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Corporate Governance and Financial Performance of Reinsurance Corporations in Kenya

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Abstract:
Financial performance of Reinsurance firms is important in any economy and financial performance plays significant role in the country's economic welfare. This study sought to explore how financial performance of Reinsurance Corporation in Kenya is affected by the corporations' corporate governance. The concept of corporate governance was measured in terms of board size, board Composition, board independence, and chief executive officer's Duality. A population of seven (7) reinsurance companies with physical presence in Kenya was targeted for the study through casual research design. This study used secondary data, where data on board size, board Composition, board independence, Chief executive officer and Return on asset was gathered through review of published audited annual reports of the seven selected reinsurance Companies for the period of study 2013 to 2017 financial year. The research adopted regression analysis to establish the extent to which financial performance of reinsurance companies is influenced by the companies' corporate governance practices. Corporate governance in regard to Chief Executive Officer duality, board independence, board composition, and board size was found to have a significant effect on the financial performance of reinsurance corporations in Kenya. Size of the board size was established to have a positive significant relationship with the corporations' financial performance. A similar relationship was found to exist between composition of the corporations' board of directors and their financial performance. Further, the study revealed a positive significant relationship between independence of the board and financial performance measures of Return on Assets. Following findings of the analyses, the study recommends the Reinsurance Corporations in Kenya to stick to the recommended board size, board composition, board independence and Chief Executive Officer duality.

Keywords: *Corporate governance, reinsurance corporations, board independence, CEO duality, financial performance*

1. Introduction

Reinsurance is a form of insurance in which an insurer, known as the reinsurer, accepts part of or all the risks of losses covered by another insurer, known as the ceding company (Orlitzky & Benjamin, 2012). This transaction whereby an insurer company cedes insurance risks and premiums to a reinsurer enables the ceding firm to simultaneously reduce the variability of its financial leverage and cash flows. On the basis of this, an insurer's decision to reinsure is both a capital structure and a risk management decision. Corporate Governance is the procedure and arrangement used to show and achieve commercial matters of the corporation to improving wealth and business accounting with the final objective of understanding stakeholder's longstanding worthwhile attractive into explanation welfares of other shareholders. This also refers to as an interior structure including rules, procedures and individuals, which help the wishes of stakeholders and other shareholders, by leading and directing managing actions with decent commercial practicality, impartiality, responsibility and honesty (Mang'Unyi, 2011). The author describes corporate governance to include agreement of associations among a business's management, stakeholders and shareholders. This delivers the arrangement in which the purposes of the business are agreed, and the way of achieving those aims and controlling productivity.

Corporate Governance is a structure in which administrations are monitored and evaluated. Murithii (2009) opined that this is an established association among corporation executives, stockholders and other shareholders as it reports the influences of management and of directing stakeholders over smaller concern, the human rights of workers, creditors' and other shareholders' privileges. The board is tasked with the role of monitoring, disciplining, and removing members of management teams who are effective. This is meant to guard managers from pursuing other interests besides those of the shareholders. Burns and Grove (2011) emphasized the importance of business insiders in providing necessary information to a firm's board of directors. However, they warned that the insiders' advice may originate from ill intentions and lack objectivity to gain personal benefits. As such, the information can distract firm's CEOs from being independent. However, outsiders of the firm are likely to provide objective monitoring and greater independence in comparison to the insiders. The challenge facing outsiders is that they have little information about activities of the firm compared to the insiders. Organizations with bigger boards and many non-executive directors are privileged with ability to collect more and valuable information through multiple members of the board to facilitate effective monitoring. The board of an organization is composed of two sets of executives. One of the sets is the executive directors who are highly dependent in all their tasks. However, the non-executive directors are not dependent but independent (Shah & Hussain, 2012). Today, corporates prefer independent directors because of the effectiveness needed in working and for purposes of reducing bias. Dependent directors play a crucial role as they have crucial information about an organization which the directors may not have. D'Amato and Gallo (2019) stress the need to select board members with less ties, because doing so reduces conflicts of interest and enhances independence within the firm.

