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Firm Size and Financial Performance of Insurance Companies Listed at NSE, Kenya.

Asola, Allan Okwenda
Department of Accounting and Finance
School of Business and Economics
Jaramogi Oginga Odinga University of Science and Technology, Kenya

Simeyo Otieno
Department of Accounting and Finance
School of Business and Economics
Jaramogi Oginga Odinga University of Science and Technology, Kenya

Maria Onyango
Department of Economics and Management
School of Business and Economics
Jaramogi Oginga Odinga University of Science and Technology, Kenya

Abstract
Review of literature on the financial performance of Kenyan insurance firms has shown a declining trend over the last few years. Insurance cover plays key role in the sustainability of life sustaining programmes and processes. The downward trend of the insurance sector and its declining motivated this study to investigate the relationship between firm size and financial performance proxied by Return on assets and Return on Equity. The purpose of this study is to explore the influence of firm size on financial performance of listed insurance firms in Nairobi Securities Exchange in Kenya. In this study, data of six insurance firms that were active in Nairobi Securities Exchange (NSE) between the years 2009 to 2018 had been used. The indicators of financial performance are Return on Assets and Return on Equity, have been used whereas Natural logarithm of Total Assets had been used as the indicator of firm size. The study used cross-sectional research design. Secondary data extracted from the Audited financial statements and was used to compute the relevant ratios. Simple regression analysis was used in estimating the research model. Correlation and regression methods have been used in the empirical analysis. The finding revealed a positive relationship between firm size and financial performance of listed insurance firms at the NSE.

Keywords: Insurance, firm size, financial performance, ROE, ROA, NSE.

1. Introduction

Firm size determines to a large extent the relationships it enjoys with its various stakeholders. A larger firm has more influence than a smaller firm on the operations of its stakeholders. This is especially evident in the significance of conglomerates and MNCs in politico-social and economic aspects of the economies they operate in. Kumar et al. (2001) postulate that there is a statistically significant positive correlation between economic growth and firm size of the business sector. The study cites Rajan and Zingales (1995) whose finding reveal that two-thirds of the growth in industries over the 1980s is attributable to firm size with only one-third attributable to new business units. Other studies (Hashmi, S.D., Gulzar, S., Khan, M.J., Akhtar, M., 2018) justify a similar observation. In addition, Firm size is also related to industry- sunk costs, concentration, vertical integration and profitability. Large insurance companies are prone to tall organizational structures, more diversified skill sets and specializations with greater bureaucratic tendencies compared to small firms. have more layers of management, greater number of departments, increased specialization of skills and functions, greater centralization and greater bureaucracy than smaller insurance companies (Brown, 2004). Brown (2009) postulates that size depicts a firm's market size translating to a competitive advantage encompassing economies of both scale and scope (Dogan, 2013). Large insurance companies are more likely to balance their portfolio and diversify market risk (company beta) thereby counter adverse market conditions compared to small insurers (Dang Yang, 2018; Malik, 2011; Burca & Batrinca, 2014; Velnampy & Niresh, 2015; Batool & Sahi, 2019).

Firm size reflects the flexibility that a firm possesses with regard to provision of commodities to its various markets. It determines the profitability of the firm which correlates with economies of scale. Larger firms have the ability to cut down on unit costs both at the fixed cost levels as well as the variable cost components. However, larger firms are weighed down by managers pursuing self-interest goals at the

expense of profit maximization and shareholder wealth maximization. With prudent cash flow management, profitability guarantees firm success. Shareholders are assured of a reliable and sustainable dividend. A satisfied shareholder adequately rewards the manager agents which goes to ensure that other stakeholders are well taken care off. Firm performance is measured variously including ratio analysis. Profitability ratios are at the centre of most performance related studies. The current study focusses on the correlation between firm size and profitability of listed insurance firms in Kenya.

2. Literature Review

The majority of the studies measuring the influence of firm size on profitability have found results with positive direction between firm size and profitability. In line with this, a positive relationship between firm size and profitability was found by Vijayakumar and Tamizhselvan (2010). The authors used different measures of size (sales and total assets) and profitability (profit margin and profit on total assets) while applying model on a sample of 15 companies operating in South India in their study, which was based on a simple semi-log arithmetic specification of the model. The part that firm size plays in profitability was examined by Lee (2009) who used fixed effect dynamic panel data model and performed analysis on a sample of more than 7000 US publicly-held firms. According to him absolute firm size plays a remarkable role in explaining profitability. Ezeoha (2008) stated that the size of a firm plays a crucial role in determining the kind of relationship the firm enjoys within and outside its operating environment. He asserts that usually, the larger the firm the greater the influence it has on its stakeholders. Again, the growing influences of conglomerates and multinational corporations in today's global and in local economies where they operate are evidences of what the role size plays within the corporate environment. Pointing out the importance of size in corporate discourse,

