ST. MARY'S UNIVERSITY

SCHOOL OF GRADUATE STUDIES

AN ASSESSMENT OF INVESTMENT PRACTICES IN THE ETHIOPIAN INSURANCE CORPORATION

BY

SHEWANGIZAW GETENET

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ADDIS ABABA, ETHIOPIA

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Under the Guidance of Mr. DEJENE MAMO (ASST. PROF.)

A THESIS SUBMITTED TO ST. MARY'S UNIVERSITY, SCHOOL OF GRADUATE STUDIES IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION (GENERAL MANAGEMENT CONCENTRATION)

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DECLARATION

I, the undersigned, declare that this thesis is my original work, prepared under the guidance of______________________________. All sources of materials used for the thesis have been duly acknowledged. I further confirm that the thesis has not been submitted either in part or in full to any other higher learning institutions for the purpose of earning any degree.

_____________________________ _________________________

Name Signature

St. Mary's University, Addis Ababa **May 2015**

ENDORSEMENT

This thesis has been submitted to St. Mary's University, School of Graduate Studies for examination with my approval as a University advisor.

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Advisor Signature

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List of Acronyms and Abbreviations

AA	Admitted Asset
NBE	National Bank of Ethiopia
EIC	Ethiopian Insurance Corporation
MIS	Management Information Systems
RAF	Readily Available Fund
ROI	Return on Investment
GIF	General Insurance Fund
LIF	Long term Insurance Fund

Abstract

In the context of insurance, much amount which is referred to be premium is accumulated with the aim to fulfill any obligations arising as a result of the contract made between insurers and insured; however, the accumulated idle funds needs to be wisely used to sustain and strengthen the financial position as well as to earn additional income for financial progress. To that end, insurance company is said to be one of the financial investor. The aim of this study is, therefore, to assess this important area of concern taking the investment management practices of the Ethiopian Insurance Corporation (EIC) through examining existing investment framework and tool or measurement techniques adopted by the Corporation. Descriptive type of research was used and data has been collected from primary and secondary sources. Questionnaire and interview was used as instrument for collecting primary data while secondary data was collected from the Corporation's annual audited report, policies and procedures. The analysis shows that the Corporation has been trying to establish an independently organized investment management function and establish asset liability management committee and put in place policies and limits though they are not effective in dealing with the investment management. Despite the forgoing, the Corporation has weak management information system, lack of the right skill and expertise in the investment areas, strict restriction in the regulatory body, lack of awareness towards the purpose and significance of investment by the boards and there is a problem in controlling and monitoring the investment management. Thus, it is recommended that EIC needs to enhance the quality of its investment in bid to maintain in a diversified manner and ensures its up-to-datedness and implementation while strengthening the monitoring and follow-up activities through strengthen its management information system to generate accurate investment position in timely manner.

Key words: - Investment

Effectiveness

CHAPTER ONE

1. INTRODUCTION

1.1. Background of the Study

Economic development is an increase of the national income or total volume of production of goods and services of a country accompanied by improvements in the total standard of living of the people. It is comprehensively defined as a multidimensional process of a total upward structural shift of the social system in terms of capacity and capability to produce, supply, distribute, and consumer goods and services required by a growing society with changing taste such that more efficient, higher and more equitable standard of living is attained and absolute poverty eliminated (Kassahun Eneyew, 2012).

The major engine of growth and development for any economy is the capital market which accommodates certain institutions for the creation, custodianship, distribution, and exchange of financial assets and management of long term liabilities. Hence, the extent to which a country's economy has grown and developed can be explained by the degree of development of the capital market. The capital market is the pivot upon which any economy revolves, especially in its role of creating, mobilizing and rationing long term funds for economic growth and development (Yabara, 2012).

The link between growth in financial system, especially financial market and economic growth as a well functioning financial markets are a key factor in producing high economic growth, and poorly performing financial markets are one reason that many countries in the world remain desperately poor. The reality at the ground also demonstrates the case in that countries with a strong stable economy do have a strong financial institutions and capital markets that make the private sector development remarkable in an economy and also allow citizens to take part in investment activities within a well organized and enabling business environment. On the contrary, the situation of least developing countries like Ethiopia is evident that the level of economic growth and development is found at the lowest level and the potential growth has been hampered by low level of financial sector development and nonexistence of well-organized capital market and enabling business environment. (Amare, 2008)

As pointed out by Amare (2008) the sub-Saharan Africa (SSA) remain the only developing region in which development assistance flows exceeds private capital flows. Except a few countries (such as South Africa, Mauritius, Botswana), most of the economies in the SSA region are not still doing anything good. This phenomenon can in part be attributed to lack of a well-developed financial sector (such as capital markets, banks, insurance and other financial institutions) and the poor economic policies and incompetent "institutions" in African Countries.

1.2. Company Background

As insurance companies is one of the financial institutions, and the ultimate goal of this study is to contribute something of value adding to the pool of the financial institutions', commencing from the establishment of insurance in our country to the progress being witnessed so far will , at a glance, be discussed as follows;

The emergence of modern insurance business in Ethiopia traced back to the establishment of the first bank which was called Bank of Abyssinia in 1905. After many years of dragging feet in the business, the first domestic insurance company, namely Imperial Insurance Company was established in1951.

Following the over threw of the Imperial regime in 1974, the Provisional Military Administration Council (PMAC), came into being with the new economic system called command economy.

Consequently, in December 1975, being after the thirteen private Insurance Companies nationalized, the provisional Military Administration Council issued Proclamation No. 68/1975 to establish the Ethiopian Insurance Corporation (EIC).

As per this proclamation, the asset, liabilities and capital of all nationalized insurance companies were transferred to EIC. The proclamation (68/1975) stated the purpose of EIC as follows:

- ✓ Engage in all classes of insurance business in Ethiopia.
- ✓ Ensure that services reach the broad masses of the people,
- ✓ … Promote efficient utilization of both material and insurance resources. With regard to the power and function, this proclamation states the following:

> *…manage, administer, supervise and direct all insurance business transaction, and negotiate, arrange, underwrite and contract reinsurance treaties and policies with foreign re- insurance companies. (Proclamation 68/1975)*

According to the Proclamation, EIC had to be organized to have an insurance Board, a general Manager, and deputy general Manager. The nationalized insurance Companies were brought under a centralized management at the head office level, and the eleven non- life insurance companies were organized to form six regional Main non life Branches.

Accordingly, the nationalized Ethiopian Life insurance Company and the Ethiopian-American Life insurance companies were organized to be under the umbrella of the Life Main Branch. The branch organization is still functioning except that of Northern Branch which was representing the then Asmara administrative region.

As mentioned above , the Ethiopian Insurance Corporation had been a monopoly, for 19 years ; that is from 1976 up to 1994 (The year 1994 is the time when proclamation no.86/1994, which proclaims the establishment of private insurance companies was declared).

In 1991, the Marxist regime collapsed and consequent to that the economic policy of the country changed to a market economy. Following this, the then Transitional Government of Ethiopia (TGE) issued proclamation number 86/1994 which sates establishment of private insurance companies.

Accordingly, EIC re-established as public enterprise under the Council of ministers Regulation no.201/94 with a paid-up capital of Birr 61, 007,038 (US$10.25million at the prevailing exchange rate of 5.95/US$). In connection with this Proclamation, the purpose of EIC revised as stated below:

- ✓ *to engage in the business of rendering insurance services*
- ✓ *to engage in any other related activities conducive to the attainment of its purposes*

The phrase “Related Activities” implies that the Corporation has been given the mandate by the government through National Bank of Ethiopia to engage in various investment activities, stating explicitly the areas where insurance companies can invest in.

The investment Directive for insurance funds has two critical view points: 1) the funds which are collected from the community in the form of premium shall be mobilized in a more secured areas of investment, 2) the funds shall be kept more of on a liquid manner so that the fund would easily and timely be used when there is any urgency of obligations. Given the mandate, EIC as a public enterprise is governed by Proclamation No.25/1992, being accountable to the Public Financial Enterprise Agency (PFEA).

Currently, there are 17 insurance companies operating in the industry and EIC manages 40% of the market share at the end of year 2014(EIC, Marketing and Strategic Planning). The total asset and capital of the Corporation as it is registered as at June 2014 is Birr 2.3 billion and Birr 435.8 million, respectively. The gross written premium (General insurance), reached 1.88 billion for the year ended 30 June 2014. The net income registered as at 30 June 2014 was 446.3 million. Over this period, EIC has remarkably grown into a large company in the insurance services industry in the country. Today, it employs about 1,274 employees. Despite all this, its investment activity by far lower than its underwriting activity for reasons we shall see latter in the discussion. (EIC Annual Report – 2012)

EIC has diversified contacts with international insurers, associations of insurance, reinsurance pools, and reinsurance companies. In addition, it accepts inward insurance business coming from various international insurance companies and deals with Outward reinsurance business with the most renowned international reinsurers.

Moreover, EIC is a member of national and international insurance and reinsurance organizations which include: the Ethiopian Insurance Association; Federation of Afro-Asian Insurers and Re-insurers; African Insurance Organization, and Organization of Eastern and Southern African Insurers.

On top of this, EIC is a shareholder of African Reinsurance Corporation headquartered in Lagos, Nigeria and African Export-import Bank, headquartered in Cairo, Egypt.

The Ethiopian Insurance Corporation (EIC), which is recognized as the most reliable and financially strong insurance institution in the country, needs to remain liquid all the time to meet its obligations when required. To that end, EIC invests its available invest able insurance funds in diversified investment areas to generate additional income so as to further strengthen its liquidity position; guarantee its sustainability and satisfy the needs of its customers.

In order to be competitive in the market the Corporation has to be responsive to the change. Hence, the Corporation has re engineered its working process in view of bringing about institutional transformation. Besides, it has also implemented insurance and accounting software package to further improve the service delivery package.

To date, the country's economic environment is changed from what has been in the past favorably. The current Economic growth, together with the Growth and Transformation Plan (GTP) of the Country requires strong financial sector. Especially, the Insurance industry should guarantee both foreign and local investors by providing risk cover for their investments. Here, however, the insurance market is lagging behind the development of the economy.
As it is well known there are 300,000 formal insurance clients and the sector contributes only 0.79% for the country's gross domestic product (GDP)(NBE, 2013/14). Hence, Insurance companies should play significant role in the economic development endeavors of the country.

Even though, the performance of the Corporation is improving from year to year, the share of investment income to that of total income is insignificant. It has a lot to do in this respect to build its capacity in response to the current economic environment, and perform in compliance to the local regulations and international standards.

On top of that, EIC should be in a position to play a forefront role in supporting the “GTP” and economic development of the country at large. However, the investment aspect has its own drawbacks to go forward at a desired level.

In view of the fact above, this stimulate the researcher to deal with the matter that affects the Corporation most. This is the poor investment practices of the Ethiopian Insurance Corporation.

Taking the above background, it is not difficult to summarize how difficult to form a feasible and knowledge based investment practices to be made in particularized insurance company. The study was mainly motivated to conduct a descriptive study on the investment practices of the Ethiopian Insurance Corporation and come up with possible recommendation(s).

1.3. Research Problem

The traditional concept of risk and return relationship applies to insurers the same as it does to other investors. The market movement is considered very crucial to the insurance companies due to the fact that the investment function is a critically important subset of the overall financial management of both life and non-life insurance companies.

According to Black and Skipper (2000), investment risk is generally defined as the potential variability of returns and comprises the insurance pricing risk and the asset-liability risk. In general, the total investment portfolio of insurance company consists of two categories. First, assets which are invested for providing guaranteed and fixed benefit payment. Second, other invested assets used to support the liabilities associated with investment risk through the products or lines of business. Any changes in the market can simultaneously affect the value of a company’s assets and liabilities and the behavior of its customers. Because of their unique operations and balance sheet structure, and also the special risk profile that results, fixed income investments make up the significant majority of life insurer's assets, particularly that of life's insurer.

Likewise, the Ethiopian Insurance Corporation has been given a mandate to undertake insurance business in the market. In addition to the provision of insurance services to the public, in general, it engages in investment activities in a diversified manner.

However, based on the preliminary survey that the researcher made, the investment made so far is by far lower than the expected areas of the investment vehicles which are set by the NBE, in fact, with given limited area of exposure. Had the Corporation optimally utilized its resources even based on the given NBE's rate, with given admitted assets, the Corporation would have been registered a remarkable achievement. (NBE's Directive # SIB/024/2005 plus own computations of actual analysis at a glance).

However, even the employees of the company have reservations as to the efficient and effective utilization of investment practices generally being exercised by the Corporation. Though EIC has been widely deployed in Ethiopia, the growth trend of EIC in size of premium does not mean growth in its investment income.

In addition to these, while reviewing the in-house research made by the investment experts', the researcher have found that there is also an indication even the need to revise the rates being given by the regulatory body following the dynamisms of the business environment.

