ST. MARY'S UNIVERSITY
SCHOOL OF GRADUATE STUDIES
MBA PROGRAM

ASSESSMENT OF PROFITABILITY OF MOTOR INSURANCE IN THE CASE OF NICE INSURANCE S.C

A Thesis Presented in Partial Fulfillment of the Requirements for the Masters of Business Administration in ST. Marry University

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St. Mary's University

Addis Ababa Ethiopia

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Endorsement

This thesis entitled, “Assessment of profitability of motor insurance in the case of Nice Insurance S.C” has been submitted to St. Marry University, School of Graduate Studies for examination with my approval as a University advisor.

Research Advisor: Zenegnawu Abiy (PhD)

Signature ________________________

Date: ________________________

Declaration

I, Abi H/Selassie declare that this work entitled **"Assessment of** profitability of Motor Insurance in the case of Nice Insurance S.C" is an outcome of my own effort and study and that all sources of materials used for the study have been duly acknowledged. I have produced it independently except for the guidance and suggestion of the research advisor.

This study has not been submitted for any degree in this University or any other University.

By: Abi H/Silassie

Signature_____________________________

Date________________________________

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FACULTY OF BUSINESS

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TABLE OF CONTENTS

LIST OF TABLES AND CHARTS

ABSTRACT

The study is intended to assess profitability of motor insurance, especially the comprehensive cover, which registered negative results during the fiscal years 2008/2009-2010/2011. The study focused on the comprehensive motor insurance cover. This is mainly due to the fact that the management and technical operation of comprehensive cover falls under the discretion of each insurance company. Mixed research approach was used to investigate why motor account was not profitable for National Insurance Company of Ethiopia. The researcher used both primary and secondary sources of data to undertake the study. The primary source consists of information that is gathered through structured questionnaire, focus group discussion and interview method from the sample choosen. In general eleven out of twenty underwriters were interviewed. However, with regard to focus group discussion the study units are limited to those who have direct exposure and involvement on underwriting and claims operations in the company. The data analysis technique was descriptive method. Charts and tables were used in order to analyze the primary and secondary source of data(i.e financial data of NICE). Generally it is found that the negative performance of motor class of business during the period from 2008/2009 to 2010/2011 was attributed, in one way or another, to inadequate pricing, failure to avoid acceptance of accident prone vehicles for comprehensive cover, claims management problem, failure to control unnecessary acquisition costs and un proportional charge of the motor account by management expense. Therefore, strict compliance to the directive issued with respect to minimum rate, avoidance to accept ISUSU(NPR, FSR) and MISSAN UD vehicles for comprehensive cover, reorganization of the claims department, putting in place control mechanism to minimize unnecessary acquisition costs, and adopting an accounting practice of charging the revenue account with only direct management expenses are suggested to improve performance of the motor account.

LIST OF ACRONYMS

CII: Chartered Insurance Institute

EU: European Union

NICE: National Insurance Company of Ethiopia

RTA: Road Traffic Act

UK: United Kingdom

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Motor Insurance premium takes the lion's share in the portfolio mix of non life Insurance Companies operating in many countries in the world. To mention few, a study conducted by Kozak (2011) to identify determinants of profitability of non-life insurance companies in Poland during integration with European Financial System revealed that motor premium accounted more than 50% of the non-life premium during the years from 2002 to 2009. A similar study carried out by Demertrion (2002) in Cyprus showed that motor premium contributed more than 60% of the non-life premium. According to unpublished sources obtained from the National Bank of Ethiopia, motor accounted 47% of the non-life premium in Ethiopia during the fiscal year ended June 30th 2013. In the case of National Insurance Company of Ethiopia (S.C.) motor premium contributed 65% of the total premium during the same fiscal year.

National Insurance Company of Ethiopia (S.C.) was established in 1994 to engage in rendering general insurance services. As it is the case in all business organizations, generating profit to its shareholders is among the objectives of the company. However, even though motor premium contributed more than 50% of the total premium of the company from 2008/2009 to 2010/2011 financial years, the financial reports indicated that motor account did not make positive contributions to the profit making objective of the company.

The contribution of motor insurance to the gross premium of the company being considerably on the high side, it is obvious that the major part of company resources are consumed by motor class of business. Hence, unless corrective measures are taken to reverse the situation, survival of the company would be in danger.

This research will, therefore, be carried out to know why Motor Insurance, with particular emphasis on comprehensive cover policies, was not profitable during the budget year from 2008/2009 to 2010/2011.

Studies conducted so far in this connection suggested that inadequate pricing, lack of underwriting skill in exercising risk selection, claims management problems are among the factors that generally contribute for the negative result of motor account.

Thus, the study will be important to the Management of national Insurance Company of Ethiopia (S.C.) to make decisions that would alter the situation experienced during the three years under consideration. Based on the research findings, the management will take corrective measures that would make motor account profitable and keep the company stay in business.

1.2 Statement of the Problem

Returns to shareholders are am-ong the primary objectives of National Insurance Company of Ethiopia (S.C.). Even though motor insurance premium takes the highest share in the portfolio mix of the company, the contribution of motor account to this primary objective is very much insignificant. For example three years data compiled in this regard revealed that motor contributed 58.65%, 58.88%, and 59.89% of the gross written premium in 2008/2009, 2009/2010, and 2010/2011 fiscal years respectively. The corresponding years underwriting surplus, however, was Birr (1,148,195.87), Birr (1,984,017.59), and Birr (1,280,561.98). This showed that the revenue generated from motor insurance business did not cover its own direct costs. Motor being the highest in the portfolio mix of the company, the losses of motor account are not generally expected to be subsidized by profits generated from other classes of business like Fire, General accident and Marine. This indicates that motor insurance was eroding overall profitability of the Company. Hence, if motor account is allowed to continue making losses, the company would not be in a position to stay in business.

