International Journal of
Finance and Accounting
(IJFA)

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PERMINUS KARIUKI NYAGA

IPRJB
INTERNATIONAL PEER REVIEWED JOURNAL AND BOOK PUBLISHING

International Journal of Finance And Accounting
ISSN xxxx-xxxx (Paper) ISSN 2518-4113 (Online)
Vol.2, Issue 6, No.5 pp 79 - 92, 2017

IPRJB
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www.iprjb.org

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[1*]Perminus Kariuki Nyaga,

[1*]Post Graduate Student,School of Business

Kenya Methodist University

***Corresponding Author's Email:** kariopermi@gmail.com

[2*]Mr. Wilson Muema,

[2*]Lecturer,School of Business

Kenya Methodist University

***Corresponding Author's Email:**

Abstract

Purpose: The objectives of the study were to establish the effect of skimming pricing strategy on the profitability of insurance firms in Kenya.

Methodology: The descriptive research design was preferred to other research designs because it reports the status of study variables. The population of study was the 45 insurance companies operating in Kenya as at 31st December 2012. Data was drawn from a period of five (5) years that is 2008-2012. The sample of this study was 10% of the sales workforce which comprised of 900 employees from the 45 insurance companies. The sample was generated by purposively sampling two employees from each insurance company.The researcher collected primary data with the help of a questionnaire. The primary data obtained from the questionnaires was summarized and analyzed by use of descriptive and inferential statistical techniques.

Results: Regression and correlation results indicated that there was a statistically significant and positive relationship between skimming pricing strategies and profitability.

Policy recommendation: The study recommends that insurance companies put in place measures assess the most effective pricing strategy to reduce product costs and thus increase profitability whenever such a strategy is used.

Keywords: *skimming pricing strategy*

1.0 INTRODUCTION

1.1 Back ground of the Study

Insurance industry, the world over forms an integral part of the financial services sector and plays a pivotal role in the economic growth of an economy. A well-developed insurance market paves way for efficient resource allocation through transfer of risk and mobilization of savings. Insurance industry is well developed in economies such as the US, Europe, Japan, and South Korea. Emerging markets are found throughout Asia, specifically in India and China, and are also in Latin America. In 2012, the global insurance market is forecast to have a value of $4,608.5 billion, an increase of 24.9% since 2007. Life insurance dominates the global insurance market, accounting for 59.7% of the market′s value (Andersen, 2008).

Insurance pricing, involves the calculation of each policy owner's fair share of losses and expenses. The price paid for insurance, called the premium, is the rate per unit or coverage multiplied by the number of unit purchased. Unit of insurance are measured differently according to the type of coverage. The rates are established before the exposure period to which they apply so that a forecast of the future must be made. The probable number and value of claims are forecast from historical loss experience with consideration given to trends and new developments. Insurers cannot set rates arbitrarily; rates are subject to state control (Andersen, 2008).

1.2 Statement of the Problem

Every firm is most concerned with its profitability. One of the most frequently used tools of financial ratio analysis is profitability ratios which are used to determine the company's bottom line. Profitability measures are important to company managers and owners alike. If a small business has outside investors who have put their own money into the company, the primary owner certainly has to show profitability to those equity investors. There has been a growing number of studies recently that test for measures and determinants of firm profitability. Financial industry's profitability has attracted scholarly attention in recent studies due to its importance in performance measurement (Kallhoefer& Salem, 2008)

According to a study conducted by Ahmed et al (2011) on the determinants of performance, it indicated that size, risk and leverage are important determinants of performance of life insurance companies of Pakistan. According to Wright (1992) due to the unique accounting system used by life insurance companies, profitability of the industry has always been difficult to measure as compared with other financial institutions or corporations. Kasturi (2006) argued that the performance of insurance company in financial terms is normally expressed in net premium earned, profitability from underwriting activities, annual turnover, return on investment and return on equity. However, none of these studies focused on the the effect of skimming pricing strategy on the profitability of insurance firms in Kenya. If not properly implemented, pricing strategies adopted by the insurance industry are prone to fail and the more the reason for the study.

1.3 Research Objectives

i. To find out the effect of skimming pricing strategy on the profitability of insurance firms in Kenya.