As an experience survey, the researcher has attempted to discuss with experts, who have long years of experience, about the major problems being faced by the Corporation with regard to its investment, and the experts have highlighted that as the core operation of the Corporation is providing insurance services to the public, lack of proper awareness regarding the contribution and even having the mandate to engage in investment activities are not rooted to the minds' of the management of the Corporation. As a result, they strongly argue that, leave alone the employees, some of the management members of the Corporation have no proper awareness, regarding the investment activities and its impact to the wealth of the Corporation. Therefore, this by itself, make the corporation not to use higher financial as well as operational benefits from investment earnings.

On the other side, the experts being placed in the investment area are not multi-disciplinary professionals. Under normal circumstance, in project area, multi-disciplinary professionals are mandatory as the work demands it. For instance, given the mandate by the NBE, real estate is one of the investment vehicles. In real estate's investment, professionals like Engineers, financial analysts and economists are a must to be the business successful. However, in the specific study under review, this discipline lacks very much. This, in turn, adversely affects the efficiency as well as the effectiveness of the investment engagements.

According to the researcher's preliminary survey, the rates being given for each allowed investment area was made before a decade. With the intention of the insurers to be very liquid, the lion's share of the insurance funds is supposed to be kept in fixed deposits. Here, however, the corporation is depositing its funds only in public bank. This by itself contradicts from the diversification points of view as the market is said to be free.

Therefore, the Corporation seems not used its resources optimally from its alternative investment point of view and even from the policy point. The definition and formulation of the problem enabled the researcher to go forward straightly to the way how to deal with and come up with possible and applicable solutions.

Generally, given the economic growth of the country as the market has various opportunities and that of the growth of the investment or asset as it is the base, the Corporation could not realize a desirable investment income, according to the pilot survey; moreover, the Corporation's investment practice in relation to the management attention is not a rewarding, particularly on real-estate development as real-estate is a lucrative business; In addition to the above mentioned constraints, Investment problem in relation to the National Bank of Ethiopia's (NBE's) Directive, particularly the rates being used as a base/coefficient are some of the points raised in detail, and the poor culture of the Corporation with regard to the investment pool that is analyzed in detail.

1.4. Research Question

In order to assess the Investment Practices of the Corporation, the research addressed the following research questions (RQs). The researcher adapted analytical frameworks from the literature and analyzed those research questions;

- RQ#1. Does the Corporation's investment income grown-up like that of the growth of the Assets of the Corporation?
- RQ#2. Do The Corporation's Board, management and staff have strong attention towards the investment practices, emphasizing on real-estate development?
- RQ#3. Do the Investment activities comply with respect to the National Bank of Ethiopia's (NBE's) Directive, particularly the rates being used as a base/coefficient?
- RQ#4. Does the culture and/or the significance of the investment activities well communicated & inspired to the concerned parties?
- RQ#5. Does the Corporation have efficient management Information Systems to communicate and easily be inspired for future undertakings?

1.5. Research Objectives

1.5.1 General Objectives

The general objective of the study was to assess the investment practices in the Corporation. Therefore, it is to point out the practices that EIC faces in investment and the rationale behind the ever slow incremental rate of investment income of the Corporation.

1.5.2 Specific Objectives

The specific objectives of this study is; therefore, to look at the following and other related points and thoroughly analyze their effects on the overall performances of the Corporation;

- Assessing the real investment practices of the Corporation overtime;
- Comparing the trend in the growth of investment income with that of the general growth of the Corporation's income;
- Highlighting the possible relationships of investment and insurance,
- Evaluating the NBE Directive against the current status of the investment of the Corporation, and
- Highlighting the Board and Management attention towards the investment practices

1.6. Significance of the Study

The study is believed to have the following benefits, which are briefly presented here under;

- It gives full understanding about the investment practice/problem to all stakeholders of the Corporation;
- It provides the possible solutions that help management to reduce the problems of investment;
- It can be used as a base for those who want to study further on this matter.

1.7. Scope of the Study

The study will be intended to search for problems of investment and other related areas in Ethiopian Insurance Corporation. To that end, the scope of the study is limited to only in Head Office as the study will be Case Study, searching investment problems, management commitment towards investment & NBE Directive.

1.8. Limitation of the Study

The researcher has the following study limitation, among others,

- The study faces time constraints as the study was a case study which requires much detail analysis on the study under review,
- The study also being challenged by financial constraints,

- The other limitation was that of the respondents' restriction and the study was highly challenged due to lack of adequate data for trend analysis as the data were not kept properly in a consumable manner.

1.9. Structure of the Thesis

The rest of the Chapters for this research study are organized in to four Chapters with logical flow as follows;

The Second Chapter:

This Chapter reviewed and organized after reviewing the work done by various writers in the area. The rational for this review was to establish the study on theoretical basis and prior research done based on the sentiments of the African context.

The Third Chapter

This Chapter described the research methodology used which included the research design and the sources of data.

The Fourth Chapter

The Fourth Chapter provided the data analysis, discussions and presentations of the data gathered.

The Fifth Chapter

Eventually, Chapter five concluded on the research study and attempted to provide useful recommendations and areas for future study.

1.10. Definition of Key Terms

Investment: - In an economic sense, an investment is the purchase of goods that are not consumed today but are used in the future to create wealth. In finance, an investment is monetary asset purchased with the idea that the asset will provide income in the future or appreciate and be sold at a higher price. (www. investopedia.com/terms/i/investment.asp)

Admitted Assets: - shall mean any property security, item or interest of an insurance company recorded in the financial statements of the insurance company but excluding the stated items in the Directive. (Directive number SIB/25/2004)

CHAPTER TWO

2. LITERATURE REVIEW

2.1. Review of Related Literature

An investment portfolio is a collection of investments held by an individual or an institution in the form of bonds, stocks, options, gold certificates, real estate, currency, or any other assets or securities generating returns. Investment portfolio management refers to the technique of management of one's investments according to the predetermined financial goals. The process of investment portfolio management involves the selection of investment options based on their past performances and estimated future growth, an analysis of which assets to buy, determining the quantity and timing of assets to purchase, and making decisions on which assets to divest. (B. Hiriyappa et al, 2008).

Portfolio analysis forms a part of the broad process of investment portfolio management. Portfolio analysis refers to the study of performance of specific portfolios under various circumstances. An investor or an investment professional can perform a portfolio analysis by means of specialized analysis tools. The objective here is to achieve the best possible trade-off between returns on investments and risk tolerance. The process of analysis involves the evaluation of investments and returns. This helps the analyst draw a picture of the financial and operational impact of the investment portfolio.(Ibid)

Investment portfolio management and portfolio analysis extends to all asset classes and securities; equities, bonds, indexes, funds, commodities, securities, and so on, and their risk factors and associated returns. The composition of investment instruments will determine the rate of success of an investment portfolio. An investment portfolio is an investment strategy of diversification. Investors invest in multiple assets to reduce risks that follow certain investments. An appropriate mix of assets and financial securities in a portfolio determines investment risk exposure and returns. To build a diversified investment portfolio, investors are required to do so (CII, 2014).

Set financial goals: Before investing, an investor must evaluate his / her present income, draw an estimate of future income, calculate the number of years left before retirement, and consider the present financial responsibilities. For novice investors, a good starting point is with mutual funds.(J.Marlett DC, 2006)

Allocate assets: An investment portfolio includes a mix of assets and financial securities. The combination of rewards and risks will be determined by the financial instrument on which investments are made.(Ibid)

Avoid regular rebalancing of investment portfolio: A good portfolio is typically one that is balanced and includes a broad range of investment classes depicting varying risk levels and returns. Rebalancing such a portfolio regularly is not advisable. Risks are usually lower in long-term investments, while the value of assets over a short term may be volatile. An investment portfolio should be balanced either annually or on long-term basis. (B. hiriyappa et al, 2008).

Building a successful investment portfolio can be achieved by taking full advantage of the investment plans offered by an investment company. Investors will need to evaluate if they are adequately insured against unexpected losses. Efficient investment portfolio management can be achieved by appointing the services of a fund manager or investment advisor.(Lintner J, 1965)

Factors Influencing Investment Portfolio Management: Before beginning the process of investment portfolio management, an investor must set his / her investment objectives. No two investors will seek the same results from their investments. One may seek safe investments and reduced risk exposure. Another may aim for rapid profit generation. Depending on investment objectives, an investor will choose between equities and debt instruments, etc. The other factors affecting investment portfolio management are: (B. hiriyappa et al, 2008).

- A portfolio owner’s circumstances
- Measurement of investment performance, including factors like risk exposure and expected returns
- Economic conditions and how they affect the financial market

- Investment preferences (Does an investor want to invest in domestic or international markets?)
- An in-depth investment culture within the operation as well as by the stakeholders has to be realized highly to boost the yield and security.

For best results when it comes to investment portfolio management, investors are advised to hire the services of financial institutions, and of investment advisors, who will not only analyze investments, but also help achieve the investor's financial goals. (B. hiriyappa et al, 2008).

2.1.1. What are Investment and its risks in Insurance Business?

Investment of insurance funds should be made with the view to achieving a reasonable balance between the twin objectives. They are security (the investment should assist the social security scheme to meet its commitments in a cost-effective way) and profitability (the investment should achieve maximum returns, subject to acceptable risk.) (Jasiene et al., 2012)

With regard to integrated approach, the investment of the funds of a social security scheme should take into account the financial system under which the scheme operates, and be consistent with its short–medium and long-term financing objectives. In addition to investment objectives and integrated approach the guideline also outline some points about investment policy and strategy. (Ibid)

The investment policy of a social security scheme should be based on prudent–person principles and appropriate qualitative restriction. It should take into account; risk management, diversification and dispersion, matching assets and liabilities, including considerations of duration and maturity, currency matching, and performance measurement and monitoring. In addition to taking consideration these concepts the investment policy and investment strategy should be consistent with the financing objective of the social security scheme and its cash-flow requirements , the investment policy of a social security scheme should be established taking into consideration the economic policies of national financial authorities such as the ministry of finance and/or central bank and ,a statement of the investment policy and strategy should be formally articulated by the governing bodies of the social security scheme and of the investing institution and should be publicly available.(John G, David CM, 2007)

No minimum level of investment should be prescribed for any given category of investment, except on exceptional and temporary basis and for compelling prudential reasons. If prudent–person principles are applies to managing the investment of funds; they should be set out, with a minimum body of rules, by the governing body of the scheme or by the government. The governing body of the investing institution should adopt criteria concerning the expertise that is required of investment managers and other advisors on investment policy and strategy and their implementation. The investing institutions should have an appropriate structure to control decisions taken on the basis of the prudent –person principles. (Ibid)

Assets should be valued in accordance with generally accepted accounting principles.

And periodic analysis of each asset class and the portfolio as a whole should be carried out to determine nominal, risk-adjusted, and inflation-adjusted (real) rates of return. The analysis of investments should be publicly disclosed.

2.1.2. Major Types of Investment Vehicles in Insurance Business

As cited from Hiwot's study (2012), internationally, there are standard investment principles that are expected in investing the fund. Safety, yield, liquidity, nation.s interest, diversification, and capital preservation are some of the most applied principles. While dealing with investment issue of the enterprise; the investment fund manager is expected to apply/consider the four principles (1) Safety- invests with minimum or no risk investment portfolio. The safety principle is lies on the fact that the fund is a trust fund and they need to be invested in care and diligence. However, the value interpretation for safety principles doesn't meet the finance theories that detect there is no risk free investment portfolio. Even risk free assets may not be risk free as long as inflation rate is there, (2) yield- allocates the investment in the area where the investment return is maximum. These principles go with the allocation of the fund on investment area that give maximum yield, this in turn demand the involvement of some risk, (3) Liquidity- allocate investment in the area where some of the investment can be converted into cash.

Nor does the fund require safety concern in its investment, it also require liquidity as soon as it is needed. Funds require liquid assets, since they have the liability that is due every time, and (4) Harmony with the public interest- Allocate investment for the best economic and social interest of the public. The investment practices of EIC revealed that investments are made taking aforementioned principles underlining investment of funds. However, it was found to give more weight to safety among the others.

2.1.3. Investment Management Framework

Pursuant to the Core Principles for effective investment management and the principle which the (Basel committee published in 2008), investment management requires that banks and the banking groups (which includes insurance companies) should establish a robust investment and risk management framework that ensures it maintains sufficient liquidity, including a cushion of unencumbered high quality liquid assets, to withstand a range of stress events, including those involving the loss or impairment of both unsecured secured funding sources. Accordingly, the committee clearly set out key elements that provide guideline to effectively manage risks. These are;

- Board and senior management oversight;
- Adequacy of Investment Policy, Procedure and Limit;
- Adequacy of Investment Management Function, and
- Effective Management Information System

2.1.3.1. Board and Senior Management Oversight

A) Board Oversight

According to the committee, the prerequisite of an effective investment and liquidity risk management include an informed board and capable management. It is primarily the duty of board of directors to understand the investment and its liquidity risk profile of the financial institutions and the tools used to manage its risks. In this regard, the Reserve Bank of India (2008) noted that a board has to ensure that the financial institutions have the necessary investment and liquidity risk management framework and capable of confronting uneven liquidity scenarios. The Basel core principles for effective liquidity risk management (2008) mentioned the oversight role of board of the institutions as follows.