Therefore, in order to make motor insurance positively contributing to the overall profitability and survival of the company, it is crucial to investigate why motor account registered negative results during the fiscal years under consideration. The research critically addresses the problems associated with the negative performance of the motor class of business.

1.3 Research Questions

The main theme of the study was concerned on the following fundamental questions:

- Did pricing of motor insurance has contribution to the negative performance of motor account?
- Did underwriting practices with respect to risk selection has contribution to the negative underwriting surplus?
- Did motor claims management contribute to the negative result of motor account?
- Did business acquisition costs contribute to the negative outcome of motor account?

1.4 Objectives of the Study

1.4.1 General objective

The general objective of the study is to investigate why motor insurance, especially the comprehensive cover, registered negative results during the fiscal years under discussion.

1.4.2 Specific objectives

The study will have the following specific objectives:-

- To investigate how pricing of motor insurance has contributed to the negative performance of motor account.
- To investigate as to whether or not the underwriting practices with respect to risk selection has contributed to the negative underwriting surplus.
- To assess the contribution of motor claims management, if any, to the negative result.
- To investigate the contribution of business acquisition costs to the negative outcome of motor account.

1.5 Significance of the study

The Study is significant to the following concerned parties:-

Management of National Insurance Company of Ethiopia (S.C.): On the basis of the research findings the management can take appropriate corrective actions to reverse the situation and make the motor account profitable.

The Insurance Industry: As stated earlier in this paper, motor insurance premium takes the lion's share in the portfolio mix of the industry in Ethiopia. However, this class of business is not profitable for many of the insurance companies operating in Ethiopia. Thus, this research would enable such companies review their status from the research findings point of view and take the necessary action to make the motor account profitable.

To future Researchers: Even though motor is believed to be loss making class of business in Ethiopia, no in depth research was carried out to investigate the reason for unprofitability of motor insurance. This study will, therefore, serve as a starting point for future researchers who are interested in carrying out research on motor insurance pricing, risk selection practice, and claims management and to develop policies and procedures to handle claim cases in the best efficient manner as well.

1.6 Scope of the study

As clearly summarized under chapter II of this paper, there are four types of motor insurance covers namely:- a) Third Party Compulsory Insurance b) Third party only c) Third party Fire and theft; and d) Comprehensive.

In the Ethiopian case, tariff in respect of motor third party compulsory insurance is set by the government body and, hence, insurance companies do not have any significant role to play in this regard. Therefore, the scope of this study is limited to the comprehensive motor insurance cover the management and technical operation of which is still left to the discretion of each and every insurance company. This is to say that companies are free to design their own policy wordings, develop premium rates, and impose deductibles. Moreover, the coming into effect of "vehicle Insurance against Third Party Risks Proclamation" and the implementation of "NO PREMIUM NO COVER" in recent years have made compilation of data to the intended purpose very much difficult. It is due to this main problem that the three years data up to 2010/2011 are opted to conduct the study.

CHAPTER TWO

REVIEW OF RELATED LITERATURE

2.1 Definition of Insurance

Insurance is risk transfer mechanism whereby the insurer, in consideration of payment of premium by the insured, agrees to indemnify the insured in case the insured suffers from unforeseen losses. According to Dorfman (2008) Insurance is defined from financial and legal perspectives. The financial definition states that insurance is a financial management that redistributes the costs of expected losses. Insurance involves the transfer of potential losses to an insurance pool. This is to mean that all members of the pool would contribute certain amount called a premium in proportion to the risk they bring to the pool. The amount collected in the pool shall, thus, be redistributed to members that suffered from unforeseen losses. On the other hand, the Legal definition states that insurance is a contact in which one party agrees to compensate another party for losses. In other words, an insurance contract is a contact under which one party (the insurer) accepts significant insurance risk from another party (the policy holder) by agreeing to compensate the policy holder if specified uncertain future event (the insured event) adversity affects the policy holder. In consideration of payment of insurance premium to the insurer by the insured, the insured shall be entitled for compensation in a situation where the insured suffered from losses.

According to Skipper and Kwon (2007), Insurance is an important risk management tool. In a typical insurance arrangement, the insurer promises, in return for a premium, to fulfill its contractual obligations upon the occurrence of some event, often a qualified loss. Insurance can be viewed as a risk transfer arrangement from view point of contract law.

Insurance arrangement is effected between two parties (the insurer and the insured) based on terms and conditions agreed upon by these parties and subject to payment of premium to the insurer in consideration of the transfer of risks from the insured to the insurer, the insurer shall indemnify the insured in case the insured suffer losses consequent upon occurrence of risks in a manner previously agreed upon. This is simply to say that the insurer will not be obliged to compensate the insured in case the insured suffered from losses which are excluded from cover in accordance with their contractual agreement (Insurance policy). The word Loss, as it is commonly used, means being without something previously possessed and it can further be classified into direct losses (the immediate first result of an insured peril) or indirect losses (also called consequential losses or loss of use) are a secondary result of an insured peril Dorfman (2008). For example if a commercial vehicle used to transport fare paying passengers insured under comprehensive motor insurance suffered from overturning accident, the cost of repairing the vehicle back to its normal operating condition is termed as direct cost. During the time the vehicle was in a workshop to get repaired, the owner would loose the revenue generated had the vehicle been operational. Thus, the loss of income suffered by the owner of the commercial vehicle is considered to be an indirect loss or loss of use.

2.2 Definition of Risk

According to Dorfman (2008) the word risk is often used in connection with finance, banking, and insurance. No simple generally accepted definition of risk exists, however. Of the many definitions, two distinctive ones commonly are used when writing and speaking about insurance. One defines risk as the variation in possible outcomes of an event based on chance. The second definition of risk is the uncertainty concerning a possible loss. Trieschmann et.al.(2005) classified Risks into:-

- Pure versus speculative risk
- Static versus dynamic Risk
- Subjective versus objective risk

The authors mentioned that pure risk exists when there are uncertainties as to whether loss will occur. Speculative risk reflects a situation when there is uncertainty about an event that could produce either a profit or loss.