Rajan, *et al*. (1995) observed that much of the economic growth takes place through expansion in the size of existing corporate organizations. Rajan & Zingales (1995) whose study of 43 countries showed that two-thirds of the growth in industries over the 1980s came from the growth in the size of existing corporate establishments, while only one-third trickled in from the creation of new ones. From the foregoing, it is evident that the importance of size of the firm in determining financial performance cannot be underestimated.

Firm size is one of the most influential characteristics in organizational studies. Chen & Hambrick (1995), and Mintzberg (1979) provide a summary and overview of the importance of firm size. Firm size has also been shown to be related to industry- sunk costs, concentration, vertical integration and overall industry profitability. Larger insurance companies are more likely to have more layers of management, greater number of departments, increased specialization of skills and functions, greater centralization and greater bureaucracy than smaller insurance companies (Brown, 2004).

Brown (2004), stated that Firm size refers to how large or small firm is measured by the firm's market value. Therefore, firm size can be concluded as how large a company is reflected by its total asset, sales, or market capitalization. According to Vieira (2010) size affects smaller firms measured by total assets or total capitalization that tend to out-perform the market even when returns are adjusted for risk. According to Haugen (1978), firm size is a picture of large or small companies that appear in the value of total assets. From the statement above, we can conclude that firm size describes how large or small of a company measured by the natural log of total assets or by its total capitalization.

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Insurance company's size according to Brown (2009) refers to how large or small firm is, it measures a firm's market value in relation to its competitors. It enables an organization obtain a competitive edge over its rivals through the creation of opportunities and cost reduction through economies of scale (Dogan, 2013). Big insurance companies can effectively diversify their assumed risk, possess a greater capacity to deal with adverse market fluctuations and respond quickly to changes in market conditions compared to small insurers (Harwick, 1997; Wyn, 1998). Various studies have linked performance of insurance companies to their size (Malik, 2011; Burca & Batrinca, 2014; Velnampy & Niresh, 2015; Batool & Sahi, 2019).

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African Insurance Organizations (AIO), which controls about $69 billion insurance markets, released its first Africa Insurance Barometer aimed at improving the transparency. The report pointed out that the main drivers behind the poor results of insurance companies in Africa are attributed to poor claims management practice. For instance, motor insurance has been rated the most frequently least profitable line of business due to frequent competitiveness of motor insurance. This has led to insurance companies registering low levels of profitability and high fake claims (Kusimo, 2016).

Ozgulbas et al. (2006) have studied the effects of firm size on performance over the firms operating in Istanbul Stock Exchange between the years of 2000 to 2005. As a result of their study, they have found that big scale firms have a higher performance as compared to small scale firms. In a similar fashion, Jonsson (2007) has studied the relation between profitability and size of the firms operating in Iceland. Results of the analysis showed that bigger firms have higher profitability as compared to smaller firms.

Size-profit relationship for the firms functioning in the financial services sector was tested by Amaton and Burson (2007). They tested both linear and cubic form of the relationship. Even though a negative influence of firm size on profitability was revealed with the linear specification in firm size, evidence of a cubic relationship was detected between return on assets and firm size.

Becker et al. (2010) have studied the effects of firm size on profitability in the firms operating in manufacturing sector in USA using the data of years 1987 to 2002. Results of the study showed that negative and statistically significant relations exist between the total assets, total sales and number of employees of the firms and their profitability.

Velnampy (2005) pointed a study on investment appraisal and profitability of toddy bottling project in Sri Lanka which found that the management of the project failed to attain the budgetary results, even though the Net Present Value (NPV), Internal Rate of Return (IRR) and benefit cost ratio showed the project as commendable.

Velnampy (2006) correlates financial position and profitability of a sample of 25 public quoted companies in Sri Lanka through the use of Altman's bankruptcy forecasting model. Findings indicate that only 4 companies were susceptible to bankruptcy. The study also reveals that earnings to total assets ratio, current total equity to book debt ratio and sales to total assets were significant in ensuring firm profitability and therefore cash flow sustainability. Banchuenvijit (2012) investigated performance factors of firms operating in Vietnam. Findings reveal a positive correlation between total sales and profitability, however, a negative correlation exists between total assets and profitability. Additionally, the study reveals non-significant correlation between employee numbers and profitability. Velnampy and Nimalathasan (2010) examined the correlation between firm size and profitability of Bank of Ceylon in Sri Lanka from 1997 to 2006. Findings indicate the existence of a positive and statistically significant correlation between firm size and profitability.
Velnampy (2014) explored the correlation between firm size and profitability on 15 listed manufacturing firms in Sri Lanka from 2008 to 2012. By using multiple regression analysis, results indicate the existence of a weak positive correlation between firm size and profitability of the listed firms.