2.0 LITERATURE REVIEW

2.2 Theoretical Orientation

2.2.1 The Weber-Fechner Law

This law relates changes in a stimulus to the evolved response as follows:

AS/S = k, where S is lie stimulus, AS is the "just noticeable difference" (i.e. so that S + AS is perceived to be different from S), and k is constant for each sensory stimulus. Fechner analyzed subjective sensations using differential increments and derived the Weber-Fechner law (Monroe, 1971).

Several authors have applied the Weber-Fechner law in the investigation of price thresholds Adam (1970), Gabor and Granger,(1966) and Monroe, (1973). The empirica1 evidence reported in these papers supports the hypothesis of upper and lower price thresholds and thus a range of prices which is considered acceptable. The Weber-Fechner law provides a means of experimentally determining such thresholds. Prices below the lower threshold are considered too low (quality is suspect) and prices above the upper threshold are considered too high. This was empirically demonstrated by Adam (Monroe, 1973).

The theory is relevant in this study as it is used to explain how perception of prices by consumers affects them in purchasing insurance products. The more the consumers perceive those prices positively the more sales they make hence aiding in making the pricing decisions of the firms specially understanding the threshold of prices of such strategies.

2.3 Empirical Literature Review

2.3.1 Skimming Pricing Strategy

Besanko and Winston,(2000) found that central assumption of price skimming is because each consumer pays a price at or below his or her reservation price, each consumer is satisfied with his or her purchase. However, beyond the purchase decision, there is scant research on consumers' responses to price skimming. Instead, investigations concern firm profit maximization and variables impacting profit maximization, such as diffusion rates, competition and production learning curves (Robinson and Lakhani 2005; Irwin and Klenow, 2004). Thus, although price skimming is widely used by managers and investigated in the economics and strategy literatures, it has received little attention in consumer research.

2.4. Conceptual Framework

Figure one:Conceptual Framework

3.0 METHODOLOGY

The descriptive research design was preferred to other research designs because it reports the status of study variables. The population of study was the 45 insurance companies operating in Kenya as at 31st December 2012. Data was drawn from a period of five (5) years that is 2008-2012. The sample of this study was 10% of the sales workforce which comprised of 900 employees from the 45 insurance companies. The sample was generated by purposively sampling two employees from each insurance company.The researcher collected primary data with the help of a questionnaire. The primary data obtained from the questionnaires was summarized and analyzed by use of descriptive and inferential statistical techniques.

4.0 RESULTS FINDINGS

4.1.1 The Response Rate

A successful response rate of 71 % (64 respondents out of possible 90) was obtained. The high response rate was achieved because of the follow up calls that were made in an effort to enhance the successful response rate. Babbie (2004) asserted that return rates of 50% are acceptable to analyze and publish, 60% is good and 70% is very good. The study response rate was very good according to Babbie (2004) standards. Results are presented in Table 4.1.

Table 1 Response Rate

	Response	% Response
Successful	64	71%
Unsuccessful	26	29%
Total	**90**	100%

4.1.2 Gender Composition of Respondents

The study attempted to establish the gender composition of the respondents working in the insurance sector. Results in table 2 revealed that majority (75%) were male while the remainder (25%) was female. The findings indicate that the gender composition of respondents in insurance companies' finance and sales/marketing managers is more skewed to males. This implies that such insurance sector is a male dominated industry.

Table 2 Gender

Gender	Frequency	Percent
Male	48	75%
Female	16	25%
Total	**64**	**100%**

4.1.3 Age of the Respondents

The respondents were asked to indicate their age and the findings were presented in Table 3.Majority of the respondents (64.1%) were persons aged between36 to 50 years. Above twenty three percent (23.4%)were51yearsand above while 6.3% were aged between 21 to 35 years. Respondents who were below 20 years were also 6.3%.From the results, majority of the

respondents were aged above 36 years which implies that they had exposure in relation to the determinants hence were suited for the study.

Table 3 Age of the Respondents

Age	Frequency	Percent
Below 20 yrs	4	6.3%
21 to 35yrs	4	6.3%
36-50 years	41	64.1
51 years and above	15	23.4%
Total	**64**	**100%**

4.1.4 Position in the Company

The study sought to establish the position of the respondents in their companies. The findings were presented in Table 4. Above sixty percent (60.9%) of the respondents were sales and marketing managers while 39.1% were finance managers. These findings imply that majority of the respondents had access to the information sought by the researcher.

