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Why Mergers for Zimbabwean Insurance Companies Are Not Attractive

Fainos Makaza
Lecturer, Midlands State University, Zimbabwe
Charity Mhaka
Lecturer, Midlands State University, Zimbabwe
Lilian Nyamwanza
Lecturer, Midlands State University, Zimbabwe
Story Masiyiwa
Lecturer, Midlands State University, Zimbabwe

Abstract:
A research was carried out to find out why the Zimbabwe short term insurance industry has not considered mergers and acquisitions as a solution to capitalization challenges. The findings showed that most of the affected companies are not attractive as target companies, though they might be willing to be taken over. There is very little capital in the market and Foreign Direct Investment (FDI) is very limited due to the country risk profile. This reduces the number of potential interests in takeover bargains, though it is generally accepted by the market that mergers and acquisitions can go a long way in normalizing the insurance market and preserving employment.

1. Introduction

The Zimbabwean insurance market is reeling under recapitalisation challenges since the dollarization of the economy in February 2009. Many insurance companies have closed due to failure to meet minimum capital requirement. February 2009 witnessed an abrupt change from the use of the Zimbabwean dollar to the use of foreign currency. This meant that insurance companies had to start from scratch to raise capital needed to write business. Most companies relied heavily on reinsurance as they fronted most of the business they accepted. The minimum paid up capital was set at US$300 000. In 2012 The Insurance and Pension Commission (IPEC) increased the minimum capital requirement to US$3 million. The pressure to meet the minimum capital requirement pushed insurers to intensively compete for business so as to grow quick enough to meet the capital targets set by the regulator. In 2010 30all the short term insurance companies wrote gross premiums of US$110 million compared to Zambia whose 8 short term insurers wrote US$174 million. This shows stiff competition which drove rates lower and lower until the regulator decided to stipulate minimum rates to be applied by the market. By 2011 the industry consisting of 26 players wrote only US$180 million According to Steger and Kummer (2007), mergers and acquisitions help companies grow if organic growth fails. The desire to grow so as to raise the statutory capital has pushed insurance companies to compete for the little business in the market in order to organically grow. The competition has resulted in rate undercutting forcing rates to grow thinner and thinner. This has adversely affected the growth of the market. Low premium volumes were recorded. This pushed the Insurance and Pensions Commission (IPEC) to set minimum premium rates to keep the insurance industry afloat. The regulator (IPEC) even hinted that mergers could help the industry overcome the challenge to raise minimum capital required. However, not many mergers have been witnessed in the industry despite capitalisation challenges. A number of insurance companies lost their operating licenses rather than merge. In 2013 the Insurance and Pension Commission (IPEC) closed SFG after failing to meet the minimum capital requirement of US$300 000. Its negative solvency ratio had risen to 97.96%. The shareholders failed to raise enough capital to meet IPEC's minimum capital requirement.

According to the Newsday of 9 July 2010, the commissioner announced the cancellation of eighteen certificates of registration. This was due to the failure of the firms to raise minimum capital requirements and pay out claims. The list of closed companies include Gallant Insurance Company and Brownstone Insurance Company, just to mention a few. IPEC further cancelled the licences of Agricultural Insurance Company, Jupiter Insurance, Suremed Health, SFG and Horizon Insurance companies in 2014. The developments are a cause for concern as a lot of jobs were lost during the period and if the development is to continue, many more jobs will be lost in an economy that has experienced a lot of company closures and / or downsizing associated with laying off of employees.

According to the IPEC third quarter report of 2013, many insurance companies experienced capitalization challenges emanating from encumbered assets and high levels of premium debts. The researcher seeks to find why mergers and/ or acquisitions have not been opted for by the market.

2. The Background of Mergers in Zimbabwe

There has been a number of mergers in Zimbabwe over the past two decades in the short term insurance industry of Zimbabwe. These mergers include that of Zimnat Insurance company and Lion of Zimbabwe in 1999. In 1998 another merger between Commercial Union Insurance and General Accident Insurance had also been witnessed by the market. In 2002 National Insurance company of Zimbabwe merged with Diamond Insurance company to form NicozDiamond Insurance company. Orion and Strategies insurance merged to form Altfin Insurance Company in 2003. The same year (2003) CGU merged with R M Insurance to form one of the biggest insurance companies in Zimbabwe. In 2005 Zimnat Lion merged with AIG to make Zimnat Lion one of Zimbabwe's biggest insurance companies. These mergers and acquisitions before dollarization managed to create highly capitalized companies which have withstood the severe economic meltdown of the 2007/8 period. After 2005, there was a slowdown in the mergers wave until after the dollarization of the economy in 2009. In 2010 FBC Holdings acquired 49.2% of Eagle insurance from Zurich South Africa as reported by Madera (2011). This is the only acquisition that has been recorded post dollarization suggesting a very low attractiveness of mergers and /or acquisitions.