The preceding literature reviews reveal that there is no consensus on the correlation between firm size and firm profitability. More empirical studies need to be undertaken and the current study steps in to bridge this gap with reference to Kenya.

3. Methodology

3.1 Mode of Analysis

The study was done on the Kenyan insurance industry. Secondary data used in this study was extracted from the audited annual financial statement of the 6 listed insurance firms at the NSE. Performance metrics was proxied by Return on Assets (ROA) and Return on Equity (ROE). The independent variable, firm size, was proxied by The data used was from 2009 to 2018, a 10-year period resulting in 60 observations.

The study adopted a descriptive research design. The population comprised all the six insurance firms listed at the NSE. In this study dependent variable is financial performance which is proxied by ROA and ROE. The independent variable of the study is firm size, which was proxied by natural log of total assets.

Regression models therefore become;

$RAO=Y_{it}= \beta_0+ \beta_{i1}X_{1i}t + \mathcal{E}_{it}$ …….(i)
$ROE=Y_{it}= \beta_0 + \beta_{i1}X_{1i}t + \mathcal{E}_{it}$…….(ii)

{βi; i=1} = The coefficients of variable representing the various independent variables.
{X_i; i=1} = Values of the various independent variables.
i = listed insurance firms from 1 to 6,
t = time period from 2009 to 2018 (10 years).
$\mathcal{E}_{it}$ = the error term assumed to be normally distributed with mean zero and constant variance.

X_{1it} = Firm Size

3.2 Variables Used in the Study

The following table gives a snapshot view of the variables and description.

Table 1. Description of variables used in the analysis

Variables	Description
Dependent Variables	
Return on Assets (ROA)	Earnings Before Interest & Tax (EBIT) /Total Assets
Return on Equity (ROE)	Earnings Before Interest & Tax (EBIT) / Shareholders
Independent Variables	
Firm Size (LnA)	Logarithm of Total Assets

3.3. Conceptual Framework

Based on the variables used in the study the conceptual framework can be developed in the following manner

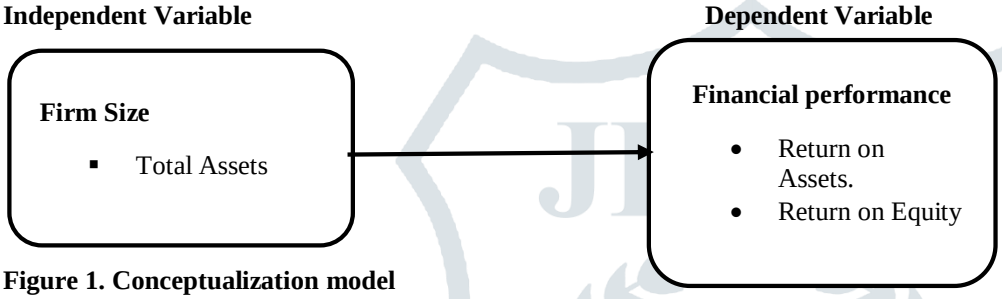

Figure 1. Conceptualization model

4. Results/Analysis

4.1 Descriptive Statistics

Table 2 Descriptive Statistics for dependent variable

Variable	Obs	Mean	Std. Dev.	Min	Max
ROA	60	.0614464	.1544019	-.3491999	.7854605
ROE	60	.1145244	.2199498	-1.270951	.4445283

SOURCE: Research data (2022)

Table 2 above, shows that RoA had a mean of 0.0614464 which implies that the insurance firms listed in the NSE over the study period registered about 6.14% RoA. This means that for every shilling in assets owned by the insurance companies, they earned Ksh 6.14 in profits. This is a good performance indicator against the 5% industry rate. The standard deviation is 0.1544019 suggests more deviation from the mean of 6.14% of RoA over the study period is a pointer to predictability and stability in the returns while minimum and maximum values are -0.3491999 and 0.7854605 respectively. This implies that there were some firms which made losses approximately 35% while others made profit of 78.55% of RoA over the study period.

