International Journal of Research in Finance and Marketing (IJRFM)
Available online at: http://euroasiapub.org/current.php?title=IJRFM
Vol. 9 Issue 4, April - 2019
ISSN(o): 2231-5985 | Impact Factor: 6.397

# FINANCIAL RESTRUCTURING AND NON FINANCIAL PERFORMANCE OF PAN AFRICA INSURANCE HOLDING COMPANY, KENYA

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**Abstract**

**Introduction:** The study examined the efficacy of financial restructuring on non financial performance of Pan Africa Insurance Holding Company. The specific objective was to determine the effect of financial restructuring on non financial performance.

**Materials and Methods:** The study used a cross sectional research design in data collection. A target population of 60 respondents was considered in the study. A sample size of 20 respondents was used in the study. Stratified and simple random sampling was used in the collection of data from the sample. Factor analysis was used to test for validity and the test retest method was used to test for reliability. SPSS version 24.0 aided in data analysis. Simple linear regression model and Karl Pearson product moment correlation were the inferential statistics metrics adopted in the study.

**Results:** The study found that financial restructuring has a significant effect on non financial performance of Pan Africa Insurance Holdings Company ($\beta = .442$, $p < 0.05$).

**Conclusion:** The study concluded that financial restructuring has a significant effect on the performance of insurance companies. Further, it improves the liquidity, increases the cash flows for a sick insurance company and reduces the cost of capital for healthy insurance companies.

**Recommendations:** The study recommended that insurance companies should opt for the restructuring of secured long term borrowings, unsecured long term borrowings, private unsecured loans, privately placed unsecured bonds, privately placed debentures, secured working capital borrowings, intercorporate deposits, clean bills and clean over drafts.

***Keywords:*** *Financial Restructuring, Debt Restructuring, Firm Performance, Kenya*

## 1.0 Introduction

Financial Restructuring is evidently of merit in any corporate firm especially in times of financial distress. Kenyan insurance companies are consequently not an exception when in times of such financial crisis. The insurance companies need to revisit their capital structure and review it with an interest to ensure it is in its optimal level. To achieve the optimal capital structure, financial restructuring may mean the insurance companies issues new debt or equity. It may also call for the total opposite in which the insurance companies' buys back its shares from the security markets or avoids debt in total. Competitiveness and competitive advantage have become the buzzwords for corporate around the world in today's globalized economy.

Financial restructuring is the process of reshuffling or reorganizing the financial structure, which primarily comprises of equity capital and debt capital. Financial restructuring can be done because of either compulsion or as part of the financial strategy of the company (Kumar & venai, 2012). The general function in that financial restructuring is the reorganization of the financial assets and liabilities of a corporation in order to create an advantageous financial environment for a corporate entity. The financial restructuring can be either from the assets side or the liabilities side of the balance sheet. If one is changed the other will be adjusted. There are two components of financial restructuring that is, debt restructuring and equity restructuring (Kumar &Venai, 2012).

The process of reorganizing the whole debt capital of the company is known as debt restructuring. It is the adjustment of debt components of the company as some of the balance sheet items. The components of debt restructuring are, restructuring of secured long term borrowings which is done for improving liquidity, increasing the cash flows for a sick company and for reducing the cost of capital for healthy companies (Kumar & Venai, 2012). Restructuring of unsecured long-term borrowings. The borrowing of long-term unsecured borrowings is done depending on the type of borrowing. These borrowings can be public deposits, private unsecured loans and privately placed, unsecured bonds or debentures. Restructuring of secured working capital borrowings are very short in nature and are generally not restructured.

Renegotiation can be done based on new terms. These types of short-term borrowings include inter-corporate deposits, clean bills and clean over drafts (Kumar &Venai, 2012). The process of reorganizing the equity capital is known as equity restructuring. It involves reorganization of the reserves and shareholders capital that are appearing in the balance sheet. Preference capital equity restructuring becomes a complex process as it is highly regulated area and it involves the process of law.

The reasons for equity restructuring are for raising fresh finance, to maintain debt-equity ratio, to write off unrecognized expenditure, to wipe out accumulated losses, reorganizing the capital for achieving better efficiency, to provide respectable exit mechanism for shareholders in the time of depressed markets by providing them liquidity through buy back and for correction of over capitalization (Kumar &Venai, 2012). Therefore financial restructuring is any substantial change in a company's financial structure, or ownership or control, or business portfolio, designed to increase the value of the firm.