3. Literature Review

Alam et al. (2014) defines a merger as a strategy of joining two companies with the resultant company having a new name. Fustec (2011) alludes that half the time mergers and acquisitions destroy the value of the firm. This makes it very necessary for due diligence before participating in a merger or an acquisition. According to Ebimoboweni and Sophia (2011) mergers in Nigerian banks did not bring the desired results. Contrary to Ebimoboweni and Sophia (2011) Abdul-Rahman and Ayorinde (2013) found out that bank performance improved post merging in Nigeria. Their findings showed an increased performance after a merger. Liargovas and Repousis (2010) found out that mergers and acquisitions in Greek banks have no impact and do not create value. The operating performance does not improve too after mergers and acquisitions. Mergers and acquisitions are a useful tool for growth in some countries but for other countries the mergers and acquisitions may not add value. Generally, companies merge to acquire each other's strength and overcome each other's weaknesses as noted by Alam et al. (2014). Growth is not the only reason. Companies today are more concerned about the bottom line, the race to the bottom concept. An analysis of the weaknesses and strengths of the merging companies need to make sure that weaknesses can be overcome and strengths can utilized.

Sankaran and Vishwanath (2008) note that for Viacom acquisitions played a major role in pushing growth from less than US$ 1 billion in 1986 to more than 11 billion in 1996. Whitaker (2012) agrees that depressed organic growth may be the reason for mergers and acquisitions. Mergers and acquisitions help companies grow if organic growth fails as highlighted by Steger and Kummer (2007). Stoyanova, Rayna; Gründl, Helmut (2013 predict that Solvency II framework may lead to an enhanced geographic re-structuring wave that involves consolidations.

Fustec and Faroult (2011) discovered that several authors say 50 per cent of mergers and acquisitions (M&A) operations destroy value. Organizations 'merge' generally with similar organizations or 'acquire' weaker organizations, and the essence as to why they do so is that the value of two is greater than one. According to Petitt and Ferris (2013) overvaluation of the growth or market penetration and forecasting error work to the failure of mergers and acquisitions. Hassan and Ghauri (2014) highlight overpayment as the overwhelming culprit of merger failure. According to Chaudhuri and Mukhopadhyay (2014) mergers and acquisitions are responsible for bringing Foreign Direct Investment (FDI) while at the same time outward acquisition can play an important role in enhancing the global competitiveness of firms from developing economies.

One discouraging aspect of mergers and acquisitions is that shareholders of the target company make a profit from the transaction while the acquirer stand a chance for a loss. Share prices of target companies increase around the announcement of the intended M&A while that of the acquirers decrease. Kengelbach and Roos (2011) discovered that equity markets are sceptical about the ability of acquirers to create shareholder value. Furthermore, where offer prices are perceived excessive the proposed synergies may be unlikely to materialise.

According to Sherman (2011) the merger process is complex, strenuous and may frustrate clients or customers.

Moreover Cartwright and Cooper (2012) bring out the distinct impression that M&A success in the global world today; is no longer a matter of good fortune than the outcome of any well-conceived management strategy. Cartwright and Cooper (2012) point out that most organisations muddle through the M&A process, leaping from one organisational crisis to another, survival of organizations hinges upon the ability to implement and manage that change successfully.

4. Methodology

The issue of mergers and acquisitions is considered as a board issue, therefore responses were sought from members of the board of the 24 short term insurance companies operating in Zimbabwe. Questionnaires were sent out to directors who sit on boards of directors of the short term insurance industries. Telephone interviews were carried out to complement the questionaires. The research was basically qualitative in nature. From each company the researchers managed to get response from a member of the board. The research sought reasons why mergers are not attractive in a market in a market that is struggling to raise capital needed to transact business.

5. Findings

Mergers can potentially increase the capital required by IPEC for insurance companies and can potentially save many companies from losing their license to operate thereby saving some jobs though some duplications may potentially result in retrenchments where there is no option for reassignments.

For the Zimbabwean market, the recurring theme is that the small companies have an insignificant market-share for them to attract potential bidders. The main players will not get any strategic advantage by taking over a very small company without a significant market. It will not help much. At the same time investors of the small companies see their small investments as their future and employment in this volatile environment. It is a source of income for them and their families. They are optimistic that the economy will recover and their businesses might do well again. Only small companies are willing to merge with each other but the process involving the valuation of the small companies is cumbersome. Some properties which are registered as company assets are solely used by owner directors and regularizing it is a very rigorous process. That's why some companies are eventually deregistered when there is the opportunity of merging the companies and survive the capitalization challenges. Big companies equally have a fair share of the market and may not need to merge as they are meeting the minimum capital requirements. They may need to use other strategies to be competitive.

Foreign Direct Investment (FDI) is not easy to attract as Zimbabwe is not seen as an attractive investment destination. The country risk is considered very high. A lot of foreign owned companies have closed or sold their stake and reinvested in other countries. Therefore, in Zimbabwe mergers are more likely to be between locally based insurance companies with very little or no likelihood to attract foreign currency injection into the economy.

6. Transparency

Some investors are worry of these struggling companies as the process of due diligence is suspected to be prone to errors and a lot of misrepresentations. Companies fear to enter into a failing merger as the history of mergers has also produced many failures both locally and internationally. Sometimes the bids are overpriced.

7. Conclusion

However, all respondents agreed that mergers are one of the best strategies as intense competition affects the profitability of the whole industry.

Even the leaders in terms of the Gross Premium Written (GWP) are struggling to get business that is commensurate with the capital employed. The number of operating insurance companies of twenty four is considered by the market too big resulting in the scramble for growth.

8. Recommendation

Mergers and acquisitions are recommended for small companies struggling to meet the required capital. This is meant to reduce competition which is seen as the cause for the market's low profitability.

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