Table 4 Position in the Company

Position	Frequency	Percent
Sales and marketing manager	39	60.9%
Finance Manager	25	39.1%
Total	**64**	**100%**

4.1.5 Work Experience

The study sought to establish the work experience of the respondents. The findings were presented in Table 4.5.About fifty four percent (54.7%) had experience of above 10 years while 32.8% had work experience of between 4 to 10 years. About twelve percent (12.5%) of the respondents had experience below 4 years. These findings imply that majority of the respondents had substantial exposure to how performance in the insurance industry is affected by its determinants.

Table 5 Work Experience

Work Experience	Frequency	Percent
Below 4 years	8	12.5%
4 to 10 years	21	32.8%
Above 10 years	35	54.7%
Total	**64**	**100%**

4.1.6 Duration in the Company

The study sought to establish the respondents had been employed in the company. The findings were presented in Figure 4.4. About forty five percent (45.3%) had been employed for a period of above 10 years while 29.7% of the respondents had been employed for 6 to 10 years. Above twelve percent (12.5%) had been employed for 3 to 6 years, while another 12.5% had been employed for a period below 3 years.

Table 6 Duration in the Company

Duration in the Company	Frequency	Percent
Below 3 years	8	12.5%
3 to 6 years	8	12.5%
6 to 10 years	19	29.7%
Above 10 years	29	45.3%
Total	**64**	**100%**

4.2 Quantitative Data Analysis

4.2.1 Skimming Price Strategy and Profitability of Insurance Companies in Kenya

The study sought to establish the effect of skimming pricing strategy on the profitability of insurance companies. The results were presented in Table 4.8.Above seventy nine percent(79.7%) of the respondents agreed that the skimming pricing strategy adopted by their firm enabled them to recover cost quickly.Eighty percent of the respondents agreed that their firmcontinued to use skimming pricing even when the products were well established in the market. Majority of the respondents (84.4%) agreed that their firm had substantial lead in competition with both new and established products making their strategy more effective. Seventy six point six percent agreed that low priced products offered by other firms do not pose a threat to them. Above eighty seven percent (87.5%) agreed that the skimming pricing strategy adopted by their firm was highly determined by the brand loyalty in their customer base. The overall likert mean was 4.00 with a standard deviation of 0.99 and this implies that skimming pricing greatly influences theprofitability of insurance companies.

The findings agree with those of Richtel& Andrew, (2004) who investigated the relationship between price skimming and profitability in logistics companies. Prior research has also found skimming pricing information, even when revealed after purchase and consumption, affects profitability levels (Voss, Parasuraman, &Grewal, 1998; Varki& Colgate, 2001; Fornell et al. 1999).

Table 7Skimming Pricing Strategy and Profitability of Insurance Companies

Statement	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree	Mean	Std. Deviation
The skimming pricing strategy adopted by our firm enables us to recover cost quickly	4.70%	4.70%	10.90%	65.60%	14.10%	3.80	0.91
Our firm continues to use skimming pricing even the products are well established in the market	6.20%	7.80%	6.0%	51.60%	28.40%	3.87	1.10

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Our firm has substantial lead in competition with both new and established products making our strategy more effective	1.60%	10.90%	3.10%	67.20%	17.20%	3.88	0.88
Low priced products offered by other firms do not pose a threat to us	3.10%	9.40%	10.90%	42.20%	34.40%	3.95	1.06
The skimming pricing strategy adopted by our firm is highly determined by the brand loyalty in our customer base	3.10%	3.10%	6.20%	14.10%	73.40%	4.52	0.97
Average						**4.00**	**0.99**

4.3 Pearson's Correlation Analysis

Bivariate correlation indicates the relationship between two variables. It ranges from 1 to -1 where 1 indicates a strong positive correlation and a -1 indicates a strong negative correlation and a zero indicates lack of relationship between the two variables. The closer the correlation tends to zero the weaker it becomes. The correlation between profitability and economy pricing strategy was strong and positive (0.706) and was statistically significant (0.000). The correlation between profitability and skimming was also strong and positive (0.693) and was statistically significant (0.000). The correlation between profitability and penetration, premium and price optimization strategies was strong and positive (0.688, 0.522, and 0.644 respectively). All the three variables were statistically significant as they each had a significance level of 0.000.