Financial performance of an organization refers to the organization's actual results computed against pre-established objectives, goals or the projected output. It measures efficiency of corporations through cost control and increasing profitability. Therefore, investors as well as other stakeholders are always interested to know how corporations are doing financially. Akodo and Moya (2012) posit that there are three definite aspects of financial performance. The aspects include return on shareholders' investment, outcome of the firm, and performance of the product in the market. Different ideas such as operations, strategic plans, development, finance, and the firm's legal aspects are often used by scholars to define organizational performance in various fields. The main roles of organizational performance are; measuring of outputs of a specific operation, process modification and increasing of outputs desired and efficiency increase is ensured for the whole process.

2. Literature and Empirical Review

2.1. Stewardship Theory

The stewardship theory emphasizes that companies are communal units that touch the well-being of various shareholders where shareholders are sets of people that relate with organization. Effective firms are refereed by their capability to add value for all their shareholders. Donaldson and Davis (2011) took an observation of stewardship theory by maintaining that bosses who plan governance configurations that make best use of the effectiveness of chief of executive detection of larger firm profitability will be compensated. Proprietor that trusts their organization needs robust oversight of organization must offer robust agency-set supremacy arrangements; for now, proprietor that trust their organization's administration necessitate the scope to make choices self-sufficiently and separately should safeguard governance arrangements let for supreme tractability in administration choice making. A stewardship theorist would contend the consequences are indication that such management arrangements enable the good CEO to take actions (Finkelstein & D'Aveni, 2015) and stands the agency dispute that such arrangements main to moral dangers that unfavorably influence organization performance as in other research (Basco &Voordeckers, 2015).

2.2. Agency Theory

The theory provides an explanation of the relationship between business owners (principals) and actual mangers of the business (agents). The term principal is often used in reference to shareholders while managers and members of company executives are referred to as agents. The agency theory suggests that the management of a company is usually done by agents on behalf of the business owners (the shareholders). This kind of arrangement underscores the need for corporate governance principles, especially in regard to board of directors' supervision. Heenetigala and Armstrong (2011) emphasized that agency theory is the foundation upon which most studies on corporate governance are built. It upholds that company shareholders are usually many, distributed, and powerless as far as daily management of the firm is concerned. Therefore, company managers are the actual controllers of the firm's resources. Elloumi and Gueyié (2001) observed that the huge number of shareholders makes the role of supervision by management to increase.

According to Elloumi and Gueyié (2001), company's board of directors and shareholders are theoretically perceived to be in need of protecting themselves from incurring costs. However, the fact that the company ownership is separated from its management implies that some conflicts of interests are likely to emerge on the part of the company's management. Ercan and Ban (2013) described the costs which may come up as a result of conflicting interests between shareholders of the company and the managers as agency costs. The major concern of agency theory is to maximize shareholders' revenue by minimizing conflicts of interests between company directors and the agents. According to Heenetigala and Armstrong (2011), the agency theory would consider the value of a company to be on the maximum when supervision measures like division of leadership among board of directors are optimized. In conclusion corporate governance mechanisms are designed to cope with agency problems. Firms with better corporate governance mechanisms have higher performance outcomes.

2.3. Board Size and Financial Performance

Board size refers to the number individual members of a firm's board. A study by Oludele and Tobiah (2016) reported that the companies' financial performance was significantly and positively related to the size of their boards of directors. The report conforms to an earlier research by Katuse et al. (2013) which revealed that the value of firms may deteriorate when the size of the board is increased beyond the ideal threshold.

2.4. Board Composition and Financial Performance

Board composition describes diversity of the board members in terms of their gender, age, and ethnicity. Different researchers have pointed out that there is a significant relationship between composition of a firm's board and its financial performance. For instance, Amoll (2015) observed that revealed that age, education level, and gender of the board members are the greatest determinants of companies' financial performance.

2.5. Board Independence and Financial Performance

Board independence was used to connote the number of executive directors compared to the total number of directors. This ratio often determines the level of independence in terms of decision making among the board members. Results from a study carried out by Zattoni (2017) showed that while independence of a firm's board has a marginally positive but limited impact on the firm's financial performance, institutions at the national level has moderated its effects significantly. Khan and Awan (2012) established that companies whose board members are independent experience better performance financially. The consequence of scope of executive board on firm's growth is negative though insignificant.