- Approve board business strategies and policies that govern or influence the management of investment of the institutions;
- Establish clear levels of delegation within the investment management function;
- Ensure that the institution's management adopts procedure to enable the achievement of the objectives set out in the strategy and policies;
- Ensure that investment is adequately measured, monitored and controlled effectively;
- Communicate the strategies and policies to all relevant personnel;
- Periodically re-evaluate significant investment management policies as well as the overall;
- Ensure compliance with all relevant laws, regulations and directives.

B) Senior Management Oversight

In principle, senior management is responsible for the day to day management of the institutions. As per the National Bank of Ethiopia (NBE. 2010) Risk Management Guideline, some of the major roles of the management to ensure that an institution has adequate levels of liquidity to meet its on-going operational needs, including at times when there are unusual demands for liquidity.

- Develop procedure and practice that facilitate the implementation of the broad security management strategy of investment and its policies adopted by the board;
- Undertake the investment management of its liquidity risk in accordance with the delegated authority developed by the board;
- Develop measures that facilitate the measurement, monitoring and control of security, profitability of the investment;
- Develop effective contingency plans to provide the institution with liquidity under adverse conditions;
- Management policies and other liquidity risk management information to all individuals involved in the process, and

- Develop an effective system of reporting to the board on issues related to the management of investment and its funds.

The responsibility for managing the overall investment and liquidity of the institutional investors should be placed with a specific & identified group within the company, normally in the form of an Asset-Liability Committee that comprises senior management and the Treasury function. Greuning & Bravatonic (2003) assert that liquidity risks are normally managed by the Institution's Asset-Liability Management Committee (ALCO) which must therefore have a thorough understanding of the interrelationship between liquidity and other market and credit risk exposure on the balance sheet.

2.1.3.2. Adequacy of Investment Policy, Procedure and Limit

A. Investment Management policies

According to the National Bank of Ethiopia (NBE, 2010) Risk Management Guideline issued to all insurance companies, noted that adequate investment management policies, procedures and limits are also one of the pillars that play a pivotal role towards of the management of investment risk, emphasizing that the Board of the company is ultimately responsible for the formulation and implementation of those operational policies, procedures and limits. Ratnoviski (2013) discussed that investment and liquidity policy initiates strategies on particular aspects of investment management.

- Asset-Liability Management: - the strategy with respect to investment outlines the mix of assets and liabilities to maintain liquidity as most common source of financial institution's vulnerability lies in liquid mismatch between assets and liabilities.(Oviloer, 2013) strongly emphasized in his study that Asset-liability management should be an integral part towards the management the overall investment management of financial institutions.
- Diversification: - Valla (2006) discussed that concentration exists when a single decision or a single factor has the potential to result in a significant and sudden withdrawal of funds. Such a situation could lead to an increased risk, placement of specify guidance is part of liquidity strategy relating to funding sources. Basis (2002) noted that

diversification of liabilities could be achieved through close monitoring in resources concentration.

B. Procedures and Limits

Institutions establish appropriate procedures, processes and limits to implement their investment policies. Reserve Bank of India (2001) the procedural manual explicitly narrates the necessary operational steps and processes to execute the relevant investment controls. In addition to the statutory limits of Liquidity Reserve Requirements, there are other limits, which should be periodically reviewed, on the nature and amount of liquidity risk the institution can assume.

2.1.3.3. Adequacy of Investment Management Function

Kumar (2013) mentioned that an effective investment and its risks management include system that helps financial institutions in identifying, measuring, monitoring and controlling its adverse exposures. The author added that key elements of an effective investment management process include an efficient MIS, systems to measure, monitor and control existing as well as future risks and reporting them to senior management.

2.1.3.4. Management Information System (MIS)

According to Basel III (2010) management information system (MIS) is essential for sound investment management decisions. Information should be readily available for day to day investment management and risk control, as well as during times of any obligations. Data should be appropriately consolidated, comprehensive yet succinct, focused, and available in a timely manner. Ideally, the regular reports a company generates will enable it to monitor even liquidity during a crises; managers would simply have to prepare the reports more frequently. Managers should keep crisis monitoring in mind when developing MIS. There is usually a trade-off between accuracy and timeliness. Liquidity problems in relation to investment can arise very quickly, and effective liquidity & investment management may require daily internal reporting. Since liquidity is primarily affected by large, aggregate principal cash flows, detailed information on every transaction may not improve analysis.

Management should develop systems that can capture significant information. The content and format of reports depend on a company's investment & liquidity management practices, risks, and other characteristics. However, certain information can be effectively presented through standard reports such as "Funds Flow Analysis" and "Contingency Funding Plan Summary". These reports should be tailored to the company's needs. Other routine reports may include a list of large funds providers, a cash flow or funding gap report, a funding maturity schedule, and a limit monitoring and exception report. Day to day supervision may require more detailed information, depending on the complexity of the company and the risks it undertakes. Management should regularly consider how best to recap complex or detailed issues for senior management or the board. Besides, other types of information important for managing day to day activities and for understanding the company's inherent risk profile. (Ibid)

- Asset quality and its trend;
- Earnings projections;
- The company's general reputation in the market and the condition of the market itself;
- The type and composition of the overall balance sheet structure and
- The type of new deposits being obtained, as well as its source, maturity and price.

2.1.4. Existence of Stock and Capital Market versus Nature of Business

The major source of investment opportunities to insurance companies is stock and capital market. The insurance funds, and reserves are mainly rotates in the stock market. The range and depth of capital and financial market are the basic instruments on the investment choice of insurance companies. (Griffith, 2006)

Investment opportunities for insurers in developing countries are often limited to secure properly the liabilities of the insurance and reinsurance companies because of the nature of financial liabilities. The investment risk that an insurance company faces will depend on the particular nature of its policyholder liabilities. (Ibid)

In insurance business distinguish should be done between non-life (property and liability) and life insurance. The liabilities of non-life insurance are mainly classified into policyholder liabilities (technical provision) and the capital base. The latter mainly includes shareholder funds. The other balances are statutory reserves and may be reserves for currency fluctuations. They are, in effect, a form of quase-money, having a financial character between policyholder liabilities and that of the capital base. (Taye Ayele – 2014)

The policyholder liabilities have two major items. The provision for outstanding incurred claims, including claims incurred but not reported, and the provision for un-expired risks (unearned premiums). The un-expired risk provisions are set in advance. Therefore, the larger and more important components of policyholder liabilities are the provision for future claims. The forecasts of the level of future claim payments in non-life insurance are subject to a good deal of uncertainty, in terms of timing and amount of settlement. This uncertainty is an important part to win the investment opportunity. Non-life insurer may face exceptionally high level of claims to pay promptly under the pressure of legal and moral pressure. To this reason, the company always has to be liquid to protect such uncertainties. Hence, in order to be always liquid, the insurance companies will tend to hold short dated and highly marketable bonds and money market instruments against these liabilities.(Ibid)

This precautionary liquidity preference will be higher for non-life insurance companies that underwrite large-scale exposures than the small sale risks. Therefore, the capital base will be invested in the financial assets that are expected to yield higher rates of return; even they may possess more default and liquidity risk. However, the capital base is further subdivided into minimum statutory capital and "free capital". The statutory capital is the level of capital that an insurance company must maintain under legal registration and the "free capital" is the amount in excess of this minimum level. (Dargea, 2014).

Accordingly, the larger the capital base, the less risk in its investment policy as a whole, compared with an insurance company that has relatively small capital base.(Nebere Degsew- 2015).

Regarding to life insurance, the capital base of a stock life insurer differs from a non-life insurer. In Life Insurance, the capital is owned by both shareholders and participating policyholders. Moreover, life insurance liabilities have much longer duration than non-life. This meant that the time frame of investment of policyholder funds is much longer in life than non-life insurance. The expected pattern of cash flows for a life insurer is also much stable than non-life. Because premiums receivable depend on a weighted average of the past sales, and claims and other cash out flows are predictable by the actuaries. To these reasons, life insurance companies have less concern to precautionary liquidity within their investment portfolios. Accordingly, shares and real estate investments are more correlated and more favored to the insurance investment policy and these are accommodate mainly in stock and capital market. (Nebere Degesew -2015).

2.2. Review of Related Empirical Studies

Many studies that have been done on insurance fund investment especially on public funds try to show the investment activities of the public funds from their governance side. Olivia S. Mitchell (2001) finds that political appointees and ex officio board members tend to dominate decision-making, frequently with many public directors chosen to represent the interests of plan participants.

It is customarily that to some extent pension fund investment and insurance investment funds share common characteristics in that both use similar principles of investment i.e. security, liquidity and that of profitability in that order.

So, a study by Pinheiro (2004) that focuses on pension funds for government workers in Organization for Economic Cooperation and Development (OECD) countries resemble the findings of Mitchell. In particular, the study finds that, Civil servants. Pension funds are more vulnerable to investment mismanagement risks. They are often required to, directly or indirectly, finance infrastructure, social projects or allocate resources on investments not necessarily linked to retirement income objectives.

Some empirical evidence for the US shows that public pension funds that had been required to make a certain portion of in-state investments generated lower investment returns compared with other funds these studies demonstrate that pension funds investment are especially public pension funds are not invested in accordance to financial criteria .

To shed some light on this issue, Iglesias and Palacios (2000), found that countries with poor governance experience achieved low return on their investment return. They have used twenty developed and developing countries public pension fund as a sample and for many of these countries, investment returns of public pension funds are often below bank deposit rates and almost always below the growth of per capita income. They also found that publicly-managed funds almost always face serious political obstacles that hamper their ability to invest effectively. Their asset allocation is systematically biased toward targeted investments and lending to government at low yields. As a result, returns are much lower than those found in privately-managed funds and mostly lower than bank deposit rates.

Evidences that attach governance and pension fund investment also found on the works of Ambachtseer (2001), Iglesias and Palacios (2000), Mitchell and Hsin (1997), and Useem and Mitchell (2000), although some of them focuses on private pension funds, for instance Ambachtseer (2001).

Other paper on this area focuses particularly on some countries practices in general with respect to some benchmarks. In his paper Yermo, J. (2008), discuss main aspects of the governance and investment of Public Pension Reserve Funds in Selected OECD Countries, using the OECD and ISSA Guidelines as reference of good practices. And the researcher concludes that the surveyed funds show relatively high levels of governance and Investment management. Although the paper tries to cover the main issues concerning the governance and investment of the funds, it fails to assess the impact of any identified weaknesses on the funds operation and in particular on its investment performance. And the analysis was limited to only select OECD countries.

Some theoretical, many empirical literatures also tried to see the investment of pension fund in light of investment regulation. Some even base their analysis on regulation that limits the investment of funds other than government securities. For instance papers done in another country and on the same cases proof that restriction, especially those restrictions that forces the fund to be invest on government bonds and other fixed income government securities in large amount doesn’t encourage the fund accumulation and lead to low return on investment because it impede the potential of the fund to diversify.

A study conducted by a Goldman Sachs (1995) for the period 1985 to 1994 to see the impact of over –investment (i.e. about 90% of the total asset) of the Malaysian fund on Malaysian Government Securities (MGS) during the 1980s and 1990s showed that if the proportion invested in MGS had been reduced to 75% and that in equities and properties had been raised to 10% and 5%, then the average returns on this more diversified portfolio would have been some 15% higher with a corresponding reduction in risk of about 12%. A more balanced portfolio with 50% in MGS, 25% in equities, 10% in cash and 15% in properties would have increased returns by about 35% and lowered risk by 10%, as compared to the Malaysian funds historical portfolio with 90% invested in MGS and 10% in cash.

Using data on china from1993 to 2004/06, Hu et al. (2007) shows that there would be better investment performance if china pension fund with pillar one were allowed to include other assets other than government bonds and deposit loan that constitute 50 - 75% of the total portfolio . They conclude that current Chinese pension fund investment regulations should consider removing lower limits on government bonds and bank deposits ,allowing investment in more asset classes (e.g. shares and real estate) and gradually allowing for assets to be invested abroad in order to strengthen the system.

Various studies show that setting a quantitative restriction whether on international diversification or domestic diversification doesn’t bring the desired optimal risk/return trade–off. Therefore, going to more liberized form of investment regulation should result in higher portfolio return. The studies proof that moving to less restricting rules reduce the risk of portfolio by leading to optimal risk –return trade off. Hu, et al. (2007) look how keeping a large amount fund on government securities increase risk, basing their empirical analysis on Pillar one B that is only allowed to be invested in Bank deposits and Government bonds that is a state investor and with the aim of providing investors with the basic needs.