Static versus dynamic classification involves the extent to which uncertainty changes overtime. Subjective refers to the mental state of an individual who experiences doubt or worry as to the outcome of a given event. Objective risk differs from subjective risk primarily in the sense that it is more precisely observable and measurable. Ideally Insurable loss exposures are:

- A large group of similar items exposed to the same peril(s)

- Accidental losses beyond the insured's control
- Definite losses capable of causing economic hardship
- Extremely low probability of a catastrophic loss to the insurance pool.

If we take the case of motor insurance, all vehicles that are to be insured are more or less exposed to accidental collusion and/or overturning risks that are beyond the control of insured. When such risks materialize, it is obvious that owners would suffer from economic losses previously expressed as direct and indirect losses. The final consideration is that all vehicles covered under the pool would not be expected to involve in an accident at the same time.

2.3 Basic Principles of Insurance

Bodla et. al (2004) states that every subject or discipline has certain generally accepted and systematically laid down standards or principles to achieve the underlying objective. Insurance is not exception to this general rule. Hansell (1975) identified the following as basic principles of insurance:- Insurable interest, utmost good faith, Indemnity, Subrogation, Contribution, and proximate cause. Each basic Insurance principle is explained further hereunder:-

2.3.1 Insurable Interest

Insurable interest in property may arise through ownership, possession or contract and in certain cases it may be created or modified by statute. Hall (1985). A property owner has insurable interest in his property because damage or loss sustained by the property would result in financial loss to the owner. On the other hand, if a person has no financial interest on the subject of insurance (property, vehicle, and etc.), such a person is said to have no insurable interest. Thus, any one person that have no insurable interest on a particular property would not be allowed to insure such property. This is what is meant by the principle of insurable interest.

2.3.2 Utmost Good Faith

In simple terms, utmost good faith in insurance means that each party to a proposed contract is legally obliged to reveal to the other all information which would influence the other's decision to enter the contract, whether such information is requested or not Hansell (1975). In motor insurance, for example, the proposal form to be dully completed by the proposer is designed in such a manner that the underwriter would adequately assess the proposed risk and set terms and condition, including the premium amount, to accept the proposed risk for insurance. Thus, if the proposer failed to tell the truth in respect of all requests stated in the proposal, the underwriter would not be in a position to assess the proposed risk and charge adequate premium. Obviously, under such circumstances, one party would benefit (the insured) while the other losses (the insurer). The principle of utmost good faith is, thus, put in place in order to protect the interest of both the insured and the insurer in this respect.

2.3.3 Indemnity:

According to Hall (1985), the intention of the parties to the contract is that the insured, on the happening of an event insured against, will be placed by the insurer in the same pecuniary position that he occupied immediately before the event, subject to any limitations which may have been agreed and written into the contract. The insured is not entitled to receive any thing in excess of the monetary extent of his loss and he will receive less than this if any limitation in the policy operates. According to this principle, if, for instance, an insured person insured his car for sum insured of Birr 300,000.00 against motor comprehensive insurance and if at some later date (say after 6 months from inception date of the policy) the vehicle overturned and sustained damage to extent it could not be repaired and if the market value (current replacement cost) immediately before the accident was Birr 250,000.-, the insured would be paid Birr 250,000.- If the insured is to be paid any amount in excess of this sum, the insured would be over indemnified which, of course, would be against the principle of indemnity. The insurance company is also entitled to posses the wreck after settlement of the claim.

2.3.4 Subrogation

Subrogation means the exercise, for one’s own benefit, of rights or remedies possessed by another against third parties. If the rights or remedies have already been exercised, subrogation entitles one to the proceeds there from, Subrogation rights are acquired by insurers once they have provided their insured with an indemnity and at common law any actions to recover from third parties must be conducted in the name of the insured. (Hansell 1975)

The principle of subrogation is further explained from motor insurance point of view as follows:- Assume that two vehicles owned by Mr. A and Mr. B involved in collusion accident and the driver of the vehicle owned by Mr. A was responsible for the accident. This was further confirmed by a traffic police that attended the accident site immediately after the accident. If Mr. B has already bought comprehensive insurance policy for his car from an insurance company, he is required to report to his insurance company about the accident. After assessing the extent of damage, the insurance company would determine the amount of claim and indemnify Mr. B. By exercising the subrogation right, the insurance company would request Mr. A for reimbursement of costs incurred by the insurance company in connection with the collusion accident for which the driver of his car was responsible.

2.3.5 Contribution

The principle of contribution, which, like the principle of subrogation, has been described as a corollary of indemnity, is concerned solely with the apportionment of liability as between insurers in the event of double insurance, and the rules adopted for its application are primarily rules of practice designed by insurers for their own guidance. Hall (1985).
When risk materializes in a situation where double insurance exists, the insured shall claim to one of the insurance companies and the insurance company that received notification of claim shall indemnify the insured and request for reimbursement proportional cost of the claim from the other insurance company. If the insured is allowed to claim from both insurance companies, it would be in violation of the principle of indemnity. In case the claim is reported to both insurance companies, there is a possibility of paying their proportional cost of the claim direct to the insured.

2.3.6 Proximate cause

The classic definition of proximate cause was given in Pawsey v. Scottish Union & national (1907) “Proximate cause means the active, efficient cause that sets in motion a train of events which brings about a result, without the intervention of any force started and working actively from a new and independent source" Hansell (1974).

According to the principle of proximate cause, if an insured person lodged a claim, he is required to justify that the loss is caused by a peril insured under the policy. In other words, he must ensure that the loss is not caused by un insured peril. For example, under motor insurance, damage caused by war and war like operation is an excluded risk. Loss or damage to the vehicle by fire, however, is covered peril. If the insured vehicle is burnt down to ash due to exchange of fire between two parties at war, the insured will not be indemnified in respect of losses incurred in this regard. Because the proximate cause for the loss is war which is a peril not covered under the policy.