2.6. CEO Duality and Financial Performance

A Chief Executive Office is said to gain a dual status if he or she is holding or playing the role of positions with the same organization. The dual status of a CEO seems to have minimal or no influence on the firm's financial performance as reported by Chi (2014), Pham (2015), and Elsayed (2016). For instance, Pham (2015) reported that there was no relationship between financial performance of not-for-profit hospitals and inclusion of physicians in the hospital's governance or duality of its CEO.

3. Methodology

This study used a casual research design in which panel data from seven (7) Reinsurance Corporation operating in Kenya was collected. Audited published annual financial statements of the seven reinsurance Companies selected for the period between 2013 to 2017 provided the secondary data for this study. The design enabled the researcher to assess how independent variable affects the dependent variable. The independent variables included CEO duality, board size, board independence, and board composition.

4. Data Analysis and Finding

The effects of corporate governance on financial performance of Reinsurance Corporations in Kenya were explained using multiple regression model; $Y=\beta_{0it}+\beta_1X_{1\ it}+\beta X_{2\ it}+\beta_3X_{3\ it}+\beta_4X_{4\ it}+\varepsilon$, where;

Y= Financial Performance (Measured by ROA)

β_0= Constant

X_1= size of the board (Number of board members)

X_2= Composition of the board (Years of experience)

X_3= board independence (Non-executive directors)

X_4= CEO duality (Conflict of interest and Role of the CEO)

B1–β4 = regression co-efficient of the respective independent variables

ε = random error term

4.1. Board Size

The board size trend was analyzed in terms of the firm with the highest number of board members (Maximum), the lowest number of board members (Minimum), average (Mean) size of the board members for each year, and the standard deviation of board size from the average size as in table 1.

Year	Minimum	Maximum	Mean	Std deviation
2013	7	19	13	1.25
2014	8	22	15	1.26
2015	7	24	15.5	1.21
2016	8	25	16.5	1.61
2017	10	26	18	1.40

Table 1: Board Size

The highest number of board size was recorded in the year 2017 when the biggest firm had a board size of 26 members while the smallest had a board of 10 members. The average board size was 18 members for the same year. The year 2013 recorded the smallest board size in which the average (mean) size was 13 members. Additionally, standard deviation was run to show variability for board sizeduring the five year period. 1.61 was recorded as the highest standard deviation in 2016 and 1.21 as the lowest SD value in 2015.

4.2. Board Composition

The composition was measured on scale of 1-5, ranging from the least diverse board to one composed of most diverse members. Table 2 shows the summarized analysis of the variable;

Year	Minimum	Maximum	Mean	Std deviation
2013	2	3	2.5	0.31
2014	2	3	2.7	0.21
2015	2	3	3.0	0.19
2016	2	3	2.8	0.57
2017	2	3	2.9	0.35

Table 2: Board Composition

Year 2015 recorded the highest value of board composition with a mean of 3.0, while the year 2013 recorded the lowest value of borad composition with a mean of 2.5. Additionally, standard deviation showed variability for borad composition during the five year period. 0.57 was recorded as the highest standard deviation in 2016 and 0.21 as the lowest SD value in 2014.

4.3. Board Independence

Board's independence entails the ratio of the independent directors to that of total directors.

Year	Minimum	Maximum	Mean	Std deviation
2013	0.2	0.4	0.3	1.31
2014	0.1	0.5	0.3	1.21
2015	0.1	0.3	0.2	1.19
2016	0.3	0.5	0.4	1.57
2017	0.2	0.4	0.3	1.35

Table 3: Board Independence

The lowest ratio of the number of independent directors to total directors was recoredd in the year 2015, which was 0.2. On the other hand, year 2016 recorded the highest ratio between independent directors to total directors0.4. This implies that in 2015, majority of the firms had 20% of their boards being independent directors. In 2013, 2013 and 2016 firms had 30% of their boards being independent directors while in 2016, firms had 40% of their board members as independent directors.

