manufacturing SMEs in Australia. The results showed a positive and significant relationship between budgeting planning and sales growth, and between budgetary control and sales growth. However, no significant difference was found between budgeting planning and return on investment, nor between budgetary control and return on investment. To explain the insignificant relationships between budgeting planning and ROI, between budgetary control and ROI, they stated that, although firms with a greater extent of planning or control report higher rates of growth in sales, these revenues were not bringing about higher profits because of internal inefficiencies.

Maritim (2013) determine the effects of budgeting on the organizational performance of manufacturing and commercial Parastatals in Kenya. A descriptive research design was adopted and data was collected by use a questionnaire. A regression was also carried out to establish the relationship between the ROA and the budgeting independent variables. The research findings were that the budgeting practices that are common among the firms are budget planning, budget participation, and budgetary sophistication

5. METHODOLOGY

The study used correlational research design. The target population of this study was all 49 units of analysis which are the licensed insurance companies in Kenya (IRA, 2013) from which the target and accessible population was drawn. The study population which represent unit of

observation comprised of 316 senior management employees and 749 middle management employees both totaling to 1065. This study used stratified and simple random sampling method on all the insurance companies. Stratified random sampling was used in each insurance company to group respondents into two strata. The strata were that of senior management and middle management employees. Within each of the two strata simple random sampling was done to identify individual respondents who were issued with a questionnaire to respond to research statements.

A sample of 282 respondents was determined through the use of a formula for small population as recommended by Mugenda and Mugenda (2003). The sample size of 282 constitutes 26% of the target population which was adequate based on the recommendation by Kothari (2004) who assert that a sample of at least 10% to 15% is able to lead to meaningful generalizations about the general characteristics of a study population.

The study used primary data specifically questionnaires. Data was collected, coded and analyzed using SPSS version 20.0. The findings were presented in form of tables and pie charts and discussions and interpretation of the same given.

6. RESULTS AND DISCUSSIONS

6.1. Response Rate

The number of questionnaires, administered to all the respondents, was 282. The questionnaires were distributed to the respondents in the 49 unit of analysis which are the insurance companies. A total of 221 questionnaires were properly filled and returned from the insurance company employees while 61 questionnaires. This represented an overall successful response rate of 78%. According to Mugenda and Mugenda (2003), a response rate of 50% or more is adequate. Babbie (2004) also asserted that return rates of 50% are acceptable to analyze and publish, 60% is good and 70% is very good.

6.2. Reliability Analysis

Cronbach's Alpha was used to verify the reliability of the proposed instrument. The findings indicated that organizational performance had a coefficient of 0.891 and financial analysis had a coefficient of 0.921. All the constructs depicted that the value of Cronbach's Alpha were above the

suggested value of 0.7 thus the study was reliable and all the items were worthy retention (Saunders Lewis and Thornhill, 2009; Christensen, Johnson and Turner, 2011).

Table 1.1: Reliability Statistics

Variable	Cronbach's Alpha	Comment
Organization Performance	0.891	Accepted
Financial Analysis	0.921	Accepted

6.3. Descriptive Statistics

The objective of the study was to determine the effect of financial analysis on organizational performance of insurance companies in Kenya. Results indicate that 81.9% of the respondents agreed that annual budgets are key in directing and monitoring financial performance, 89.1% agreed that insurance industry in Kenya has key organizational performance indicators which are used to gauge performance and 88.2% agreed that their company management was particular about monthly targets for each department as guided by departmental targets. Furthermore, 81% of the respondents agreed that management in their company conducted variance analysis every month as a way of monitoring performance, 72.8% agreed that management in their company conducted monthly and yearly budget variance analysis and 58.4% agreed that management in their company does produce daily, weekly, monthly, quarterly and yearly financial reports. The mean score for responses for this section was 4.04 which indicates that majority of the respondents agreed that financial analysis was a key determinant of organization performance of insurance companies. On average 78.6% of the respondents agreed while 9.2% disagreed and 12.2% were neutral that financial analysis in insurance companies affects the organizational performance of the firm.