Further, the table 2 shows that the mean of ROE is 0.1145244. This implies that shareholder received 11.45% return on investment in shares that is quite good as compares to industries of 6.2%. The minimum and maximum were -1.270951 and 0.4445283 respectively for the period of 10 years (2009 to 2018) and this means that some equity holder did not receive return on investment in equity due losses made by the respective firms. The standard deviation was 0.2199498 indicating considerable deviation around the mean.
Hence, the existence of positive RoA and RoE suggest improved returns to both shareholders and stakeholders.

Table 3 Descriptive Statistics for independent variable

No table of figures entries found.

Variable	Obs	Mean	Std. Dev.	Min	Max
LnA	60	10.32485	.7213524	8.15800	12.2790

Source: Research data (2022)

Table 3 above explains the results of independent variables. The mean log of total assets was 10.32485 while the maximum and minimum were 12.279 and 8.158 respectively. The standard deviation value of 0.7213524 indicates that was a large variation from the average. This

means that the listed insurance firms recorded increase in financial performance over the period of study among the listed insurance firms in the Nairobi Securities Exchange.

3.3 Test of Association among the Variable Used in the Study

Correlation is a statistical method used to assess a possible linear association between two continuous variables. The study subjected to Pearson's correlation analysis for the insurance firms listed in NSE on the following variables: firm size, capital adequacy, claim costs, capital structure and firm age on RoA and RoE.

Table 3. shows the correlation matrix of all the variables under the study.

The results in Table 3 below depicts the correlation between the explanatory and response variables. It is observed that firm size as proxied by LnA (r = 0.02512, p = 0.0046) had a positive but weak significant correlation association with return on assets. This implies that an increase in firm size is associated with increase in RoA.

Table 3 Correlation matrix

	RoA	RoE	LnA
ROA	1.0000		
ROE	0.3893	1.0000	
	0.0021		
LnA	0.2512	0.2784	1.0000
	0.0046	0.0013	

Regression results for Dependent variable financial Performance: RAO

The R squared was used to check how well the model fitted the data. The study was supported by coefficient of determination R square of 0.574. This means that independent variables explain 57.4% of the variations in the dependent variables. The results revealed that there was a positive and significant relationship between firm size and ROA (β =0.750, p=0.009). This was supported by a calculated t-statistic of 12.5 that was higher than the critical t-statistic of 1.96

Table 4 Regression results for Dependent variable RAO

ROA	Coef.	Std. Err.	t	P	[95% Conf.	Interval]
LnA	0.750	0.006	12.5	0.009	-.0452245	0.067
cons	0.042	0.053	0.792	0.005	0.071	0.138

F(1, 58) = 0.15, Prob > F = 0.000, R-squared = 0.574, RMSE =50.212

$RAO=Y_{it}= 0.042+ 0.750X_{1i}t + \varepsilon_{it}$

Regression results for Dependent variable ROE

The R squared was used to check how well the model fitted the data. The study was supported by coefficient of determination R square of 0.829. This means that firm size, capital adequacy, claim costs and capital structure explain 82.9% of the variations in the dependent variable; ROE.

The results further revealed that there was a positive and significant relationship between firm size and ROE (β 0.028, p=0.004). This was supported by a calculated t- statistic of 2.33 that is larger than the critical t-statistic of 1.96.

Table 4 Regression results for Dependent variable ROE

ROA	Coef.	Std. Err.	t	P>|t|	[95% Conf.	Interval]
LnA	0.028	0.012	2.333	0.004	0.205	.079
cons	0.420	0.062	0.530	0.003	0.092	0.528

Prob = 0.000, R-squared = 0.829, RMSE = 45.130

$Y_{it}= .420 + 0.28X_{1i}t + \varepsilon_{it}$

Where: Y = ROE (Return on Equity)
X_1 = firm size
εit= Error term

4. Summary, Conclusion, Limitations and Recommendation

4.1 Introduction

The study presents a summary of the actual findings of this study, sets out the relevant conclusions and makes recommendations for practice and suggestions for further research based on the findings. The study sought to establish the influence of firm characteristics on financial performance of insurance firms listed in the Nairobi Securities Exchange. It established the relationship between firm size and on financial performance of insurance firms listed at the NSE.

4.2 Summary of Major Findings

The objective of the study was to determine the influence of firm size on Financial Performance of insurance firms listed in the Nairobi Securities Exchange.