4.4. CEO Duality

The descriptive analysis of CEO duality was also done in form of mean and standard deviation minimum and maximum of the data from 2013-2017;

Year	Minimum	Maximum	Mean	Std deviation
2013	0.2	0.4	0.3	1.23
2014	0.2	0.3	0.3	1.32
2015	0.3	0.5	0.4	1.54
2016	0.2	0.4	0.3	1.32
2017	0.2	0.4	0.3	1.32

Table 4: CEO Duality

The findings revealed that 2013, 2014, 2016 and 2017 recorded the lowest CEO duality of the board as shown by a mean value 0.2. On the other hand, year 2014 recorded the highest ratio of 0.4 of members of the board. This implies that in 2014, majority of the reinsurance firms had 0.4 duality of their boards while 0.6 had no duality. Additionally, standard deviation showed variability for dualityduring the five year period. 1.54 was recorded as the highest standard deviation in 2015 and 1.23 as the lowest SD value in 2013.

4.5. Financial Performance

Return on Assets (ROA) measures of performance were used to determine financial performance.

Financial Performance	Mean	Std. Dev.	Min.	Max.
ROA	13.77785	11.1399	-6.186083	46.89982

Table 4: Financial Performance

The results shown by table 5 indicates the least (minimum) ROA across the sampled corporations was -6.186083% while the highest (maximum) ROA was 46.89982%. The table also shows an average mean of 13.77785% and a Sd of 11.1399%. The average mean, 13.77785% is an indication of a high ROA meaning that most firms are able to efficiently make profits from their assets regardless of size. It shows a solid financial performance for the reinsurance firms. However, the minimum value for ROA -6.186083 gives the investors' the impression that the respective reinsurance companies management is inefficient.

4.6. Regression Analysis

A linear relationship between the independent and dependent variables was established by performing multiple linear regression analysis.

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.745	0.851		3.226	.003
	Board Size	0.463	0.201	0.412	2.303	.028
	Board Composition	0.375	0.112	0.323	3.348	.002
	Board Independence	0.304	0.135	0.248	2.252	.032
	CEO Duality	0.247	0.093	0.182	2.666	.012

Table 5: Variables Coefficients

The Value of Coefficients in Table 6 Can Be Rewritten as a Mathematical Equation As,

$$Y= 2.745 + 0.463X_1 + 0.375X_2 + 0.304X_3 + 0.247X_4 + e$$

The regression model results indicates that a unit increase in board size, with all the other factors kept constant, would cause a positive change in the financial performance of reinsurance corporation in Kenya by a factor of 0.463. This implies when size of the board is increased by one unit (one member), the corporation's financial performance is expected to increase by 0.463 units (β_1=0.463, p=0.028<0.05). Regression results also revealed that board composition significantly influences financial performance of reinsurance corporation as indicated by β_2=0.375, p=0.002<0.05. The implies that a unit increase in board composition causes an increase in financial performance of reinsurance corporation by β_2=0.375. Further, the model revealed that board independence has a significant positive influence on the financial performance of reinsurance corporation as indicated by β_3=0.304, p=0.032<0.05. Therefore, a unit increase in board independence, when all the other factors are kept constant, would cause an increase in the financial performance of reinsurance corporation. Last but not least, the study also revealed that the CEO duality has a significant effect on the financial performance of reinsurance corporation as indicated by (β_1=0.247, p=0.012 <0.05).

5. Summary and Conclusion

The sampled reinsurance corporations had moderate board size throughout the five-year period. However, the sizes of the board seemed have been growing from a mean of 13 members in 2013 to 16 members in 2016. On board composition, there was no major variation since the average rating fell the range of 2.5 in 2013 to 3.0 in 2015. The same trend was observed on aspects of corporations' board independence and CEO duality which indicate that minor variations throughout the period under study.

In terms of the variable's contribution to the firms' financial performance, the regression analysis indicates that board size has the greatest influence (0.412), followed by board composition which contributes 0.323 influence on the firms' financial performance. Nevertheless, all the four components of corporate governance had statistically significant relationship or influence on the reinsurance corporations' financial performance.

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