2.3.7 Reinsurance

A basic principle to all insurance is that the risks underwritten should be spread or shared as widely as possible. Reinsurance is an extension of this principle. It is a System whereby an insurer who has accepted a risk can himself insures the liability he has thereby assumed, in whole or in part, with another insurer. He is entitled to do so because he has an insurable interest, not in the subject matter of the original insurance but in the insurance contract he has entered into in respect of it. Hall (1985).

Reinsurance enables insurance companies to accept huge risks that would have not been accepted in the absence of reinsurance because of limitation of capacity. Based on their paid up capital, insurance companies determine their retention limit from each classes of insurance and arrange reinsurance program on annual basis. The reinsurance program is renewable every year subject to revision of terms and conditions as may be necessary. Risk acceptance limit of insurance companies is determined by the amount of risk retained by the company and the amount of risks covered by the Reinsurers according to the Reinsurance Program. The annual Reinsurance program comprises treaties such as surplus, quota share, and excess of loss. When insurance companies accept risks with sums insured exceeding treaty limit, another kind of reinsurance called "facultative" should be arranged. Facultative reinsurance is arranged on case by case basis where insurance companies are to accept huge risks that exceed treaty limit.

2.4 Types of Motor Insurance Covers

2.4.1 Road Traffic Act Cover

Williams (2005) states that as a national consequence the requirements of the road traffic Act 1988 (RTA 1988), this is the minimum cover provided by motor Insurers in the UK.

Basic RTA cover comprises the following in the context of UK:-

- Legal liabilities to third parties for death or bodily injury to any person which is unlimited in amount, and for damage to third party property up to a maximum of 250,000.-
- Emergency treatment payments under the road traffic act.
- Legal costs incurred in defending an action for damages, including claimant's costs awarded against the policy holder.
- Cover abroad, sufficient to comply with the various EU directives as incorporated into the RTA.

In the Ethiopian context even though the scope of cover is almost similar, the extent of liability is restricted as follows (proclamation no. 99/2013)

a) an amount not less than Birr 5,000.- and not exceeding Birr 40,000.- in respect of death of one person;
b) an amount not exceeding Birr 40,000.- in respect of bodily injury of one person ; or
c) an amount not exceeding Birr 100,000.- in respect of damage to property;
d) Emergency medical treatment costing up to Birr 2,000.-

The main difference is that death or bodily injury claim is not limited in amount in the case of UK while such claims are limited to a maximum amount of Birr 40,000.- in our case.

2.4.2 Third Party only

According to Hansell (1975) a third party only policy covers the insured's legal liability towards other people, arising out of the use of motor vehicles. Rate charts of insurance companies currently operating in Ethiopia reveal the liability limits of third party only policy covers to be as hereunder:-

Bodily injury		
	Per person	Birr 30,000.-
	Per event	Birr 150,000.- in respect of private vehicle
		Birr 200,000.- in respect of commercial vehicle
Property damage		Birr 75,000.- in respect of private vehicle
		Birr 100,00):- in respect of commercial vehicle

2.4.3 Third Party, Fire and Theft

In this type of cover the third party liability limits being as stated under "third party only" cover, the policy is extended to provide cover in respect of loss or damage to the insured's vehicle arising from fire and theft. The maximum liability of insurance companies in this regard shall be expressed in terms of replacement cost of the vehicle usually termed as sum insured.

2.4.4 Comprehensive

Hansell (1975) states that this is a term in very common usage, but in some ways it is an unfortunate one. Comprehensive implies that every conceivable risk is covered, which is not the case with this type of policy. It is the widest form of cover available, but certain risks, such as loss through deterioration or through loss of use of the vehicle, are excluded. In additional to the cover provided under Third Party only policy, this type of policy provides cover to loss or damage sustained by the insured vehicle consequent upon any cause other than specifically excluded in the policy.

2.5 Factors Affecting Profitability of Motor Insurance

Fook (1995) identified that the Malaysian General Insurance Industry was confronted with the following problems prior to 1985:-

- lack of control particularly in respect of underwriting- acceptance of risk, issuance of cover notes/policies and payment of claims
- High management expense

- High acquisition costs
- High claim processing costs
- Un professional rating and rate cutting due to competition
- Fraud

Demertrion (2002) identified the following reasons for the negative result of motor account in Cyprus:-

A. ***Increased cost of claims being the result of:-***
    - Increased cost of medical expense
    - Increased cost of legal expense
    - Increased cost of labour
    - Increased cost of spare parts
    - Increased court award
    - Increased no. of Fraudulent claims
B. ***High commission rates paid to Agents***
C. ***Low premium rate***

Although these studies were conducted abroad, it is believed that profitability of motor account is highly affected by most of the factors indicated in the above mentioned research papers even in the case of other countries like Ethiopia.

Quoting law premium rate would negatively affect the motor account. According to Trieschmann et. al (2005) the premium is designed to cover two major costs; the expected losses and the cost of doing business. In order to make the motor account profitable certain percentage of profit margin should be further loaded. Thus, unless the rate is set considering all these factors, the amount of premium collected may not be sufficient to cover costs and leave certain profit margin.

Similarly, fraudulent claims would increase the amount of losses which would negatively affect profitability. A fourth report delivered by the CII and Ernest & Young in UK under the title “bringing profitability back from the brink of an extinction a report on the UK retail motor insurance market” concluded that profitability will be enjoyed by the few who demonstrate a firm grip on the fundamentals of their business through operational excellence (control over their claims costs, operating expenses, and acquisition costs). Hence, service excellence would enable companies to minimize costs and to win business even by quoting premium rates relatively higher than competitors.

2.6 Factors affecting motor insurance profitability: An Empirical review

The researcher noted that very limited empirical studies were conducted on the subject. It was also learned that issues directly related to profitability of motor insurance were being addressed through studies conducted to compile reports to some interested parties.