A corporate entity may need to reorganize its financial assets in order to create the most financially beneficial environment for the company (Kumar &Venai, 2012). This will inturn lead to an increase in the value of the firm. In order to remain competitive and grow profitability, corporate worldwide have been aggressively trying to build new competencies and capabilities (Mantravadi & Reddy, 2008). One of the most high profile features of the globalised business and investment world is financial restructuring; it embraces many things in addition to debt and equity restructuring. It can be construed as almost any change in capital structure, operations, or ownership that is outside the ordinary course of business. Such things as leverage buyouts, divestures, sell offs, spin offs are some examples. The recombinant techniques of corporate finance often have an impact on the financial markets far beyond the individual companies to shareholders.

Virtually, without exception, stock prices of participating companies rise in response to announcement of financial restructuring (Zhenhu et al., 2004). All economies in Kenya inclusive always strive to ensure growth and improvement in the financial sector. The financial sector is seen as an engine room of an economy because they provide the required financial support to the insurance sector in terms of investment capital required to make the economy grow. Hence, financial sector can be called the auxiliary sector. The insurance sector on the other hand is that sector that utilizes the funds that the financial intermediaries have been able to mobilize from the surplus unit of the economy at any point in time. This sector plays major role in a nation’s economic development. They are usually responsible for production used to determine the Gross Domestic Product.

When the sector is not performing well subsequently the Gross domestic product is affected negatively and hence the need for financial restructuring for improvement of the financial performance of the insurance companies. The Kenyan insurance industry is governed by the Insurance Act and regulated by the Insurance Regulatory Authority. In 2015, a total of 46 companies were licensed to transact insurance operations in Kenya, of which 23 companies functioned as general insurers, 14 as composite players, and 9 as pure life assurers. The insurance industry has undergone a series of changes through financial reforms, advancement of communication and information technologies, globalization of financial services and economic development during the last few years. Efficiency, market structure, productivity change, and performance in the insurance industry emerged as a result of those changes.

The Blue shield insurance company has been facing bankruptcy for a number of years. This is to demonstrate all is not well for some of the insurance companies; therefore this study seeks to find out the effects of financial restructuring on the non financial performance of the insurance companies in Kenya more specifically the study was conducted at Pan Africa Insurance Holdings Company and add to the body of knowledge that is existing on financial restructuring and non financial performance in the insurance sector in Kenya. The remainder of this article paper is organized as follows. Section 2 covers review of past studies and defines the main hypothesis. Section 3 covers materials and methods. Section 4 covers the results and discussion. Section 5 presents the conclusion and recommendations.

## 2.0 Review of past studies and Hypothesis statement

### 2.1 Concept of Non financial performance

Performance is best looked at in two ways that is, end results and a means to achieve the results. It is the ability to distinguish the outcomes of organizational activities (Ukko, 2009). The two folds of performance are financial and non-financial performance (Ittner, 2008). Non financial performance metrics includes market share, innovation rate or customer satisfaction (Hyvonen, 2007). This study adopted non financial performance metrics such as employee motivation, customer retention, employee empowerment, innovation rate, and employee alignment.

### 2.2 Agency Theory and Financial Restructuring

Agency theory features greatly in financial restructuring, and was widely accepted in the 1980s. The agency theory focuses on the firm as a profit-maximizing one. Separation of ownership and control in the corporation is therefore important. The theory was espoused by Jensen and Meckling (1976) and they posit the agency-theoretic firm as a 'nexus of contracts’. The agency relationships are achieved through internal and external market transactions that are governed by either explicit contracts or implicit ones. It is through these contracts that providers of managerial expertise, employees, intermediate goods and risk capital are interlinked. The Shareholders are therefore thought of as principals by virtue of their role as residual risk-bearers, and their contracts convey ownership.

Agency contracts are however likely to be imperfect due to informational problems, but an optimal balance between accuracy and contracting costs is achieved designed to base each provider's compensation on its marginal product. The company's stock is an effective contractual payment in this model because its price is seen as reflecting not only the (prospective) performance of the firm, but also the manager's marginal contribution to that performance (Fama, 1980). The managerial contracts are therefore important under Agency theory as they seek to align the interests of the managers (agents) to those of the firm and by extension to those of the shareholders (principals).

There should be a focus on the incentives provided in the managerial contracts. This is because the firm's profit opportunities and how they are to be achieved, for instance through technological intervention is assumed to be known. To maximize shareholders' value therefore remains a question of how well the managers motivated to make the right choices to that respect. The basic framework employed by 1980s financial restructuring participants is very much a Principal-agent one, in which asymmetric information and managerial opportunism figure strongly (Goldstein, 1997).