The study findings corroborate with those of Yang (2010) who intended to gain a deeper understanding about how budgeting affects the performance of SMEs in China. He reviewed the budgeting process in business organizations and performance measurement in SMEs and found out that more formal budgeting planning promotes higher growth of sales revenues in SMEs, clear and difficult budget goals improve budgetary performance of organizations, a higher level of budgetary sophistication results in a lower profit growth of SMEs ,more formal budgetary control leads to a higher growth of profit in the organizations and a greater budgetary participation leads to better managerial performance. Medium-sized firms achieve higher profit growth than small firms and state-owned enterprises achieve better non-financial performance than small firms.

The findings agree with those in Kyrili and Martin (2010) who carried out a study to investigate the effect of government intervention on budgeting. The study examined 56 low-income countries in 2009 and 2010. The findings showed that government intervention on budgeting caused financial crisis which created a huge fiscal hole in the 56 low-income countries (LICs). This in turn reduced their budget revenues (and their ability to spend to confront the crisis and reach the MDGs) by $53bn in 2009 nearly 10 per cent of their pre-crisis revenues and by $12bn in 2010. This created a total additional fiscal hole of $65bn over the two-year period. Revenues fell in 60 per cent of LICs in 2009. This indicated that poor budgeting results to poor organization performance.

7. REGRESSION ANALYSIS

Regression analysis was conducted to empirically determine whether financial analysis was a significant determinant of organizational performance of insurance companies in Kenya. The coefficient of determination R^2 and correlation coefficient (r) shows that the degree of association between the independent variable and organizational performance. The results of the linear regression indicate $R^2 = .124$ and R= .352 as shown in Table 1.2. This is an indication that there is a weak relationship between independent variable; financial analysis and the dependent variable organizational performance.

From the model summary table 1.2 below adjusted R^2 was 0.105 this indicates that financial analysis explains 10.5% of variations in organizational performance. Therefore further research should be conducted to investigate these other factors that affect organizational performance in insurance companies.

Table 12: Model Summary for Financial Analysis

Indicator	Coefficients
R	0.352
R Square	0.124
Adjusted R Square	0.105
Std. Error of the Estimate	1.690420755

The overall model significance was presented in Table 1.3. An F statistic of 6.626 indicated that the overall model was significant as it was larger than the critical F value of 3.88 with (1, 48) degrees of freedom at the P=0.05 level of significance. The findings imply that financial analysis

was statistically significant in explaining organization performance of insurance companies in Kenya.

Table 1.3: ANOVA for Financial Analysis

Indicator	Sum of Squares	df	Mean Square	F	Sig.
Regression	18.934	1	18.934	6.626	0.013
Residual	134.304	47	2.858		
Total	153.238	48			

The financial analysis coefficients are presented in Table 1.4. The results show that financial analysis contributes significantly to the model since the p-value for the constant and gradient are less than 0.05. The fitted equation is as shown below

$Y= 10.475 + 0.572X_3$

The findings imply that one positive unit change in financial analysis led to a change in organization performance at the rate of 0.562. This confirms the positive effect of financial analysis on organization performance of insurance companies in Kenya.

Table 1.4: Coefficients of Financial Analysis

Variable	Beta	Std. Error	t	Sig.
Constant	10.475	2.985	3.509	0.001
Financial Analysis	0.562	0.218	2.574	0.013

8. CONCLUSIONS

Financial analysis was statistically significant in explaining organization performance of insurance companies. The study concludes that the firms have embraced the budgeting process which involves all the parties to ensure that all departments are well financed. The study findings also led to the conclusion that indeed budget was used in decision making and it is really management tool.

9. RECOMMENDATIONS

Effective budget implementation at the company level should be facilitated through capacity building, robust systems and processes, prioritization close monitoring and evaluation. All

stakeholders should get involved in budget execution in enhancing the overall budget implementation.

The financial management systems need to be supported in order to ensure prudent management of funds. There is a need for adequate sensitization of both the employees and the public on best financial management practices so that the oversight role is enhanced.

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