Most of the literature on restriction of fund investment focuses on a one type of qualitative restriction that is international investment restriction. This kind of argument found on the studies of Davis (1995, 2001, 2002b, 2002c), Hu (2008), and Oxera (2007).

On the role of financial structure in influencing the investment of pension funds there are also some country specific evidences. For instance, Studart (2000) present the case for Brazil, he found that, at least five aspects of the Brazilian macro economy and the functioning of its financial markets has to do with a minor role played by investment funds as providers of long-term funds to productive investors and directing most of their resources to the financing of public debt and the acquisition of real assets, such as real state. They are:

- High inflation and macroeconomic instability, which led to highly uncertain financial environment and to short-termist behavior of most financially surplus units in the country;
- High levels of public debt financed by issuance of highly remunerated government bonds;
- The existence of relatively easy access (for large companies) to long-term, subsidized credit from public institutions;
- Too much volatility of asset prices both in the short and medium run, which makes institutional investors reluctant to invest, and
- The lack of appropriate regulatory arrangements and institutions to stimulate the direct acquisition of corporate securities by the funds, or to channel their savings towards the financing of productive investment.

According to Thillainathan (2000), the investment performance of the Malaysia.s Employees Provident Fund (EPF) is seriously constrained by financial markets that are under-developed in addition to the nature of the provident fund scheme, and the regulations imposed upon it. One of their key conclusions is that pension reform perse can drive capital market development only up to a point. Pension reform also requires a reform of capital markets.

On their paper Barbone and Sanchez B (1999), presets that the problems with the management of pension reserve funds in sub-Saharan Africa do not arise exclusively from bad governance. It has also been the case that over the last decades investment opportunities have been very limited. It appears, in fact, that investment returns in the sub-continent have been low if not negative over the last decades. The profitability crisis and the crisis of the financial sector have not been any less dramatic than the social security crisis. The result has been a loss of credibility in both the public and private sectors.

In order to see the asset allocation of pension funds, various empirical studies have been formulated, however many surveys on the pension fund asset allocation have been carried out in the developed countries, especially in USA and UK markets (Blake et al. 1998).

Blake et al. (1998) report asset allocation and performance of more than 300 UK pension funds. They find that the allocation practices of funds have remained rather steady from 1986 to 1994.Notable observation is the high allocation to equities (78 percent) with only 14 percent in fixed income. Since, the study focuses on the performance rather than asset allocation; it is difficult to state why U.K. pension funds prefer to invest more in equities than us pension funds. Looking for the U.K financial sector in general and the equity market in particular at the same period may give answer for this question.

Outside developed countries, Fahd (2010) conducted a study on asset allocation for government pension funds in Pakistan. By using a Mean variance model, the study shows that the portfolio is balanced with stocks. Share of 51% and aggregate bonds and bills share of 47%. In addition he argues that pension fund assets should neither be invested to retire the government debts of provincial governments nor to bolster the stock exchanges in times of economic crises.

2.3. Related Empirical Studies in Ethiopia

Some related studies were undertaken by different researchers in Ethiopia. Specifically, Hiwot (2012), in her study showed some of the determinant factors of investment in SSA. In brief, the result of the study showed that human capital, investment committee, diversification, detail analysis of each investment vehicles had positive and statistically significant impact on the Agency’s performance.

Generally, the study explicitly states that the investment activities should have an independent investment committee, thereby the performance may show progress as it would create a chance of creating investment policy and guidelines that can benefit the enterprise's employees, in particular and that of the country's economic growth in general.

2.4. Regulatory Body Environment

Regulations are set on the basis of the economic environment prevailing in the country. These regulations could involve restrictions being placed on the maximum or minimum to be involved in any particular asset, restrictions on the percentage that can be invested in any particular instrument. This means, it is common for insurance regulatory/ supervisory bodies of many countries to regulate the investment activities of insurers.

According to the informants from the well experienced professionals, insurance policy funds are liabilities of the insurance policy holders. Thus, these funds should be invested wisely so that the interest of policy holders is protected. The possibility of mishandling insurance policy fund cannot be ruled out.

Thus some supervisory measures are necessary to ensure that the interest of policy holders is well protected and, at the same time the insurer is not heading towards financial distress due to such inefficient investment management.

The main rational for imposing such restrictions by the supervisory body on investment of insurance companies is to protect policyholders from loss of insurance policy funds due to possible weak investment decisions by insurers. (EIC, Risk Management Guidelines by Fikru Tsegaye & Shumetie Zerihun- 2014).

An insurance company is legally responsible to receive and handle insurance policy funds properly and control misuse of such funds. Accordingly, supervision of activities to a reasonable degree by the supervisory body becomes necessary.

In this regard, Proclamation No. 86/1994 empowers the supervisory body (NBE) to prescribe areas in which insurers invest their funds and to issue directives pertaining to the subject.

Accordingly, effective March 1, 1994, insurance companies were expected to invest their insurance funds in a manner prescribed under Directive No. SIB/25/2004. This Directive specifies the investment instruments and the limit of investment in these instruments in terms of percentages of total admitted assets as depicted in the following table.

Most foreign countries have regulations that cover the assets of the insurer. But the extent to which these regulations seek to control the assets of the insurance company, differ from country to country. Regulations are set on the basis of the economic environment prevailing in the country.

These regulations could involve restrictions being placed on the maximum or minimum to be involved in any particular asset restrictions on the percentage that can be invested in any particular instrument.

This means, it is common for insurance regulatory/ supervisory bodies of many countries to regulate the investment activities of insurers. Here, however, our country's insurance investment directive is tabulated as follows:

Table 1.

Limits on Investment of Insurance Funds

No.	Investment Area	Limit of Investment as % of Admitted Asset	
		General Insurance Business	Long-term Insurance Business
1	1.1 Treasury bills and bank deposits	Not < 65%	Not < 50%
	1.2 In any one bank	Not > 25%	Not > 25%
2	Other Investment Areas (2.1+2.2+2.3)	Not > 35%	Not > 50%
	2.1 Investment in company Shares	Not > 15%	Not > 15%
	2.2 Investment in real estate	Not > 10%	Not > 25%
	2.3 Investment in insurance company's choice	Not > 10%	Not > 10%
Total (1 + 2)		100%	100%

Source: *- NBE Directive (SIB/025/20004) (May, 2015)*

According to the NBE's directive of investment of insurance funds, the base for the computation of potential investment fund on each investment area is the" Admitted Asset" (A.A).

The insurance funds are classified into "General insurance" and "Long-term insurance". The former refers to all kinds of insurance other than long-term insurance and the latter to all insurance businesses, which have long-term nature. Hence, on the basis of the nature of the insurance businesses, NBE has stipulated investment limits of insurance funds to be invested on each type of investment area.

NBE has stipulated the maximum and minimum level of potential investible fund of each insurance business to be invested on each investment area.

With regard to the minimum level of investment, the amount to be invested on treasury bills and bank deposits shall not be less than 65% and 50% of the admitted asset of the general insurance business and long-term insurance business, respectively.

In this respect, treasury bills and bank deposits deserve to take the whole of the admitted assets separately or jointly as long as the insurance companies have liquid cash and provided that the deposit in any one bank does not exceed 25% of the admitted asset of the respective insurance businesses.

As far as the maximum limits of the investment funds are concerned, the aggregate amount to be invested on all the other investment areas allowed by NBE shall not exceed 35% and 50% of the admitted assets of the respective insurance businesses.

In spite of low earning opportunities from treasury bills and bank deposits, the directive of NBE obliges to inject the highest share of insurance funds into these two investment areas.

Therefore, by comparing the returns to be obtained from these investment areas with that of other investment areas, one can imagine how much revenue EIC has forgone in the past, and will also be deprived of in the future, if the rates of NBE's directives are not improved in addition to the attention of the management towards it. Either it might be in terms of resource provision or proper control and follows up of the investment.

Here therefore, although NBE's allocation of funds is sound from protection point of view, it is obvious that it seriously affects the investment income since it disfavors the investment area and base which enable to earn relatively higher returns.

2.4.1 Theoretical Framework of the Study

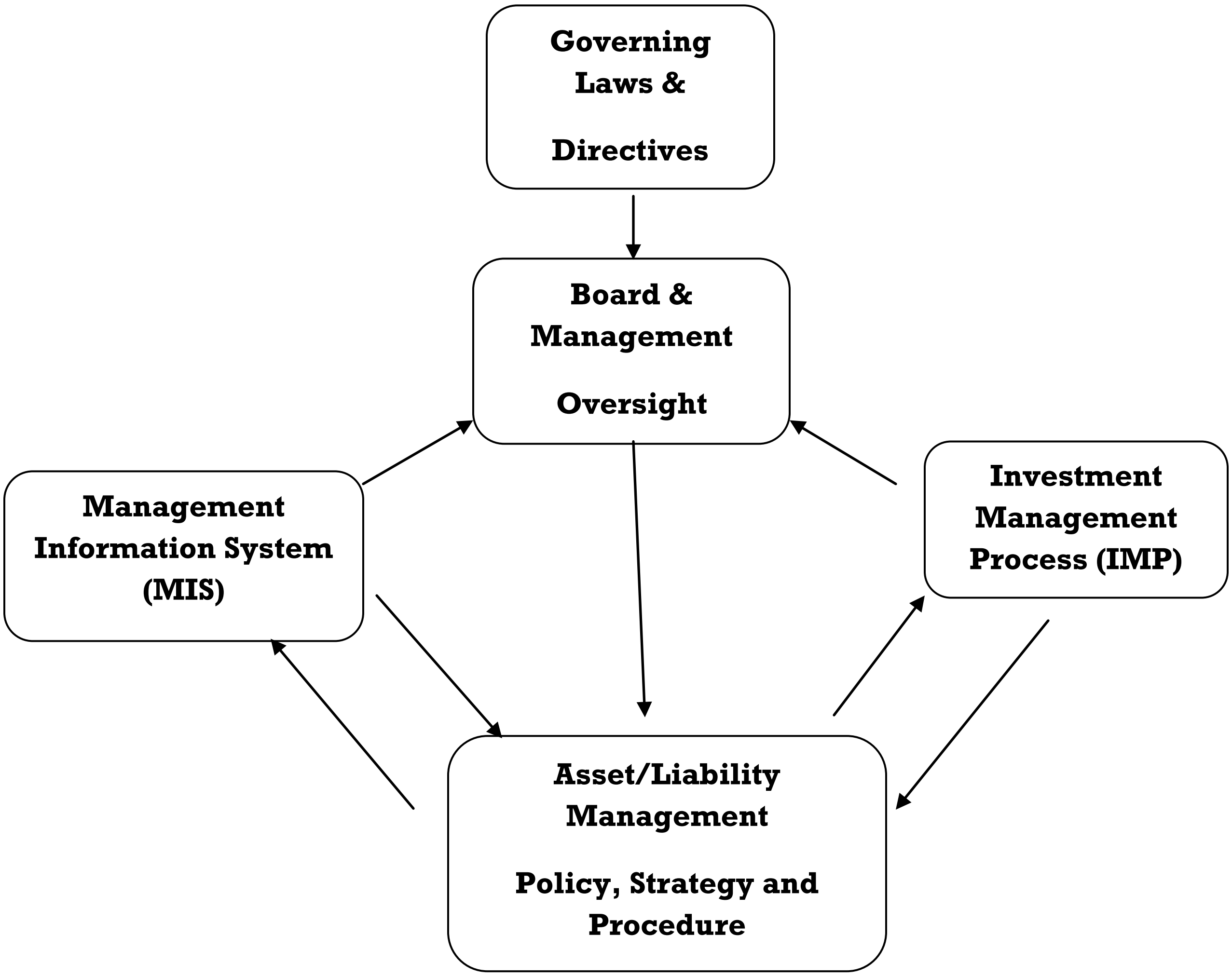

Figure 1: Research Model

Source: - Adapted by the researcher from literature review

CHAPTER THREE

3. RESEARCH DESIGN AND METHODOLOGY

3.1. Introduction

This section of the study presents the methodology used to select sample, collect and analyze the data in way that support the researcher to assess the investment management practices of the Ethiopian Insurance Corporation.

3.2. Research Design

To find answer for the research question, descriptive research method was used and hence the study attempted to describe the investment practices of the Corporation. It explained the extent of application of different tools/techniques used to identify measure, monitor and control the investment. Both primary and secondary data were used to undertake this research. As the research approach is descriptive, primary data was collected through questionnaire and interview/focus group discussion while secondary data from the Corporation's annual reports, policy and procedures and regulatory body Directives.

The collected data have been summarized and presented by means of tables and graphs and data also further been analyzed using simple measurement tools such as frequency count, percentage and ratio computation.

