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**EFFECT OF PENETRATION PRICING STRATEGY ON THE  
PROFITABILITY OF INSURANCE FIRMS IN KENYA.**

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## EFFECT OF PENETRATION PRICING STRATEGY ON THE PROFITABILITY OF INSURANCE FIRMS IN KENYA.

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### Abstract

**Purpose:** The objectives of the study were to establish the To determine the effect of penetration 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 31<sup>st</sup> 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 penetration pricing strategies and profitability. These results implied that penetration pricing has a positive effect on the profitability of insurance companies.

**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:** *penetration 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 effects of penetration 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 determine the effect of penetration pricing strategy on the profitability of insurance firms in Kenya.

## **2.0 LITERATURE REVIEW**

### **2.1 Theoretical Orientation**

#### **2.1.1 The Weber-Fechner Law**

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

$\Delta S/S = k$ , where  $S$  is the stimulus,  $\Delta S$  is the "just noticeable difference" (i.e. so that  $S + \Delta S$  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 empirical 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.

### **2.2 Empirical Literature Review**

#### **2.2.1 Penetration Pricing Strategy and Profitability of Insurance Firms**

Henard, (2001) observed that the penetration price strategy is realized by setting a relatively low price for the new product aiming at reaching deeper market penetration in the current period and providing, as well as, a greater market share in subsequent periods. This strategy is applied only in the case when the price of demanded product is at the level which provides a sales volume increase. Therefore, in an industry where the considerable part of total costs could be reduced thanks to the economies of scale and experience, the justified penetration pricing application enables the company to realize greater a profit in the market.

## 2.4. Conceptual Framework

### Independent variables



Source: Figure 1: Conceptual Model Researcher (2013)

## 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 31<sup>st</sup> 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	<b>90</b>	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**

<b>Gender</b>	<b>Frequency</b>	<b>Percent</b>
Male	48	75%
Female	16	25%
<b>Total</b>	<b>64</b>	<b>100%</b>

#### 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 between 36 to 50 years. Above twenty three percent (23.4%) were 51 years and 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**

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

#### 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 4.4 Position in the Company**

<b>Position</b>	<b>Frequency</b>	<b>Percent</b>
Sales and marketing manager	39	60.9%
Finance Manager	25	39.1%
<b>Total</b>	<b>64</b>	<b>100%</b>

#### 4.1.5 Work Experience

The study sought to establish the work experience of the respondents. The findings were presented in Table 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**

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

#### **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 table 6. 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**

<b>Duration in the Company</b>	<b>Frequency</b>	<b>Percent</b>
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%
<b>Total</b>	<b>64</b>	<b>100%</b>

## **4.2 Quantitative Data Analysis**

### **4.2.1 Penetration Pricing Strategy and Profitability of Insurance Companies in Kenya**

The study sought to establish the effect of penetration pricing strategy on the profitability of insurance companies. The results were presented in Table 4.9. Above eighty two percent (82.9%) agreed that penetration pricing in their firm enabled them secure a wide market acceptance hence a bigger customer base. Majority of the respondents (85.4%) agreed that the strategy helps them discourage competition in that it focuses more on acceptance rather than profits. Eighty nine percent of the respondents agreed that their firm adopted penetration pricing when it expected competition with similar products in other firms. Seventy six point five percent agreed that there had been success in the penetration pricing strategy whenever their firm adopted it in the recent past. Above eighty seven percent (87.5%) agreed that most of the competitor firms had not been in a position to effectively use penetration pricing as their firm had done. The overall likert mean was 4.00 with a standard deviation of 0.99 and this implies that penetration pricing greatly influences the profitability of insurance companies.

These findings agree with Parkim, (2003) who found that the penetration price strategy is analogous to the maximizing sales strategy with limited profit. They also agree with Szymanski and Henard, (2001) who examined the penetration pricing strategies adopted by the health market place and concluded that the combination of state regulation pervasive pricing and other market peculiarities resulted in significant effect on profitability.

**Table 7 Penetration Pricing Strategy and Profitability of Insurance Companies**

Statement	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree	Mean	Std. Deviation
Penetration pricing in our firm enables us secure a wide market acceptance hence a bigger customer base	4.70%	6.20%	6.20%	43.80%	39.10%	4.06	1.07
The strategy helps us discourage competition in that it focuses more on acceptance rather than profits	4.70%	4.70%	4.70%	50.00%	35.90%	4.08	1.01
Our firm adopts penetration pricing when it expects competition with similar products in other firms	1.60%	6.20%	3.10%	40.60%	48.40%	4.28	0.92
There has been success in the penetration pricing strategy whenever our firm adopts it in the recent past	7.80%	3.10%	12.50%	65.60%	10.90%	3.69	0.99
Most of the competitor firms have not been in a position to effectively use penetration pricing as we have	3.10%	4.70%	4.70%	46.90%	40.60%	4.17	0.95
<b>Average</b>						<b>4.06</b>	<b>0.99</b>

### 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 penetration, and price optimization strategies was strong and positive

**Table 8: Pearson's Correlation Analysis**

		ROA	Economy	Penetration
ROA	Pearson Correlation	1.000		
	Sig. (2-tailed)			
Penetration	Pearson Correlation	0.688	0.644	1.000
	Sig. (2-tailed)	0.000	0.000	0.000



#### 4.4 Regression Analysis

Table 9 below shows the fitness of the regression model in explaining the variables under study. The results indicate that the variables; penetration 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 9 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 10 indicate 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.

**Table 4.15 Analysis 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 4.16 shows that there is a positive relationship between profitability and penetration pricing, premium pricing and price optimization strategy and whose beta coefficients is 0.052. The results indicate that; an increase in the penetration pricing by one unit leads to an increase in profitability by 0.052 units;

**Table 4.16 Regression of Coefficients**

	B	Std. Error	t	Sig.
(Constant)	-0.551	0.075	-7.390	0.000
Economy	0.069	0.017	4.018	0.000
Penetration	0.052	0.028	1.847	0.030

## **5.0 SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS**

### **5.1 Summary of study.**

#### **5.1.1 Penetration Pricing Strategy and Profitability of Insurance Companies**

The third objective was to establish the effect of penetration pricing strategies on the profitability of insurance firms in Kenya. The descriptive statistics indicated that majority of the respondents agreed that penetration pricing in their firm enabled them secure a wide market acceptance hence a bigger customer base, the strategy helped them discourage competition in that it focused more on acceptance rather than profits, their firm adopted penetration pricing when it expected competition with similar products in other firms, there had been success in the penetration pricing strategy whenever the firm adopted it in the recent past and most of the competitor firms had not been in a position to effectively use penetration pricing as the firm had. Regression and correlation results indicated that there was a statistically significant and positive relationship between penetration pricing strategies and profitability. These results implied that penetration pricing has a positive effect on the profitability of insurance companies.

These findings agree with Parkim, (2003) who found that the penetration price strategy is analogous to the maximizing sales strategy with limited profit. They also agree with Szymanski and Henard, (2001) who examined the penetration pricing strategies adopted by the health market place and concluded that the combination of state regulation pervasive pricing and other market peculiarities resulted in significant effect on profitability.

### **5.2 Conclusion**

Penetration pricing was a strong determinant of insurance company's profitability. This was concluded because insurance companies had put in place effective penetration pricing practices which enabled them secure a wide market acceptance hence a bigger customer base and also the strategy helped them discourage competition in that it focused more on acceptance rather than profits.

### **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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