Resolving of the agency problem is in itself financial restructuring especially when faced with contractual breakdowns resulting from slowing growth and stress from competition (Goldstein, 1997). To achieve this, changes in the capital structure, plus managerial replacement coupled in some instances with new forms of organization, are seen to bring about efficiency by effecting changes in the terms of agents' contracts throughout the organization. It is notable that the said changes in the contracts need to be both explicit and implicit. Jensen and Meckling (1976) states that the key result in these scenarios, with the pressures of debt servicing being the chief instrument, is reduced agent discretion. At no instance will free cash flow be diverted to empire building and waste, and hence effort and efficiency will rise. There will be an upsurge in profitability and market value of a firm because the new incentive environment causes managers to act responsibly.

### 2.3 Financial Restructuring and Non financial Performance

Siro (2013) conducted an empirical study on the effects of capital structure on the financial performance of firms listed on the NSE found that financial restructuring has a negative effect on financial performance of firms quoted on Nairobi securities exchange. The finding indicate that the higher the debt ratio, the less the Return on equity which therefore supports the need for more equity injection rather than borrowing, as the benefits of debt financing are less than its cost of funding.

Ngige (2012) researched on the implication of restructuring on the performance and long-term competitiveness within the Kenyan insurance sector and further, the significance of different modes of restructuring adopted by the insurance companies in influencing performance. Findings revealed that generally, restructuring resulted to improvement in performance in terms of market share growth, competitiveness, growth in quality of products, geographical spread and customer retention. Further findings revealed that insurance companies used different strategies of restructuring which had different motives in influencing performance. The study found mixed and inconclusive results as performance in some cases improved after financial restructuring whereas in other cases it declined.

Suka (2012) studied the impact of capital adequacy on the financial performance of insurance companies Quoted at the Nairobi Securities exchange. In the study the researcher showed that capital adequacy has impact on the profitability of the insurance companies and further that, capital adequacy contributes positively to the profitability of insurance companies. Hence, insurance companies must have a sound capital base in order to remain competitive and maintain the confidence of customers.

Mbogo and Waweru (2014) did a study on corporate turnaround response by financially distressed companies listed on the Nairobi Securities Exchange, surveyed companies that were listed for the entire period of the study (2002-2008). The results of the survey were that employee layoff was the most preferred course of action being carried out by 63% by the companies. Asset restructuring was the second most preferred turnaround strategy being carried out by 50% of the companies. Top management change and debt restructuring were the least preferred turn around strategies each one of them being taken by one company each. Literature reviewed led to the development of the following hypothesis statement:

*$H_0$1: Financial Restructuring has no significant effect on the non financial performance of Pan Africa Insurance Holdings Company*

**3.0 Material and Methods**

Research philosophy can simply be defined as a belief about the way in which data about a phenomenon should be gathered, analyzed and used (Cooper, Schindler, & Sun, 2006). For this study, a positivism research philosophy was adopted. The choice for the positivism research philosophy is supported by the principle underlying this philosophy. According to the principles of positivism, the philosophy depends on quantifiable observations that lead themselves to statistical analysis (Kothari, 2004). It is noted that positivism is in accordance with the empiricist view that knowledge stems from human experience (Singh, 2006). This principle conforms to the nature of the study in that it deals with the quantifiable observations. With regard to the progression of this study, it was guided by the hypotheses in attempt to show the association between independent variable and dependent variable. All these attributes of the study apply for the positivism research philosophy hence its choice as the ideal research philosophy. The study adopted a cross sectional research design and sought to determine the effect of financial restructuring on performance of Pan Africa Insurance Holding Company. A target population of 60 respondents was considered in this study. Out of the 60 respondents only a sample size of 20 respondents was used in the study computed based on (Mugenda & Mugenda, 2003), 10 – 30% Rule. The study utilized both primary and secondary data. It employed a stratified random sampling technique. Pan Africa Insurance Holding Company was stratified into departments thereafter simple random sampling was used to select the respondents from the finance department that was used in this study.

The department received 20 questionnaires that were filled by the Head of Department and 19 junior staffs in the same department. The questionnaires were administered at the Head office of the insurance company. The primary data was obtained through 20 questionnaires with closed-ended questions. The primary data was supplemented by use of secondary data obtained from published financial statements. Most of the items adopted a Likert scale (such as 1-strongly disagree, 2-disagree, 3-undecided, 4-agree, 5-strongly agree). Factor analysis was used to test for validity and the test retest method was used to test for reliability. SPSS version 24.0 aided in data analysis. The analyzed data was presented inform of inferential statistical methods such as Karl Pearson product moment correlation and simple linear regression model. The regression model was as follows:

$Y = \beta_0 + \beta_1 x_1 + e$

Where; $x_1$ = Financial Restructuring; e = error term; $\beta_0$ = intercept, $\beta_1$ = coefficient of $x_1$

## 4.0 Results & Discussions

Correlations among the study variables are reported in Table 4.1. The levels of correlations among the variables are relatively modest, with most variables exhibiting significant correlations. Pearson Correlations results in Table 4.1 showed that financial restructuring was positively and significantly associated with non financial Performance as shown by ($r = .222$, $\rho<0.05$).