A research conducted in Poland on determinants of profitability of non-life insurance companies concluded, among others, the following:

Reduction of the level of company's operating costs improves profitability of the company and increase its cost efficiency. As acquisition costs and administrative expenses constitute majority of company's expenses, reduction of any of these types of expenses has a significant impact on the increase of values of its technical results and financial profit.

- The share of motor insurance in the company's insurance portfolio negatively impact its profitability and efficiency, it means in a similar way as the level of operating costs. The analogy may come from the fact that motor insurance requires higher marketing expense and creates higher values of compensations and gross claims paid by the company. Reduction of company's involvement in such insurance class results in lower operating expenses and has positive impact on company's technical results and net financial profit and overall profitability. Kozak(2011) although this study was conducted on determinants of profitability of non-life insurance in general, it revealed that motor took the lion's share of acquisition and operating costs. It was also identified that motor registered the highest share of the claims incurred. In conclusion, therefore, the researcher noted that too much involvement in motor class has negative impact on the overall profitability of an insurance company.

  On the other hand, Demertriou (2002) concluded that motor insurance in Cyprus, with a gross premium volume of over CYP 48,000,000 is the largest class of non-life business mainly because of its compulsory by law nature but the only one, which continuously records negative results.

The main causes of the negative result have been identified as follows:-

1. The low premium charged
2. The increased cost of claims
3. The high acquisition costs by way of commission paid to agents.
4. The high administrative costs.
5. The inadequate Investment incomes.

In view of the above, the research suggested the following possible solution to improve profitability of motor insurance:-

1. Increase premium rates through the assistance of actuaries to provide advices on the statistical information to be collected and analyzed.
2. Reduce claim costs- claim costs can be reduced by way of training insurance companies employees to handle claims more efficiently and be able to identify cases of overcharging, or of fraudulent claims.
3. Reduce acquisition costs through direct sale.
4. Reduce administrative costs by investing in new technology or implementing more simplified procedures that can lead to reduction of administrative costs.
5. Improve cash flow that would avail funds for investment.

Poor pricing strategies can lead to short-term business expansion at the expense of sustainable financial positions. Under pricing, for one, leads to negative business margins. The problem is compounded if poor pricing also leads to poor estimations of reserving needs, or if it compromises an insurer's capacity to reserve adequately for future claims. Brennan (2013)

Fook (1995) conducted a similar study in Malaysia and noted that the Malaysian general insurance industry prior to 1985 was confronted with a multitude of problems many of which related to motor insurance:

- Corporate philosophies and strategies that emphasized premium growth rather than profitability.

- Luck of control particularly in respect of underwriting- acceptance of risk, issuance of cover notes/ policies and payment of claims.
- High management expenses tending to increase over the years.
- High acquisition costs through payment of excessive commission to intermediaries.
- High claim processing costs.
- Un professional rating and rate-cutting due to competition.
- Outstanding premiums and failure to actively collect premium
- Un professional intermediaries and lack of regulation of these intermediaries by insurers.
- Fraud - especially in motor insurance.

To the contrary, a study conducted by Galhest and Young (2011) identified that average losses in these markets can be high but some insurers consistently perform better than the market because they have leading age practice in key operational areas, including;-

- Accessing the market- embracing new distribution trends
- Servicing the customer- creating a seamless claims experience for customers.
- Managing cost- using IT and systems to manage costs
- Right product right cost- offering the right product at technically considered prices.

As can be noted from research findings explained above, many of the factors mentioned by the researchers as causes for the negative performance of the motor class of business are almost similar to the causes discussed under this paper for the negative performance of motor account in the case of NICE.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This section of the study presents the methodology that the researcher used to select sample, collect data and analyze the data in investigating why motor account was not profitable for National Insurance Company of Ethiopia during the fiscal years under consideration.

3.2 Research Design

For the purpose of the present study, mixed approach which advocates the combination of both qualitative and quantitative research approach was pursued to investigate why motor account was not profitable for National Insurance Company of Ethiopia. Qualitative approach was needed in this study because the topic is new and has never been addressed with the particular sample or group under study so far. Quantitative approach was needed to generalize about why motor account was not profitable for National Insurance Company of Ethiopia. Specifically the current study employed structured questionnaire, focus group discussion and interview method from the sample chosen. The researcher used descriptive research design to investigate why motor account was not profitable for National Insurance Company of Ethiopia

3.3 Sources of Data

The researcher used both primary and secondary sources(i.e. financial data of NICE) of data to undertake the study. The primary source consists information that is gathered through structured questionnaire, focus group discussion and interview method from the sample chosen.

Questionnaires were distributed to some claimants to know their expression about claim service of the company and what their response would be for slight increase in price.

As the underwriters are believed to be relatively the right sources of information, underwriters of all branches operating in Addis and underwriting staff of Main Branch were requested over the telephone through a structured interview questions to express their feelings about the existence or otherwise of unethical behavior that inflate acquisition cost and their replies were compiled.

The focus group discussion comprised the Claims Manager, Marketing Manager, Main Branch Manager, Addis Ketema Branch Manager, Senior Claims Officer, and senior underwriting officer. The focus group discussion was facilitated (chaired) by Manager, Marketing Department. Group members were invited to freely express their views not only in respect of claims management but in connection with motor underwriting practice (including pricing) as well. Accordingly, all group members shared their views one at a time, followed by common discussion on important issues and the discussion was noted as a minute.

In order ensure that the company has charged adequate premium rate, secondary data was gathered with respect to annual sums at risk (total sum insured), gross premium earned and gross claims incurred. The data was classified into the following four major motor insurance classifications.

- Motor private
- Motor Commercial
- Motor Buses
- Motor cycles

Thus, the claims incurred amount was compared with the gross premium to know whether or not the gross premium written was sufficient to cover direct costs.

The actual average premium rate charged was also determined by dividing the gross premium amount to total sum insured (sum at risk).