3.3 Types of Data and Instrument of Data Collection

Primary and secondary data was collected to conduct the study. Primary data was collected to get first hand information from the target respondents through questionnaire, observation as well as interview to learn about the investment management practice of the Corporation. Similarly, the research has also found additional secondary data as a main tool which cannot be obtained from respondents regarding with trends of Admitted Assets, the trends of investment and investment income of the Corporation, composition of asset diversification, and governing laws by reviewing different secondary sources such as annual reports, policies, programs of the Corporation, regulatory bodies laws and Directives.

3.4. Population and Sample Design

In general, the total numbers of staff who are currently working in Ethiopian Insurance Corporation are 1,274 and this constitutes total population of the study. However, the study units are limited to those who have direct exposure and involvement on the investment management of the Corporation. More specifically, staff and management members of finance and investment and Risk Management comprise the target population sampling frame of the study. Accordingly, the total size of the sampling frame were 100, of which, managerial level constituted 12, supervisory 14, professional staff 18 and both clerical and non-clerical constituted 56.

There are situations in real life under which sample design other than simple random samples may be considered better(say easier to obtain, cheaper or more informative)and as such the same may be used. In a situation when random sampling is not possible, then we have to use necessarily a sampling design other than random sampling. (C.R. Kothari, 1990).

So, purposive sampling is considered more appropriate when the universe happens to be small and a known characteristic of it is to be studied intensively. (Kothari, 1990).

To make valid representation in the study, non-random sampling method was used in order to purposively select respondents and hence all professionals, managers and supervisors were taken as sample population. Being adopting purposively could help the researcher to understand the problem and that of the question in detail (Creswell, 2003). While both clerical and non-clerical staff was excluded from the sample population. therefore, for this research in aggregate a total of 44 employees constituted the final sample size for this study and questionnaire were distributed to all respondents while primary data collection effort have further been strengthened through interview that was conducted with Heads of Investment Fund.

3.5. Data Analysis

All the data gathered through this research were analyzed using descriptive statistics. Thus, frequency count and percentage were used to analyze the data. Tables were employed to substantiate the research undertaken.

CHAPTER FOUR

4. DATA ANALYSIS AND DISCUSSION

4.1. Introduction

This chapter presents an overview of the study and discusses the results of the empirical data collected and analyzed from which conclusions and recommendations of the study will be drawn thereafter. The analysis is done in relation to the two main sources of data used for this study, that is, primary and secondary data sources. The primary data are used using frequency distribution tables, while the secondary data are descriptively analyzed using ratios.

4.2. Survey Results

The questionnaires were distributed to 44 employees of the Corporation who have direct exposure and involvement on the investment management of the Corporation. Thus, out of the total of 44 distributed questionnaires, about 86% filled and returned which the response rate can be said satisfactory. Therefore, the collected data from such respondents have been summarized and analyzed accordingly.

4.2.1. Demographic Representation

Table 2
Demographic Attributes of the Respondents

Qualification	**Frequency**	**Percentage**
Masters	4	11
First Degree	34	89
Diploma	-	-
Total	38	100
Current Position	**Frequency**	**Percentage**
Managerial	10	26
Supervisory	10	21
Professional	18	53
Total	38	100

Sources*: - Survey Results and Own Computation(May, 2015)*

About 89% of the sampled population has first Degree while the remaining (11%) Master degree and above. This shows that since larger share of the respondents are at least first

Degree holder, relevant information might be obtained from those respondents. Position wise, the lion's share of the respondents (53%) were professional while respondents with managerial position accounted for 26% of the total sampled population.

working experience records of the respondents showed in the Table 3 that about 28% of the respondents have been working in the Corporation for the period of time ranging between 1-5 years and 22 of the respondents representing 58% fall within 6-10 years while the remaining respondents 5 (13%) have been working more than 10 years. this shows that most of the respondents have been with the institution consistently for relatively longer period of time and are more likely to know about the Corporation's investment management practices.

Table 3
Years of service in Current Organization

Years of Service	Frequency	Percentage
1-5yrs	11	29
6-10yrs	22	58
Above 10	5	13
Total	38	100

Sources*:- Survey Results and Own Computation (May 2015)*

4.2.2 Assessment of Overall investment management

4.2.2.1 Investment Management Framework assessment

Respondents were given a chance to reflect their opinion on the components of the investment management framework and their view were sought and summarized in light of oversight role of board and management , adequacy of investment management function, internal control system, adequacy of policy and procedure and management information system. Accordingly, the respondents' views have been thoroughly analyzed herein.

A. Board and Management Oversight

As per the review made on secondary sources of data, it was found out that the board approves policy issues that govern the investment management of the Corporation. Adding to this, the sample selected respondents were also asked to evaluate the overall knowledge of the board in the investment management area and it was found out that 63% of the respondents have a dim view and replied negatively whereas 26% of the respondents were of the opinion that board has enough knowledge on investment management area and the remaining 11% neither agree nor disagree. Thus, it can be summarized that board members of the Corporation participates in investment management process by approving relevant policy issues, however, there are some doubt on the overall knowledge of the board towards crafting effective investment management policies and strategies.

Table 4

Response Rate of Board and Management Oversight Role

Board and Management Oversight;	Strongly Disagree -1	Disagree -2	Neutral -3	Agree -4	Strongly Agree -5
Boards have adequate knowledge on investment Management area.	8 (21%)	16 (42%)	4 (10.5%)	6 (16%)	4 (10.5%)
Management in place appropriate procedures and process to implement the investment management policies	7 (18.4%)	19 (50%)	-	10 (26.3%)	2 (5.3%)
Asset Liability Committee (ALCO) meets on a frequency that is commensurate with the Corporation's business activities	10 (26.3%)	14 (36.8%)	9 (23.7%)	4 (10.5%)	1 (2.6%)
ALCO passes relevant decisions on pertinent	10 (26.3%)	10 (26.3%)	-	10 (26.3%)	8 (21%)

Source: - *Survey Result and Own Computation (May 2015)*

On the other front, a significant share of respondents (68%) agreed in the opinion that the management in place appropriate procedures and process that governs the day to day investment management operations of the Corporation while about of 32% the sample respondents contrarily reflects their view. Linked to this, assessment on the management committee namely, Asset –Liability Management Committee (ALCO) revealed that about 64%of the respondents have given a favorable replied against the existence of frequent meetings of ALCO members while 14% of the respondents unfavorably replied. In the meantime, 48% of the respondents declined the relevance of decision passed by ALCO members while 52% of the respondents were of the opinion that ALCO members passed relevant decision. Here, it is worth mentioning that as per the interview made with the Director, Investment Directorate, it was noted that the decision passed by the ALCO's member is not as such critical in most of the time blaming the composition of the committee by arguing that the Chief Executive Officer (CEO) is not being the member of the ALCO which might be a pitiful to pass critical decision in timely manner.

B. Policies and Procedure

Placing effective policy and procedure is of paramount importance in managing the investment of the Corporation. These policies and procedures clearly outline investment management decisions. In this regard, respondents were asked to evaluate the effectiveness of those policies and procedures in dealing with it and hence about 29% of the respondents were of the opinion that they have agreed the existence of adequate policies that defined investment management criterions at the organization which they abided by. About 58% of the respondents disagree on the existence of effective policies and procedure which might cast a doubt to conclude the prevalence of effective investment management policies and procedure in the Corporation.

Table 5
Adequacy of Investment Management Policies and Procedures

Investment Management Policy and Procedure;	**Strongly Disagree -1**	**Disagree -2**	**Neutral -3**	**Agree -4**	**Strongly Agree -5**
The investment management policy includes funding strategies that provide diversified, stable & cheap funding sources	10 (26.3%)	12 (31.6%)	5 (13.2%)	6 (15.8%)	5 (13.2%)
The investment policies evaluated (annually) to ensure that it remains up-to-date.	8 (21%)	18 (47.4%)	5 (13.2%)	4 (10.5%)	3 (7.9%)

Source:- *Survey Result and Own Computations(May 2015)*

C. Management Information System(MIS)

Inquire made to know about the adequacy and reliability of management information system of the Corporation as shown in the table below that majority of the respondents

(27) representing 72% of the total have a gloomy view on the overall adequacy of management Information System in providing relevant, timely and forward-looking information on the investment and its liquidity position , contrarily about 28% of the respondents, though they are less in number, were of the opinion that there is a reliable , timely and relevant MIS. This indicates that the corporation has week information management system that may dismayingly affect the quality of decision made by the board and senior management. Thus, being mindful of its ramification effect on the quality of the decision, the Corporation should exert maximum effort to set MIS, perhaps supported by Asset-Liability management reporting module, to produce relevant and timely information on the investment position of the Corporation.

Table 6 Response Rate on Monitoring and Controlling of Risks

Monitoring and Controlling of Investment Risk	**Strongly Disagree -1**	**Disagree -2**	**Neutral -3**	**Agree -4**	**Strongly Agree -5**
There is independently organized investment management function(evidenced by reporting to the Board)	4 (10.5%)	11 (28.9%)	-	12 (31.6%)	11 (28.9%)
The investment management function proactively identifies, measures, monitors and controls the risk exposure.	12 (31.6%)	14 (36.8%)	3 (7.9%)	6 (15.8%)	3 (7.9%)
Management Information System and Controlling System					
Management Information System (MIS) produces timely and relevant information.	11 (28.9%)	12 (31.6%)	4 (10.5%)	6 (15.8%)	5 (13.2%)
There is an effective control system that ensures the implementation of policies, procedures & limits.	10 (26.3%)	13 (34.2%)	2 (5.3%)	8 (21%)	5 (13.2%)

Source*:- Survey Result and own Computation (May 2015)*

4.2.2.2. Determinant factors of investment

A. Internal Factors Affecting Investment

Financial institution's specific determinant factors naturally vary across due to the difference in balance sheet composition and structure. Hence, one company might have strength or weakness on particular aspect and that particular issue may or may not be the case in other. In this regard, respondents were asked to rate factors that are causing risks and impact on the level of investment risks.

Table 7 Ranked Factors That causes Investment risk

Factors	**Very Insignificant -1**	**Insignificant -2**	**Neutral -3**	**Significant -4**	**Very Significant -5**
Rapid Long term asset expansion	3(7.9%)	7(18.4%)	6(15.8%)	15(39.5%)	7(18.4%)
High off-balance sheet exposure	8(21%)	8(21%)	6(15.8%)	10(26.3%)	6(15.8%)
Limited Capital Base	8(21%)	7(18.4%)	6(15.8%)	14(36.8%)	3(7.9%)
Implication of deterioration in the investment portfolio	5(13.2%)	10(26.3%)	7(18.4%)	12(31.6%)	4(10.5%)
Difficulty in managing intraday liquidity position	4(10.5%)	9(23.7%)	6(15.8%)	14(36.8%)	5(13.2%)

***Source:-** Survey Result and own computation (May 2015)*

The result depicted in the table states that Rapid Long term Asset expansion is the most salient factors causing occurrence of liquidity risk as it can be further supported by the larger response rate of 58%. This was followed by Difficulty in managing intraday liquidity position(50%) and the Implication of deterioration in the investment portfolio(42%). whereas limited capital base and high off balance sheet exposure were found the least important weighted factors by the majority of the respondent.

Thus, rapid long term asset expansion is the most rated salient to cause occurrence of liquidity risk in the Corporation.

On the other hand, limited capital base and high off balance sheet exposure are termed as factors which don't have a significant impact on the level of investment risk exposure of the corporation.

Moreover, a detailed look in to the respondents to the subjective questions indicate that there are some additional factors such as problem of the decision making at the spot and week integration between the finance Directorate and that of the Investment Directorate. These are some of the factors that the respondents specified in this regard.

Table 8

B. External Factors Affecting Investment Risk

Factors	**Very Insignificant -1**	**Insignificant -2**	**Neutral -3**	**Significant -4**	**Very Significant 5**
Adverse Change in policy environment	4(10.5%)	8(21%)	5(13.2%)	15(39.5%)	6(15.8%)
Volatile markets which results sudden fluctuations	7 (18.4%)	12 (31.6%)	3 (7.9%)	10 (26.3%)	6 (15.8%)
High competition for fund mobilization in the investees' industry	3 (7.9%)	5 (13.2%)	6 (15.8%)	16 (42%)	8 (21%)
Decreasing Insured's trust on the industry	12(31.6%)	7(18.4%)	4(10.5%)	10(26.3%)	5(13.2%)
Absence of developed money market	8 (21%)	7 (18.4%)	4 (10.5%)	12	7 (18.4%)
Low/slow economic performance	10(26.3%)	10(26.3%)	3(7.9%)	8(21%)	7(18.4%)
Catastrophic events	8 (21%)	12 (31.6%)	5 (13.2%)	8 (21%)	5 (13.2%)

Source: *- Survey Result and Own Computation (May 2015)*

According to the response derived from the research questions, the following are the most significant factors affecting the investment and its risks exposure of the Corporation. As can be seen in the above table, 63% of the respondents agreed that high competition for fund mobilization in the trustee side have adverse impact on the level of risk exposure, closely followed by the adverse change in policy environment governing laws and regulations as it was supported by about 55% of the respondents, absence of developed money market and low economic performance with equal share of 50% were also indicated as significant factors in affecting investment and its risk exposure. However, larger percentages of respondents were of the opinion that catastrophic events and decreasing investee's trust of the investors industry have had insignificant or no impact on overall risk exposure the corporation. this shows that the external factors presented in above have an impact on the risk exposure of the corporation with varying degree of influence and thus the attention should be given to those that have a complete supremacy over the other factors, notably, adverse change in government policy and stiff competition of fund in the industry.