**Table 4.1: Correlation statistics**

**Correlations**

| | | Performance | Restructuring |
|---|---|---|---|
| Performance | Pearson Correlation | 1 | |
| | Sig. (2-tailed) | | |
| | N | 20 | |
| Restructuring | Pearson Correlation | .222 | 1 |
| | Sig. (2-tailed) | .046 | |
| | N | 20 | 20 |

**Source: (Survey data, 2019)**

**Regression**

A Simple linear regression model was used to predict firm non financial performance in the study. The prediction was carried out basing on the effect of financial restructuring on firm non financial performance. From Table 4.2, the findings indicated that the model coefficient of determination (adjusted R2) was .323 which indicated that 32.3% total variation of non financial performance is explained by financial restructuring.

**Table 4.2 Regression Model Summary**

**Model Summary[b]**

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate | Durbin-Watson |
|---|---|---|---|---|---|
| 1 | .601[a] | .361 | .323 | 8.31300 | 1.927 |

a. Predictors: (Constant), Restructuring
b. Dependent Variable: Performance

**Source: (Survey data, 2019)**

The F-ratio was .937 at 1 degree of freedom which is the variable factor. This represented the effect size of the regression model and was significant with a p-value of 0.046 as shown in Table 4.3.

**Table 4.3: ANOVA Statistics**

| Model | | Sum of Squares | Df | Mean Square | F | Sig. |
|---|---|---|---|---|---|---|
| 1 | Regression | 4.642 | 1 | 4.642 | .937 | .046[a] |
| | Residual | 89.158 | 18 | 4.953 | | |
| | Total | 93.800 | 19 | | | |

a. Predictors: (Constant), Restructuring
b. Dependent Variable: Performance

**Source: (Survey data, 2019)**

According to hypothesis statement that, financial restructuring has no significant effect on firm performance, However, research findings disagrees with the hypothesis since financial restructuring recorded coefficient estimates of $\beta_1 = .442$ (p-value = 0.046 which is less than $\alpha = 0.05$) as shown in Table 4.4, hence in this study the null hypothesis is rejected and the conclusion is that financial restructuring has a significant effect on the performance of insurance companies. The current study concurs with Suka (2012) as the researcher argued that financial restructuring has a positive effect on firm performance. The more Pan Africa Insurance Holdings Limited conducted financial restructuring the better the performance of the insurance company. Empirically the study disagrees with the findings of Siro (2013) that financial restructuring has a negative effect on financial performance of firms' listed on Nairobi securities exchange.

**Table 4.4: Regression Coefficients**

| **Coefficients**[a] | | | | | | |
|---|---|---|---|---|---|---|
| Model | | Unstandardized Coefficients | | Standardized Coefficients | T | Sig. |
| | | B | Std. Error | Beta | | |
| 1 | (Constant) | 30.116 | 18.616 | | 1.618 | .123 |
| | Restructuring | .442 | .457 | .222 | .968 | .046 |
| a. Dependent Variable: Performance | | | | | | |

**Source: (Survey data, 2019)**

## 5.0 Conclusions and Recommendations

The study findings affirm that Financial Restructuring has a significant effect on the non financial performance of insurance companies. Financial Restructuring if carried out well improves liquidity, increases the cash flows for a sick insurance company and reduces the cost of capital for healthy insurance companies. The practise of debt restructuring or equity restructuring improves financial performance of the insurance companies. Financial Restructuring is suitable to maintain debt-equity ratio, to write off unrecognized expenditure, to wipe out accumulated losses, reorganizing the capital for achieving better efficiency, to provide respectable exit mechanism for shareholders in the time of depressed markets by providing them liquidity through buy back and for correction of over capitalization.

The insurance companies should opt for the restructuring of secured long term borrowings, unsecured long term borrowings, private unsecured loans, privately placed unsecured bonds, privately placed debentures, secured working capital borrowings, intercorporate deposits, clean bills, clean over drafts for improved firm performance. Reshufling of share capital and reserves appearing in the balance sheet, preference capital as good strategies for improvement of the financial performance of the insurance companies in Kenya and around the globe.

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