3.4 Sample Size and Sampling Technique

In general eleven out of twenty underwriters were interviewed. Underwriters are insurance professionals that are responsible to assess and either decide to accept or reject a proposed risk. However, with regard to focus group discussion the study units are limited to those who have direct exposure and involvement on underwriting and claims operations in the company. More specifically professional staff and management members of Claims and Underwriting Departments comprise sampling framework of the study. Accordingly, the number of staff and management constitutes about 32, of which, managerial level comprised 4, underwriting Officers 23 and the remaining 5 are Claims Officers. To make more valid representation in the study non-random sampling method was used in order to purposively select respondents and, hence, Underwriting Officers (10), department managers (4) and Claim Officers (1) together constituted a total sample population of the study. Further to this, 11 claimant customers who were conveniently available were also considered as sample population.

3.5 Method of Data Analysis

After the data collection, the appropriate data analytic technique was used (i.e. descriptive method). Charts and tables were used in order to analyze the primary and secondary sources of data.

CHAPTER FOUR

PRESENTATION AND INTERPRETATION OF FINDINGS

4.1 Introduction

The analysis and interpretation of this study is based on the data collected from structured interview, questionnaire and focus group discussion. Hence, the data gathered were organized and analyzed in a manner that enables to investigate why motor insurance is not profitable.

4.2 Data Presentation and Analysis

As Kozak(2011) and Demertriou (2002) suggested, various factors are contributing to the negative performance of motor account. Inadequate pricing, poor underwriting practice in selection of risks, poor claims management, an increase in acquisition costs are among the major factors identified as causes for unprofitable performance of motor insurance. When viewed from the case of National Insurance Company of Ethiopia, the research revealed that all such factors have, in one way or the other, contributed for the negative results registered by motor account during the period from 2008/2009 to 2010/2011. Besides, the research identified that the accounting practice of the company unduly used to charge the motor account with excessive and the un-proportional management expense was also one of the reasons for the negative performance. Details are presented as follows:

4.2.1 Inadequate Pricing

In order to examine whether or not the motor insurance was priced in a way that it would bring positive results to the overall performance of the company, data related to gross premium and claims incurred were compiled by major classifications of motor insurance namely, motor private, motor commercial, motor bus and motor cycles.

4.2.1.1 Motor Private

The data compiled in respect of motor private for fiscal years running from July 2008/2009 to June 2010/2011 is summarized under the table below:-

Table 1: Loss Ratio and Combined Ratio of Private Motor from 2008/2009 – 2010/2011

Fiscal year	Claims Incurred	Written Premium	Operating expenses	Loss Ratio	Combined Ratio
2008/2009	5,037,608.72	6,105,565.83	1,237,294.35	82.51%	102.77%
2009/2010	4,886,034.20	7,156,842.97	1,290,098.93	68.27%	86.30%
2010/2011	6,598,266.29	8,964,801.61	1,613,792.40	73.60%	91.60%

Source: *NICE Financial Statements and Own Computation*

Note: Incurred claims = o/s claims Ending + claims paid – o/s claims beginning

The table reveals that except in 2008/2009 fiscal year, private motor insurance has registered underwriting surplus to some extent. Thus, it can safely be concluded that limited percentage of upward price revision would be required to make the private motor profitable.

4.2.1.2 Motor Commercial

Of the four classifications of motor, motor commercial plays the lion's share and, therefore, has significant impact on the overall performance of motor account. Similar data compiled in respect of motor commercial is summarized under table 2.

Table 2: Loss Ratio and combined Ratio of Commercial vehicles from 2008/2009 to 2010/2011

Fiscal year	Claims Incurred	Written Premium	Operating expenses	Loss Ratio	Combined Ratio
2008/2009	15,389,059.17	15,102,180.71	3,060,460.47	101.90%	122.16%
2009/2010	18,470,934.20	20,901,771.83	3,767,772.13	88.37%	106.40%
2010/2011	23,844,732.97	27,569,060.12	4,962,824.79	86.49%	104.49%

Source NICE Financial Statements and Own Computation

The Commercial motor insurance registered negative underwriting surplus during all the periods under consideration. This is a clear indication that the company did not set a premium rate that would have positive contribution for the overall performance of the company. As explained under the literature review part of this paper, premium should be set in such a manner that it would bring income to shareholders in the form of dividend covering direct costs (claim costs), acquisition costs (commissions), running costs (operating costs), and other general expenses and taxes. Thus, the data revealed that there was pricing problem in commercial motor policies that contributed for the negative performance of motor account during the fiscal years 2008/2009 to 2010/2011.

4.2.1.3 Motor Bus

The data compiled in respect of motor bus is summarized under table 3 as follows:-

Table 3: Loss Ratio and combined Ratio of motor buses from 2008/2009 to 2010/2011

Fiscal year	Claims Incurred	Written Premium	Operating expenses	Loss Ratio	Combined Ratio
2008/2009	4,034,561.87	5,225,230,.01	1,058,894.09	77.21%	97.48%
2009/2010	5,263,463.78	7,034,292.58	1,268,007.89	74.83%	92.85%
2010/2011	8,421,917.80	10,717,898.45	1,929,374.88	78.58%	96.58%

Source NICE Financial Statements and Own Computation

As can be noted from the above table premiums collected from motor bus policies have covered direct costs and operating costs bearing very insignificant margin as contribution for underwriting surplus of motor account. However, the surplus is not adequate by any standard and, therefore, it can be concluded that motor bus policies were not adequately priced. Accordingly, upward revision of the premium should be exercised to improve profitability of motor bus policies.