Table 9

4.2.2.3 Challenges for the effectiveness of Investment risk management system

Challenges	Very Challenging (1)	Challenging (2)	Neutral (3)	Least Challenging (4)	Not Challenging (5)
Lack of technical knowledge and skill ;	11 (28.9%)	16 (42%)	3 (7.9%)	6 (15.8%)	2 (5.3%)
Inadequate investment management Information System	10 (26.3%)	14 (36.8%)	2 (5.3%)	8 (21%)	4 (10.5%)
Absence of Institutionalized Investment Management Culture	12 (31.6%)	11 (28.9%)	2 (5.3%)	6 (15.8%)	6 (15.8%)
Difficulty of Integrating Investment management with other business process	8 (21%)	10 (26.3%)	2 (5.3%)	8 (21%)	8 (21%)
Difficulty of Quantifying investable funds (For Both General & Long term insurance Funds)	6 (15.8%)	9 (23.7%)	5 (13.2%)	10 (26.3%)	8 (21%)

***Source:-** Survey Result and Own Computation (May 2015)*

In understanding the major challenges the Corporation has faced for effectiveness of investment risk management system, respondents were asked to rate some of the challenges that cause hindrance on successful implementation of robust investment risk management system. In view of that, the result of the enquiry indicate that all the factors considered are challenging factors but with different level of influence. Table 9 yielded lacks of technical knowledge and skill, inadequate management information system, absence of strong investment management culture, as very high challenging factors in their order of presence which can be vindicated by the participants' rate of response 71, 63, and 60, respectively. this is followed by Difficulty of Quantifying investable funds (For Both General & Long term insurance Funds)(47%). this shows that the above factors challenges the investment management system with, in fact, varying degree of influence. thus, the corporation should give much emphasis on the above mentioned very challenging factors.

Table 10

4.2.2.4. Monitoring and controlling of investment

Item(s)	Strongly Disagree -1	Disagree -2	Neutral -3	Agree -4	Strongly Agree -5
The Corporation in places effective MIS for monitoring compliance issues.	10 (26.3%)	16 (42%)	3 (7.9%)	5 (13.2%)	4 (10.5%)
Policy exceptions and breaches are reviewed and reported timely	7 (18.4%)	15 (39.5%)	4 (10.5%)	7 (18.4%)	5 (13.2%)
There are times when Investment Management guidelines are overridden by management and staffs	2 (5.3%)	5 (13.2%)	4 (10.5%)	15 (39.5%)	12 (31.6%)

***Source**:- Survey Result and own Computation (May 2015)*

Good investment management requires periodic monitoring of intraday liquidity position. In this regard, respondents were asked whether there is effective management information system (MIS) for monitoring compliance issues. It was found out that (68%) of the respondents disagree the existence of effective MIS in the Corporation. Despite this, some of the respondents which accounted for (24%) of the total were of the opinion that there is an effective MIS that adequately support monitoring of compliance issues in the corporation.

Thus, it is apparent that MIS of the Corporation is not as such effective in providing relevant information on the investments liquidity position of the Corporation and this may put a strain over the monitoring task of investment management.

In understanding whether there are times when established investment management procedures and limits of the Corporation is overridden by management and staff , the Table 10 shows that more than half of the respondents replied that there are times when management and staff of the Corporation fail to comply with existing policies and limits . For the question raised related to timely identification and reporting of such policy exceptions or branches only 31% of the respondents were favorably replied that policy and limits exceptions or breaches are identified and reported timely for appropriate actions and the remaining larger share of respondents (58%) replied unfavorably about the timely reporting of those exceptions and breaches.

Table 11

4.2.2.5 Contingency Funding Plan (CFP)

Contingency Funding Plan	Strongly Disagree -1	Disagree -2	Neutral -3	Agree -4	Strongly Agree -5
Does the contingency plan set out a possible course of action to generate cash inflow in crisis situations?	3(7.9%)	14(36.8%)	3(7.9%)	14(36.8%)	4(10.5%)
Does the plan define clearly the responsibilities of all personnel in a crisis situation?	8(21%)	14(36.8%)	8(21%)	5(13.2%)	3(7.9%)

Source*:- Survey Result and Own Computation (May 2015)*

As it was mentioned in "Banking Institutions Risk Management Guideline", published by the National Bank of Ethiopia (2010) to develop comprehensive risk management framework, financial institutions should have a way-out plan (Contingency Funding Plan). the Author also defines the contingency funding plan is a projection of future cash flows and funding sources of an institutions under market scenarios including aggressive asset growth or rapid liability erosion.

In this regard, it was found imperative to assess whether there is a contingency plan or not. As per the secondary data source review, the corporation out in place a contingency way out plan. However, with regard to the up-to-datedness of the plan, it was found that the plan stayed for more than two years without updating and considering any changes. Linked to this, respondents were asked to evaluate its adequacy to generate cash inflow in times of liquidity crisis and hence, 45% of the respondents has bright view in that the plan has outlined possible courses of action that allow the corporation to generate cash inflow in times of crisis, contrarily, about 47% of them replied that the plan is inadequate in maintaining possible courses of actions that are mean to generate cash flow up on liquidity crisis situations. Lastly, issues were raised to assess whether the plan delineate responsibility of personnel involved in managing crisis situation; consequently, only 21% of the respondents replied positively while 60% replied contrarily and the remaining share of the respondents replied " they don't know" , this might be absence of effective communication of the plan to all concerned organ.

4.2.2.6 Strategies to improve investment management

Respondents were asked to forward issues that will improve the overall investment management of the corporation’s long term as well as general insurance fund. In this regard, the respondents forwarded the following issues that are meant to improve the investment management practices of the Corporation;

- Enhance coordination among different functional work units of the Corporation, particularly with those strategic and finance areas,
- Put a controlling mechanisms to reduce operational expenses,
- Increase the number of branches (Branch Expansion) to enhance insurance service provision, in turn to increase the insurance fund. hence, increase the investment yield,
- Pay attention as to the staff composition of the investment to be efficient and effective as well as to be innovative in visualizing new investment ideas’,
- Revise the rate(s) of the admitted asset which is the main base for investment in accordance with the prevailing market and economy environment,
- Replace the term Admitted Assets (AA) by Readily Available Fund (RAF), as admitted assets include those that cannot be easily convertible to cash or cash equivalent,
- Recognize the investment performances like that of the recognition paid to the operational activities, and etc…

4.3 Secondary Data Analysis

To further assess the investment management practices of the Corporation, data on the major asset and liability components of the corporation was used and discussed. Accordingly, the corporation’s investment position against and its commitment (Liability) have been assessed in light of the prevailing governing laws and some prudential limits. Therefore, the past five years’ data ranging 2010 up to 2014 have been considered as sufficient for the researcher analysis.

4.3.1. Share of investment income out of total income (Operational Income plus Investment Income)

It is obvious that just like any other insurance companies, the corporation provides various class of insurance coverage and in turn, generates income in the form of premium on the one hand, and investment, on the other.

Accordingly, the Corporation has been registering an average annual growth rate of 17%, the total income of which are Birr 161.4 million, Birr 198.6 million, Birr 252.8 million, Birr 291 million and 446 million in the operating years of 2010,2011,2012,2013 and 2014, respectively.

As can be seen in the table, there is a growth rate of 17% with regard to total income and at the same time the Corporation has managed an investment income of Birr 51.6 million in 2010 and Birr 134.5 million in 2014, showing a growth rate of 160.6%- which is a significant move in absolute terms.

Table 12

Share of Investment Income out of the total Income

(for the last five years- In Birr)

Designations	Years					Average
	2009/10	2010/11	2011/12	2012/13	2013/14	
Total Income	161,405,776	198,633,858	252,838,960	291,040,665	446,300,000	
Investment Income	51,659,433	52,83,394	61,594,089	78,040,000	134,500,000	
Share of Investment Income	**32.01%**	**26.6%**	**32.27%**	**26.81%**	**30.14%**	**29.6%**

Source:- *Respective Audited Annual Report and Own Computation (May 2015)*

When we compare the total income being generated by the corporation with respect to the investment income during 2013/14, on average, the share of investment income is increasing by 29%. This shows the significant contribution of investment to the wealth of the corporation. This achievement was made by investing only in short term securities which are relatively said to be less risky. Here, however, if the Corporation was able to invest relatively in long term investment like that of the Co financing loan or on real estate, the corporation would have been generated a better yield.

4.3.2. Evaluation of investment against the corresponding investment income

Pursuant to the NBE Directive and its investment policy, EIC has been investing its insurance investable fund in different investment areas with the prospect of generating additional income.

Having this in mind the investment performance of the Corporation for the last five years that is from year 2011 up to 2014 would be discussed here below. As the data below shows (Table 13) Investment is lagging behind investment income by 13.3% on average, which shows investment in EIC has an inherent problem.

This is because much of the invest able fund is invested in areas where the yield/return is low like that of time deposit which constitute 85% of total investment.

In other words, this is to mean the growth rate of investment income is higher than that of investment.

To reiterate, had it been not invested on areas with low yield, income would have been far better than the amount being registered, which is shown below in the table.

As can be seen in the table below, the income obtained from rent in 2010 was only, 9.5 million, but in 2013/14 it has been sky rocketed to Birr 22.4 million, showing an increase of 135.8% growth. (Ref. table 14)

Here, one can deduce that if the Corporation invests in real estate development, the income that is to be generated would be significant.

4.3.3 Investment income

As can be seen in table 2.4 below, the Corporation has registered an investment income of Birr 51.72 million in 2009/2010 and Birr 134.5 million in 2013/2014 which has an absolute growth rate of 160%.

Table 14

Investment Income by Category, Growth Rate and Share of Income on each Investment Area (In millions of Birr)

Designation	2010	Share in %	2011	Share in %	2012	Share in %	2013	Share in %	2014	Share in %
Interest on Fixed Time Deposits	34.5	66.7	35.8	67.7	38.7	63.4	45.8	62.3	78.2	60.8
Interest on Loans	1.8	3.5	1.4	2.6	0.37	0.6	7.79	10.6	3.9	3
Interest on Treasury Bills	0.83	1.6	0.97	1.8	1.08	1.8	1.08	1.5	1.08	0.8
Dividend Income	4.3	8.3	4.6	8.7	10	16.4	8.49	11.6	17.6	13.7
Rent Income	9.5	18.4	8.98	17	9.87	16.2	10.1	13.8	22.4	17.4
Interest on Bond	NA		NA		NA		5.5		5.5	4.3
Others	0.79	1.5	1.1	2.1	1	1.6	0.2	0.3	5.8	
Total	**51.7**	**100**	**52.9**	**100**	**61**	**100**	**73.5**	**100**	**135**	**100**

Source:- *Respective Audited Annual Report and Own Computation (May 2015)*

4.3.4 Share of investment income of each investment area as % of total investment income.

In 2013/2014, the total investment income was registered as Birr 134.5 million. Out of this amount, 78.2 million is generated from fixed time deposits, which has a share of 61 %, followed by rent income which is 22.4 million (17.4%). In addition to this, the dividend income has been registered to be Birr 17.6 million (13.7%). (For the details please see table 14 above.)

4.3.5 EIC's Invest able fund (Capacity) vs. Actual Investment pertaining to the NBE Directive

Pursuant to the issuance of the insurance Directive of the National Bank of Ethiopia, in general, and its investment Directive, in particular, the Ethiopian Insurance Corporation, as an insurer, has been investing its resources (general insurance fund as well as long-term insurance funds) in various investment areas, as it is shown below in the following table.