Firm size was found to be satisfactory in explaining financial performance. Further, results showed that firm size is a good predictor of financial performance. Correlation analysis revealed that firm size was positively and significantly associated with financial performance. Regression coefficient results revealed that there was a positive and significant relationship between firm size and ROA. This implies that a unit increase in firm size would lead to an increase in financial performance.

Under ROE, Regression coefficient results of insurance firms listed in the NSE revealed that there was a positive and significant relationship between firm size and ROE. This means that a unit increase in firm size would lead to an increase in financial performance.

Based on the findings, the study concluded that firm size had a positive and significant effect on financial performance of Listed Firms in the Nairobi Securities Exchange. The size of the firm influences the financial performance because large firms can benefit from economic of large scale. Large firms have the capacity of competitive advantage in the sense that larger companies tend to be more efficient than Their Smaller Counterparts.

4.3 Conclusion

This study examined the influence of firm size on the financial performance of the listed insurance firms in the Nairobi Securities Exchange. In this study, data of 6 companies which were active in Nairobi Securities Exchange (NSE) between the years 2009 to 2018 has been used. simple regression and correlation methods have been used in the analysis.

Based on the finding above, the study concluded that firm size had a positive and significant influence on financial performance of insurance firms listed in the Nairobi Securities Exchange. The size of the firm influences the financial performance because large firms can benefit from economics of large scale. Large firms have the capacity of competitive advantage in the sense that larger companies tend to be more efficient than their smaller counterparts and have better resources to survive economic crisis. In addition to this, optimal capital structure, new technology and a change in tactical logic of firms might be the reasons for this kind of relationship

The R^2 values of 0.0.574 ROA and 0.829 ROE, which are in the models denote that 57% and 83%, of the observed variability in the financial performance measures of Return on Equity and Return on Assets were explained by the variability in the Log of Total Assets. Remaining 43% and 17% of the variations in the Return on Equity and Return on Assets related to the variables which are not shown in the models. Hence, other factors are probably found to be better predictors of financial performance.

4.4 Limitations and Scope of Future Research

The limitations of the study are the usage of the data belonging to the years 2009 to 2018 and only 6 insurance firms listed in the Nairobi Securities Exchange (NSE) operating in the insurance sector have been included. In future studies the effects of firm size on financial performance. may be analyzed by differentiating by sector. The R^2 values reveal that the size indicators is the determining factors of financial performance.

4.5 Recommendations

4.5.1 Recommendations to the Management

The findings of the study showed that the size of the firm measured by its natural log of total assets was positively and significantly affected the financial performance of the insurance firms listed in the NSE. The study recommends that the firms should consider increasing their assets. This can be done by obtaining loans from commercial banks to increase the total assets base. Large firms enjoy more competitive advantage in the market as compared to small firms due to their size.

4.5.2 Policy Recommendations

The study found out that the firm characteristics had a significant effect on financial performance of insurance firms listed at the Nairobi Securities Exchange. Therefore, the researcher recommends that the policy makers should embrace indicators such as firm size, capital adequacy, and claim costs on their strategic decision-making. The government policy makers would also be important in interpreting the firm characteristics on financial performance of the listed insurance companies in the NSE.

4.5.3 Academic Recommendations

The current study contributes knowledge on firm characteristics and it has added value to the existing literature on financial performance. The study recommends that the academicians and scholars should team up to develop theories of financial performance that will enhance the knowledge of finance in the developing world instead of relying more on theories from the western world.

4.5 Areas for further research

This study was limited to the listed insurance firms in the NSE. Because of the differences in organisation structures in various industries, the finding of the study cannot be generalized to other sectors in Kenya. Therefore, the study recommends that similar studies should be done on different sectors in Kenya and should include the banking and other financial sectors.

This study used only four variables; firm size, capital adequacy, claim costs and capital structure as the only variables that influence financial performance. Future studies can incorporate other variables like exchange rates, economic growth and inflation rates since they can influence financial performance.

4.6 Contribution to the Body of Knowledge

The study contributes to the body of knowledge in the following ways; study would assist the firm managers to evaluate firm size, capital adequacy, claim costs and capital structure as the study discovered that the stated characteristics contributed to financial performance. By undertaking the study, the firm characteristics and financial performance were explored. This adds value to the past findings and enable users to have information and a deeper understanding of the need for enhancing firm size, capital adequacy, claim costs and capital structure to improve on financial performance. The study also offered a logical ground on which empirical indicators and hypotheses could be identified and tested to verify the theories. It contributed to the body of knowledge and to other researchers, as they will be able to appreciate the effects of the underlined firm characteristics, inspire similar and further research in other areas, and contribute to the existing literature on financial performance.

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