4.2.1.4 Motor Cycles

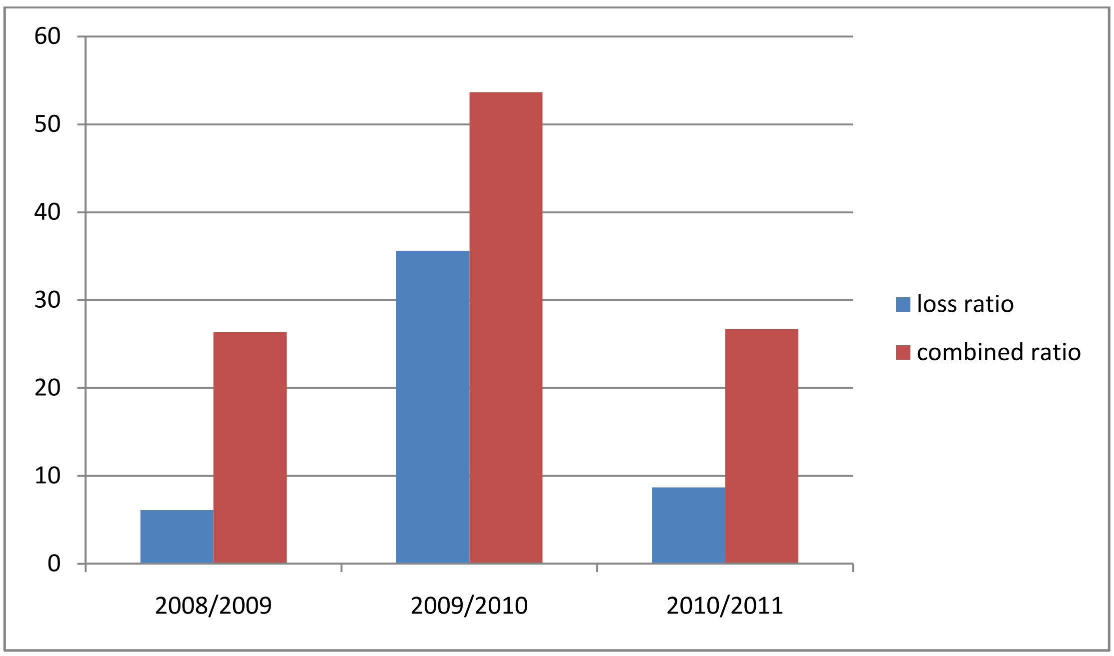
The fourth category under the motor class of business is categorized as “Motor Cycles”. The data compiled is respect of motor cycles is summarized under the table presented below:-

Table 4: Loss and Combined Ratio of motor cycles from 2008/2009 to 2010/2011

Fiscal year	Claims Incurred	Written Premium	Operating expenses	Loss Ratio	Combined Ratio
2008/2009	10,310.36	168,605.23	34,167.89	6.12%	26.38%
2009/2010	44,125,.02	123,838.27	22,323.20	35.63%	53.66%
2010/2011	10,780.33	123,946.41	22,312.13	8.68%	26.70%

Source: *NICE Financial Statements from 2008/2009 to 2010/2011 and Own Computation*

Chart 1: Loss and Combined Ratio of motor cycles from 2008/2009 to 2010/2011



Source: *NICE Financial Statements from 2008/2009 to 2010/2011 and Own Computation*

The table reveals that even though the contribution of motor cycles premium to the motor portfolio is very much insignificant, motor cycle business is very much profitable for its own account. However, it seems that no attention was given by the management to develop these category motor classes of business. The premium generated from this category, as can be noted from the table, was much lower than Birr 200,000.- a year. Thus, if this category of motor insurance is adequately promoted and the volume of sales is increased by reducing the premium rate reasonably, the company would benefit from writing motor cycle comprehensive policies.

4.2.1.5 Minimum Premium in respect of motor private and commercial vehicles

It is observed that the company, via memo dated September 29 2005 has set minimum premium rates for acceptance of motor private and motor commercial vehicles for comprehensive cover. According to this memo the minimum premium rates are 1.85% for private vehicles and 2.15% for commercial vehicles. However, the data compiled and summarized under table 5 shows that the directive passed through the memo cited above was not complied with.

Table 5: Average premium in respect of private & commercial vehicles

Fiscal year	Private			Commercial		
	Premium	Sum Insured	Average Premium Rate	Premium	Sum Insured	Average Premium Rate
2008/2009	6,105,566	458,797,319	1.33%	15,102,181	1,113,308,451	1.36%
2009/2010	7,156,843	506,832,708	1.41%	20,901,772	1,654,541,755	1.26%
2010/2011	8,964,802	651,313,750	1.38%	27,669,060	2,295,232,912	1.20%

Source: *NICE ICT Department and Own Computation from 2008/2009 to 2010/2011*

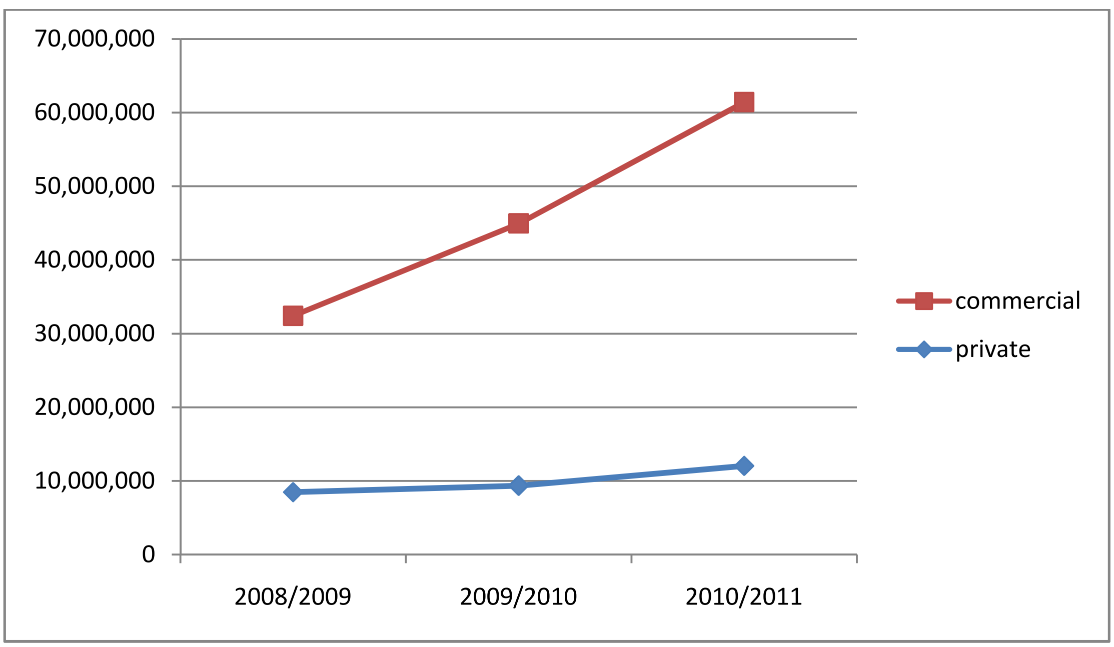
From this table, one can easily notice that the average rates charged during the years under discussion were very far below the minimum rates set by the company. Surprisingly, the average rates charged during same period for commercial vehicles were even lower than the rates charges for private vehicles. Had the minimum rates been complied with uniformly (practically not always possible), the premium earned from private and commercial vehicles would have been as follows:-