Table 15

EIC's Investable Insurance Funds and Actual Investment As At June 30, 2014

(In millions o Birr)

No.	Description	Investable Insurance Funds	Investments as ratio of Admitted Asset (%)	Actual Investment	Remark
	Balance of Total Admitted Assets as at 30.06.14 = 2,924,714,617.00				
	* General Insurance Funds = 2,304,436,617				
	* Long-term Insurance Funds = 620,278,000				
1	Deposits, Treasury Bills and Bonds				
	1.1. General Insurance Funds	1,498 (minimum deposits)	≥ 65%	1,412	
	1.2. Long-term Insurance Funds	311 (minimum deposits)	≥ 50%	548	In line with NBE Directive
	sub-total	1809			
2	Investment in Company				

	Shares				
	2.1. General Insurance Funds	346	≤15	59.8	Actual Investment is below the limit
	2.2. Long-term Insurance Funds	93	≤15	-	No inv’t* made
	sub total	439			
3	Real estate Development				
	3.1. General Insurance Funds	230	≤10	-	No inv’t* made
	3.2. Long-term Insurance Funds	155	≤25	-	No inv’t* made
	sub total	385			
4	Investments by the Insurance Company’s Choice				
	4.1. General Insurance Funds	230	= 10	38.1	
	4.2. Long-term Insurance Funds	62	= 10	-	No inv’t* made
	Sub total	292			
	Grand total	2,925		2,057.9	

***Source**: - EIC-Finance Directorate and Own computation (May 2015)*

inv’t=investment*

As can be seen in the table above, the amounts of investment that can be invested in the stated areas are explicitly stated in the Directive.

Based on the balance of June 30, 2014 of the Corporation, the minimum allowable funds for short term securities for general insurance and long term insurance is be Birr 1,498 million and Birr 311 million respectively, and the rest are clearly shown in the table above. Generally, it has to be noted that the actual investment made as at June 30, 2014 is 2,058 million.

As far as the short term securities are concerned, the investments from general insurance fund and that of long term insurance fund are 1,412 million and birr 548 million, respectively.

From this analysis we can conclude that there is a deficit of Birr 86 million of general insurance fund whereas an excess of Birr 237 million of the long-term insurance fund.

With regard to long-term insurance fund, except short term securities, (Fixed time deposits and Treasury Bills) no investment has been made so far. This is contrary to investment principle where long term insurance fund has to be invested in areas where the nature of the investment is advisable to be long term like that of real estate.(LOMA).

Concerning the general insurance fund, the actual investment made for the rest of investment areas is below the potential/required level which is set by the NBE.

For example, the actual investment made for Company Choice's is only Birr 38 million, but the required amount is Birr 230 million which shows an excess of Birr 192 million unused funds for this particular investment area.

Secondly, when we see the actual investment on real estate development, there is no investment yet registered in the books of accounts. Despite the fact, it is clear that, there are real-estate investments in various regional towns.

In this regard, it is advisable that the concerned office register the amount of investment made particularly in real-estate investments. In general, the total amount allotted for real-estate investment is Birr 230 million from general insurance fund and Birr 155 million for that of long term insurance fund. In total, it is Birr 385 million.

As far as the equity investment is concerned, only Birr 59 million is actually invested, however the potential/required amount for this option is Birr 346 million, indicating 83% is not yet invested particularly from general insurance funds.

Generally, when we look at the investment of the Corporation, leave alone the challenges being imposed by the central regulatory body, would not optimally used its allowed resources as a result the corporation is highly investing its resources on short term securities where its return is very low. Long term insurance by its very nature, it is very long; hence, advisable to invest its idle fund on a long term basis. Though the risk is high in such scenario, once the investment is made based on a feasibility study, the risk would be minimized, and the return would be lucrative.

4.4. General Observation and Discussion

4.4.1. Investment Management Process

Investment management, also referred to as portfolio management is the practice of professionally managing and selecting several securities and assets, examining the market, assessing the securities and arriving at calculated decisions and choices so as to meet the investor's specific investment goals and reach the greatest ROI. Here are some aspects that may help to explore and understand the investment management process. The first step for an investor is to set an investment goal. This goal differs for every individual investor (whether the investor is a bank, an institution or an individual).

After setting the investment goal, the next step is to create an investment policy. This starts with asset allotment between the key asset categories present in the capital market ranging from equities, fixed income securities, property, currency and the like. An investment management consultant keeps into consideration various parameters during the process of instituting the investment policy for the investor. These parameters include constraints of the environment such as the governmental rules, laws, etc. Moreover, the parameters also include the constraints of the investor such as monetary ability, time constraints, risk profile, etc.

The next step that an investment management consultant follows is the selection of the portfolio strategy. This is done in compliance with the investment goals and investment policy guiding principles. This step is equally crucial as the aforementioned ones. Hence it is pertinent to seek the guidance of an expert investment management consultant if you are unsure about the entire investment management process because any inconsistency here would make the things confused and cause the entire process to go ended and lead you in the direction of losses. Portfolio strategies are primarily categorized into two forms; viz. active and passive. Active strategies provide more prospects regarding the features that are projected to control the asset categories' performance, whereas passive strategies involve fewer prospects.

The next step in line is the process of selecting the assets. The selection and inclusion of specific assets in the portfolio is extremely important. It is here that the investment management consultant advises the investor about building a well organized portfolio, one that would give the anticipated ROI.

The next step is the measurement and evaluation of the performance. This is done in absolute and relative terms, against a preset, practical and attainable yardstick. Additionally, the portfolio performance is assessed in the context of the goal and various performance considerations.

As investment management calls for extensive economic know-how and market awareness, not every investor makes a decision to manage his/ her investments by themselves. Professional and reliable investment consultants can be a remedy in such cases.

4.4.2. Factors Affecting Investment

As discussed in the forgoing sections, insurance companies are supposed to be the rich in terms of financial accumulations as they receive a huge amount of money in the form of premium from various classes of businesses. This accumulated premium is most of the time referred as insurance funds which are emanated either from long term insurance or general insurance. These funds need to be properly and wisely managed. To that end, well managed premiums can help the company to comfortably meet its legal as well as social and contractual obligations in such a way that the insured/assured may come across with unexpected request of obligations/claims. Hence, once the funds are properly managed in a systematic manner, the insurance company can comfortably settle its obligations.

Here, however, there are factors that internally as well as externally affect the investment activities. The internal and external factors that can affect the insurance investment are cited from various authors as follows;

In insurance companies, there are different factors that influence the investment of their funds. These influences can be grouped under two broad headings, namely, internal and external factors.

4.4.2.1 Internal Factors

The internal factors include factor endowment such as size of market, volume and spread of business, financial and human capital, technological development, reputation and skills and expertise. The internal factors further are classified into firm specific factor endowments and market specific according to Dargea's 2012.

4.4.2.2 Firm Specific Factor Endowment

A) Nature of Business

An appropriate way to view the investment policies of insurance companies, in the absence of regulation, is to earn the highest rate of return on available financial assets consistent with ensuring to meet their liabilities to policy holders. Hence, the investment risk that an insurance company faces will depend on the particular nature of its policyholder liabilities. Insurance companies that supply similar types of insurance contracts will tend to face similar investment risks, while insurance companies supplying different types of insurance contracts will face different risks.

Therefore, the nature of business transacted by life and non-life companies determines the investment behavior of insurance companies. The types of contracts to be insured against the forms of financial risk, and the predictability of the cash flow for insurance benefits determine the financial decision of the insurance companies into two forms. The first is related to the composition of the portfolio of assets and liabilities, and the second is emphasized on the return of the companies' asset and on the cost of liabilities over the time. (Birritu newsletter- 2014)

In insurance business, the company's portfolio should be structured in such away that the maturities of assets should exceed the maturities of liabilities and the returns on the company's assets should exceed the cost of liabilities. Sources of funds, the stability of underwriting flows, and potential liquidity are the determinant factors of investment in insurance companies, and these factors differ significantly between life, and non-life insurance companies. (CII 2009)

A.1) Life Insurance

In life insurance, the principal types of contracts are term life, whole life, endowment insurance, annuities and group life insurance. Whole life policies have substantial accumulation of assets than term individual or group policies. Endowment insurance, on the other hand emphasizes on saving while group retirement plan represents a large source of investment. Therefore, the types of contracts can influence the size and form of life insurance assets. (LOMA 2011)

Most life insurance contracts are long-term contracts containing a substantial saving element in addition to insurance. Life companies can accurately predict their cash out flows.

Both the amount and timing of insurance benefits are predictable. However, the least predictable and a major source of liquidity uncertainty to life companies are loans policyholders. Most policyholders have the right to borrow at any time against the cash value of their policy.

Accordingly, because of the long-term nature of life contracts, and the predictability of the pattern of their cash flows, life insurance companies have significant role as institutional investors. The investment could be in short term such as Treasury bill and saving, to long-term investment such as time deposit and bond. The short-term investment can be continually reinvested when they mature. The implications of the relatively predictable and positive net cash inflows are clear. Actually, investments in securities without fixed maturities such as preferred stock and equity stock are preferred as long as the rates of returns are satisfactory. However, due to the absences of capital market in Ethiopia, the options are short-term investments such as Treasury bill, and medium term investment like government bonds and time deposits.

Therefore, in terms of investment funds of life more emphasis should not be given to short-term investment, but to long-term fixed income securities. Investments in long-term assets would enable the company to earn more return than short-term assets. (Dargea Alemu – 2012).

A.2) Non-life

In case of non-life or general companies, the general nature of the business mainly is to provide service rather than financial intermediation. Therefore, the funds that is likely to be accumulated and available for investment by non-life insurance companies would be much smaller because of its short-term contractual nature. Consequently, the annual premium would be required to cover liabilities to policyholders for unexpected periods of their policy plus provisions for outstanding claims.

Accordingly, like the life insurance, the nature of insurance contracts in the general insurance business determines the investment portfolio of non-life companies. Firstly, the liquidity of non-life is much greater than the life insurance because of its less predictability at least over relatively short periods of time. The incidence of risk is evenly distributed throughout the contract period. Moreover, the amount of claims will vary and tends to increase with inflation, although, the advance payment of the premiums will reduce the inflation.

Accordingly, the lower predictability of out flows for the insured events and the tendency for the costs of claims to increase with inflation enforces the non-life companies to be more liquid than life companies. This meant that the non-life companies have lower asset accumulation for investment than life companies. The investment portfolio of non-life companies is more liquid for protection against heavy insurance losses.

As a result, the sizeable investments are regarded for short-term investments, and the long-term investments are undesirable. Moreover, the investment options should also be to the areas that cover the risk of claims payments due to inflation, and increasing costs of insurance risks.

B) Company Size

The size of an insurance company will also influence investment choices. Large insurance companies have a wider range of options. The size of the company varies in financial capital human capital and technology. The availability of financial capital would be first ingredient. Similarly, human capital and skill have significant role in influencing the investment choice of the company. It is generally agreed that skilled work force is essential to the competitiveness of the insurance firm. The level of know-how and professional expertise are determining factors of corporate success.

The utilizations of modern technology and communication systems, computerized database, and prudent management in line with reliable investment policies are core competitive advantages. Moreover, the volume of business, wide scope of products and diversification of the insured risks are other important competitive factors to an insurance company.

Indeed, the operational basis of an insurance company lies in its ability to balance the indemnities paid with premium income.

C) Profit distribution policies

Dividend payments to shareholder can influence investment. It the annual dividend payment is high, the returns on financial assets that emanate in the form of interest and capital appreciation will be affected. In case of underwriting losses, the situation will be more complicated. Accordingly, the decision of the dividend distribution and other profit distribution policies has contribution on investment fund.

D) Investment Management

In addition to the investment regulations provided by the supervisory authority, the board of directors of each insurance company will set up company's investment policy. Therefore, the design of internal investment policy has an impact on the financial asset of the policyholder's liability.

4.4.3. Market Specific

A) Market Structure

Structural characteristics of the market for financial institution play a major role in determining efficient allocation of the demand for and supply of financial services. In insurance, stability of insurance business will depend on market structure. Naturally, the market structure of any country could be monopolistic, competitive, and competitive but restricted to national companies.

In Ethiopia, the market structure of insurance industry is competitive but restricted to national companies. Moreover, the market is very small and highly fragmented among the private companies on the one hand, and it is concentrated in the public owned insurance company on the other. In 2013, out of the total market 46.5 percent was belonged to Ethiopian Insurance Corporation.

In addition, the insurance industry is composed of two distinctly different markets. The life insurance market and non-life or general insurance business. The structures of the two markets have important implications for the investment behavior of insurance companies. Life insurance contracts provide protection against personal financial risks, and the non-life provide insurance to protect the insured against losses of physical damages to property or the damages to others for which the insured is being liable.

By 2013, there were 17 insurance companies. Among them, seven companies write only non-life or general insurance contracts, and three companies operate in both non-life and life insurance business. There is no company writing only life insurance contracts.

B) Size of Market

The size of the market for property and liability insurance is evaluated by means of the ratio of gross premiums written to the gross domestic product, and for life insurance by growth level of income and growth rate of the populations.

At the company level, the volume of business depends very much on the market shared among the various companies and on domestic insurance density. The insurance density in turn depends mainly on the level of economic development related with financial development.