Table 7 Pearson's Correlation Analysis

		ROA	Economy	Skimming	Penetration	Premium	Optimization
ROA	Pearson Correlation	1.000					
	Sig. (2-tailed)						
Skimming	Pearson Correlation	0.693	0.651	1.000			
	Sig. (2-tailed)	0.000	0.000				

4.4 Regression Analysis

Table 8 below shows the fitness of the regression model in explaining the variables under study. The results indicate that the variables; economy pricing, penetration pricing, premium pricing, price optimization strategy and skimming pricing were satisfactorily explaining profitability. This conclusion is supported by the R square of 0.651. This further means that the independent variables can explain 65.1% of the independent variable (profitability).

Table 8 Model Fitness

Indicator	Coefficient
R	0.807
R Square	0.651
Adjusted R Square	0.620
Std. Error of the Estimate	0.0778

4.5 Analysis of Variance

ANOVA statistics presented on Table 9indicate that the overall model was statistically significant. This was supported by a probability (p) value of 0.000. The reported p value was less than the conventional probability of 0.05 significance levels thus its significance in the study. These results indicate that the independent variables are good predictors of performance in terms of profitability.

The findings led to rejection of null hypothesis that economy pricing, skimming pricing, penetration pricing, premium pricing and price optimization strategies did not significantly contributeto financial performance of insurance companies.

Table 9Analysis of Variance

Model		Sum of Squares	df	Mean Square	F	Sig.
	Regression	0.653	5	0.131	21.596	0.000
	Residual	0.351	58	0.006		
	Total	1.004	63			

Regression of coefficients results in Table 9 shows that there is a positive relationship between profitability, skimming pricing, and price optimization strategy and whose beta coefficients is 0.051.

The results indicate that; an increase in the skimming pricing strategies by one unit leads to an increase in profitability by 0.051 units;

Table 10 Regression of Coefficients

	B	Std. Error	t	Sig.
(Constant)	-0.551	0.075	-7.390	0.000
Skimming	0.051	0.0028	18.21429	0.000

5.0 SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary of study

5.1.2 Skimming Pricing Strategy and Profitability of Insurance Companies

The general objective was to establish the effect of skimming pricing strategies on the profitability of insurance firms in Kenya. The descriptive statistics indicated that majority of the respondents agreed that the skimming pricing strategy adopted by their firm enabled us to recover cost quickly, their firm continued to use skimming pricing even when the products were

well established in the market, their firm has substantial lead in competition with both new and established products making their strategy more effective, low priced products offered by other firms did not pose a threat to them and the skimming pricing strategy adopted by our firm was highly determined by the brand loyalty in their customer base. Regression and correlation results indicated that there was a statistically significant and positive relationship between skimming pricing strategies and profitability.

These results implied that skimming pricing has a positive effect on the profitability of insurance companies. The findings agree with those of Richtel& Andrew, (2004) who investigated the relationship between price skimming and profitability in logistics companies. Prior research has also found skimming pricing information, even when revealed after purchase and consumption, affects profitability levels (Voss, Parasuraman, &Grewal, 1998; Varki& Colgate, 2001; Fornell et al. 1999).

5.2 Conclusion

It was also possible to conclude that the insurance companies had put in place effective skimming pricing practices as they helped them to recover cost quickly enabling firms to have substantial lead in competition with both new and established products were in a better position to adopt skimming pricing. The study noted that skimming had a positive effect on profitability of insurance companies.

5.3 Recommendations

5.3.1 Recommendations for study findings

The study recommends that insurance companies put in place measures assess the most effective pricing strategy to reduce product costs and thus increase profitability whenever such a strategy is used. They should also adopt ways to implement their pricing strategies better compared to competitor firms. They should also ensure that the strategies they adopt help them discourage competition and focus more on both acceptance and profits. They should also use strategies that positively influence consumer's perception through fair pricing in setting their product prices so that customers will be satisfied when paying for such services.

5.3.2 Recommendations for Further Research

This study was not exhaustive by any means and therefore it is suggested that another study be conducted in the insurance industry in probably using the same variables so as to establish whether the findings of this study will hold true for individual products since the risk rating is different from one product to another with special focus on Medical and Motor private classes which have been reported as loss making by many firms. An additional research can be done to find out exactly the reason for bad performance of these classes.

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