In 1987, total premiums as a percentage of GDP totaled 9 percent in the United States, (UNCTD, 1996). In 2004 the ratio of gross premium to GDP was 0.9 percent in Ethiopia (NBE, 2006). This explains that the difficulties of many low-income countries in reaching competitive positions in insurance market are because of the country's low national income. In 2004, for example, the ratio of gross premium to GDP of Morroco, Kenya, Zimbawe, Tanzania, Zambia and Ethiopia was computed to be 3.6%, 3.3%. 2.4%, 1.2%, 1.1% and 0.7% respectively. The figure shows that the market size of Ethiopia is still smaller than many African countries. Computed from AIO report (UNCTD – 1996).

CHAPTER FIVE

5. FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1. Findings

The ultimate goal of this paper was to assess the investment practices of the Ethiopian Insurance Corporation. In order to achieve the intended purpose of the study, the researcher used both primary as well as secondary data sources of the Corporation. Hence, based on the thorough analysis made in the previous section, the following conclusions have been drawn as follows;

From the argument above particularly on the investment profile of EIC, the following facts are observed. These facts would lead to the problems which attribute to the problem of investment.

- Investment is lagging behind invest income, which shows investment in EIC has an inherent problem. This is because much of the investable fund is invested in areas where the pay- off is low,
- The gap between income from operation and income from investment is wider.

Having the above facts as the manifestation of the problem, following, the researcher would identify the core and specific problems which hinders investment activity in EIC. These are:

A) Board of Directors

Almost all the Board members have no adequate knowledge as to the investment activities as a result the strategy and that of the policies and procedures lack to update timely based on the prevailing business environment.

B) Rate of investment

The NBE Directive stipulates the highest portion of invest able fund to be invested in small interest rate bearing investment areas like treasury bills and time deposits as a result there is chronic problem to derivate adequate fund for real estate development projects which practically is safe with low risk and high yield.

C) Base to compute invest able fund

Admitted asset is used as a base to compute invest able fund using the rate as a coefficient. As the NBE Directive puts it, admitted asset also includes all non cash items like fixed assets, account receivables and long term investments such as, investments in company shares, co financing loans, mortgage loans etc.

Here due to the inclusion of non cash items in the computation, the entire invest able fund would be absorbed by treasury bills and bank deposits.

D) Though, the NBE's directive is sound from protection point of view (that is safety and liquidity), the return side of investment is given low attention.

E) Investment activities viewed as ancillary or incidental to underwriting.

F) The investment office is not equipped with the necessary skills in investment management.

It has been discussed in the forgoing that invest able fund is not sufficient to cover the investment requirement of all projects if they would be implemented simultaneously.

In this case building projects that have been found feasible for implementation but not materialized are good examples. EIC has no tradition using such method of investment. With this regard, prioritizing is the only remedy.

G) Lack of timely decision and MIS

Decisions goes with time, otherwise it will pay off. There are real estate projects with approved feasibility studies without any sort of action towards actual implementation. Activities should also be supported by the information systems in an integrated manner to be efficient and effective if not the consequence will not be fruitful.

5.2. Conclusions

Insurers are required to generate reserves which defray insurance claims at the time of registered loss. It is important that insurance companies invest these funds judiciously with the combined objectives of liquidity, maximization of yield and safety. It has to be ensured that the insurer must at all times maintain a prescribed minimum level of solvency as a protection to the policy holders' legitimate interest.

The investment directive sets the rate and the base at which investment would be made. The principal concern of the directive is to keep the Corporation liquid and solvent, and thereby protect public's money. Thus, the directive requires the Corporation to invest the lion share of admitted asset in bank deposits and treasury bills, which is almost risk free.

This of course helps the liquidity position of "EIC" and meanwhile generates return. Such move, however, hurts and bites other areas of investments.

In response to this, the result achieved so far from investment is not encouraging, therefore extra ordinary assistance and effort is expected both from the regulatory body in revising the rates and that of the Corporation respectively in giving due concern in skills of the investment staffs, knowledge of the Boards, culture to the investment of insurance, utilization of MIS and prioritizing projects that demand high cost

5.3. Recommendations

As it is well known and said in the foregoing part, investment is an integral part of insurance and thus, has been given due attention by many insurance companies in the world. Investment is made by insurance companies aiming at supporting the insurance operation and strengthening their liquidity position so as to meet their future obligation. To this end, insurance companies invest their funds extensively in view of maximizing their investment income.

EIC is trying to do all its best towards the enhancement of its investment growth for the purpose of strengthening its financial reliability and liquidity position so as to comfortably meet its future obligations. Despite the exerted effort on investment activities, the corporation is not able to perform as desired due to the problems mentioned above.

Having the above mentioned problems in mind and based on the facts and figures previously discussed, the researcher proposes the following recommendations.

A) Concerning the Boards of Directors

The researcher recommends that the overall knowledge of the board towards crafting effective investment management policies and strategies should be strong and vibrant.

B) Regarding the Rate of investment

It is common for insurance regulatory bodies of many countries to regulate the investment activities of insurers by the supervisory body; however, how far investment activities should be supervised to a reasonable degree remained to be the bone of contention among the insurer and the supervisory body to date.

Here, the paper has a bad feeling that the rates stipulated by the regulatory body are unfair. Particularly the rate assigned to real estate which naturally fetches high yield combined with low risk is given the lowest regrettable attention. Therefore, the researcher recommends the rates to be revised.

C) Regarding the Base to compute invest able fund

As it has been discussed before computation of invest able fund is unthinkable without considering admitted asset as a base. This form of asset has its own limitation when it is viewed from investment perspective. The lion share of this asset comprised of non cash items which cannot be in use readily at the time of actual investment.

Here the researcher proposes the base for computation to be "readily available fund for investment". This fund avoids all the values of non cash items mentioned before and substitute in place cash and bank balances and all the short term investments.

D) Regarding project prioritizing problem

As it is well exemplified in the tables above investment requirements of the envisaged projects by far higher than the available fund for investment. In such instances prioritizing projects is the best method to go forward.

In the same way, In order to alleviate the shortage of invest able fund arising from The NBE directive it would be inevitable to prioritize the projects and implement them accordingly.

E) With regard to skills in investment management

The risk in investment starts with unwise use of poorly skilled staff. Therefore, it is wise of the Corporation to equip the investment staff at least with the required training.

F) With regard to giving more weight/culture to insurance operation than investment activity.

Investment activities in the insurance industry have traditionally been viewed as ancillary or incidental to underwriting. Hence much time and attention spent on underwriting and claims business.

Investments are contributory factors towards the profitability of insurance companies. An insurance company that exhibited negative underwriting surplus can still show profits if its investment income exceeds the underwriting loss. Thus investment management is also crucial in the insurance industry for two reasons first a steady increase in investment income improves profitability and benefit shareholder. Secondly and, in general terms, a steady increase in investment income will lead to a decrease in premium charges. This helps policy holders. Higher investment returns on insurance funds tend to lower premium charges to policy holders.

G) Concerning Management Information Systems (MIS)

As far as the information systems of the corporation with respect to the investment activity is concerned, in the Corporation, the investment Directorate seems an independent organ which would highly affect the efficiency as well as the effectiveness of the investment activities. Therefore, to be efficient and effective, integrated information systems should be made. So the activities to be performed would be informed and the inputs would also be timely.

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Appendices

Appendix A

QUESTIONNAIRE

ST. MARY'S UNIVERSITY (SMU)

SCHOOL OF GRADUATE STUDIES (SGS)

Dear Sir/ Madam,

Currently, I have been undertaking Master of Business Administration (MBA) thesis work on the topic ***"An Assessment on the Investment Practices of Ethiopian Insurance Corporation."*** I would much appreciate if you could kindly take a little of your time to complete the attached questionnaires. The information supplied by you will be held in a strict confidential manner; it will be utilized for academic purpose ONLY.

Eventually, I would like to seize this opportunity to thank you in advance for your kind participation and timely return of your completed questionnaire.

If you have any queries, please don't hesitate to contact me through my cell phone No. **0911-55-20-00 or E-mail =>** **shewaman2010@gmail.com**

Thank you once again for assisting me in this survey.

Sincerely yours,

Appendix B

Part One: - Questionnaire

Section I: Brief Personal Profile

1. What is your level of current Position/Job Title in the Corporation?

   ☐ Managerial ☐ Supervisory ☐ rofessional ☐ erical

2. Years of service in your Corporation

   ☐ 1-5 ☐ 6-10 ☐ 11-15 ☐ 16-20 ☐ =21

3. What is your level of Education? ☐ Diploma ☐ Degree ☐ er's or Above

Section II: Assessment of Investment management Practices

4. **Investment Management Framework:** Please rate the extent to which you agree or disagree with each statement by putting a tick mark (√) on the following:

Board and Management Oversight;	**Strongly Disagree (1)**	**Disagree (2)**	**Neutral (3)**	**Agree (4)**	**Strongly Agree (5)**
Boards have adequate knowledge on investment management area.					
Management in place appropriate procedures and process to implement the investment management policies					
Asset Liability Committee (ALCO) meets on a frequency that is commensurate with the Corporation's business activities					
ALCO passes relevant decisions on pertinent issues, and follows up implementation					
Investment Management Policy and Procedure;	**Strongly Disagree (1)**	**Disagree (2)**	**Neutral (3)**	**Agree (4)**	**Strongly Agree (5)**
The investment management policy includes funding strategies that provide diversified, stable & cheap funding sources					

The investment policies evaluated (annually) to ensure that it remains up-to-date.					
Monitoring and Controlling of Investment Risk	**Strongly Disagree (1)**	**Disagree (2)**	**Neutral (3)**	**Agree (4)**	**Strongly Agree (5)**
There is independently organized investment management function(evidenced by reporting to the Board)					
The investment management function proactively identifies, measures, monitors and controls the risk exposure.					
Management Information System (MIS) produces timely and relevant information.					
There is an effective control system that ensures the implementation of policies, procedures & limits.					

5. How do you evaluate the effectiveness of the overall investment management framework of the Corporation? ☐ **Very Satisfied** ☐ **Satisfied** ☐ **Neutral** ☐ **Unsatisfied** ☐ **Very unsatisfied**

6. **Challenging Factors for effective Investment Management System:** Indicate the extent to which the following factors challenges the implementation of effective investment management system in your Corporation.

Challenges	**Very Challenging (1)**	**Challenging (2)**	**Neutral (3)**	**Least Challenging (4)**	**Not Challenging (5)**
Lack of technical knowledge and skill ;					
Inadequate investment management Information System					
Absence of Institutionalized Investment Management Culture					
Difficulty of Integrating Investment management with other business process					
Difficulty of Quantifying investable funds (For Both General & Long term insurance Funds)					
Others					

7. **Monitoring and Controlling of the Investment:** Please rate the extent to which you agree or disagree with the statement below by putting a tick mark (√).

Item(s)	Strongly Disagree (1)	Disagree (2)	Neutral (3)	Agree (4)	Strongly Agree (5)
The Corporation in places effective MIS for monitoring compliance issues.					
Policy exceptions and breaches are reviewed and reported timely					
There are times when Investment Management guidelines are overridden by management and staffs					

8. **Contingency Funding Plan(CFP):** Please indicate your opinion in each of the following statements by putting a tick mark (√)in the table below;

Contingency Funding Plan	Strongly Disagree (1)	Disagree (2)	Neutral (3)	Agree (4)	Strongly Agree (5)
Does the contingency plan set out a possible course of action to generate cash inflow in crisis situations?					
Does the plan define clearly the responsibilities of all personnel in a crisis situation?					

9. **Liquidity Risk Factors in relation to Investment:** The following are some of the factors which could be considered as the causes for liquidity risks in the insurance sector. (Please rate to what extent the following factors affect the level of liquidity risk in your Corporation).

A. Internal Factors

Factors	Very Insignificant (1)	Insignificant (2)	Neutral (3)	Significant (4)	Very Significant (5)
Rapid Long term asset expansion					
High off-balance sheet exposure					
Limited Capital Base					
Implication of deterioration in the investment portfolio					
Difficulty in managing intraday liquidity position					
Others					

B. External Factors

Factors	Very Insignificant (1)	Insignificant (2)	Neutral (3)	Significant (4)	Very Significant (5)
Adverse Change in policy environment					
Volatile markets which results sudden fluctuations					
High competition for fund mobilization in the investees' industry					
Decreasing Insured's trust on the industry					
Absence of developed money market					
Low/slow economic performance					
Catastrophic events					
Others					

Part Two: - Interview

1. How do you see the composition of the staff expertise with respect to the demand of the competency of the investment functioning as it requires a multi-discipline, in principle?

2. Is there any parametric measure to decide whether the working capital is enough before investing the available investable fund/ readily available fund so as to protect the Corporation from liquidity problem?

3. What do you forward issues that, you think, will improve the overall investment and its management practices of the Corporation?

4. How do you see the rates being given by the National Bank of Ethiopia with respect to the Investment Directives?

5. What is your idea regarding the linkage between investment and that of insurance provision in insurance industry?

Thank you again!