Table 6: Premium calculated at minimum premium rate for private & Commercial vehicles

Fiscal year	**Private**		**Commercial**	
	Sum Insured	**Premium**	**Sum Insured**	**Premium**
2008/2009	458,797,319	8,487,750	1,113,308,451	23,936,132
2009/2010	506,832,708	9,376,405	1,654,541,755	35,572,648
2010/2011	651,313,750	12,049,304	2,295,232,912	49,347,508

Source: *NICE ICT Department and Own Computation from 2008/2009 to 2010/2011*

Chart 2: Premium for private & Commercial vehicles



Source: *NICE ICT Department and Own Computation from 2008/2009 to 2010/2011*

Thus, from the above table it can be learnt that, had the minimum premium rates were strictly applied, the picture of motor account would have been changed. The account would have been profitable had the minimum premium rates were applied for most of the policies issued during the periods under consideration. Therefore, the big gap in adhering to the directive issued in respect of minimum premium rates have also contributed for the unprofitability of motor account. Table 7 and 8 would well explain how the loss and combined ratio would improve, had the minimum rates were uniformly applied.

Table 7: loss and combined ratio of private vehicles premium rate

Fiscal year	Claims Incurred	Written Premium	Operating expenses	Loss Ratio	Combined Ratio
2008/2009	5,037,608.72	8,487,750.40	1,237,294.35	59.35%	73.93%
2009/2010	4,886,034.20	9,376,405.09	1,290,098.93	52.11%	65.87%
2010/2011	6,598,266.29	12,049,304.37	1,613,792.40	54.76%	68.15%

Source: *NICE ICT Department and Own Computation from 2008/2009 to 2010/2011*

Table 8: loss and combined ratio of commercial vehicles premium rate

Fiscal year	Claims Incurred	Written Premium	Operating expenses	Loss Ratio	Combined Ratio
2008/2009	15,389,059.17	23,936,131.69	3,060,460.47	64.29%	77.08%
2009/2010	18,470,934.20	35,572,647.73	3,767,772.13	51.92%	62.52%
2010/2011	23,844,732.97	49,374,507.61	4,962,824.79	48.32%	58.38%

Source: *NICE ICT Department and Own Computation from 2008/2009 to 2010/2011*

Therefore, the two tables reveal that the company would have obtained considerable amount of underwriting surplus from private and commercial vehicles, had the minimum premium rates set by the company been uniformly applied to all private and commercial motor comprehensive policies issued during the periods under consideration.

4.2.2 Underwriting practice related to risk selection

Risk selection and prudent underwriting practice is believed to be among the tools that enable insurance companies to manage any class of insurance in their portfolio mix profitable. In view of knowing as to whether or not poor risk selection practice has also contributed to the negative performance of the motor account, the researcher planned to examine 67 claim files that were closed after payment of Birr 150,000.- and above during the period from 2008/2009 to 2010/2011 financial years. 44 such files were examined and the result is summarized under table 7. The main aim of the examination was to know if vehicles that were listed as exclusions for comprehensive cover by the company were still included in the list of vehicles involved in an accident. Fortunately, the outcome of the examination revealed that none of such vehicles were included in the list of vehicles involved in an accident. However, the examination revealed that some types of vehicles were recurrently involved in an accident. Details are summarized under table 9.

Table 9: List of Vehicles Recurrently Involved in an Accident

Item No.	**Type of vehicles**	**No. of Vehicles**	**Type of Accident**			**Claim amount**
			Collusion	**Overturning**	**Fire**	
1	Isuzu Truck (NPR, FSR)	9	4	5	-	2,832,803.73
2	Nissan UD	7	2	5	-	3,372,421.4
3	Fiat Trucks	11	4	7	-	2,511,611.46
4	Toyota Minibus	4	1	3	-	906,011.00
5	Others (one from each type)	13	3	9	1	3,342,350.55
	Total	44	14	29	1	12,865,248.20

Source: *NICE settled Claim files from 2008/2009 to 2010/2011*

The table shows that Fiat Trucks are recurrently involved in an accident compared with others. However, the amount of claim incurred in respect of Fiat Trucks was lesser the claim amount involved in connection with Isuzu Trucks and Nissan UD Trucks. Moreover, despite the fact that lesser number of Nissan UD Trucks were involved in an accident compared with that of Fiat Trucks and ISUZU Trucks, the amount of claim incurred in relation to Nissan UD Trucks was much higher. The main reason for this fact is that Nissan UD Trucks are relatively expensive compared with others. Spare parts of Nissan UD Trucks are also expensive too. Therefore, from the above analysis, it can be concluded that underwriting measures should be taken in connection with accepting ISUZU and Nissan UD Trucks for comprehensive cover.

4.2.3 Claims Management Problem

The contribution of claims management problem to the negative performance of the motor account, if any, was addressed through obtaining primary data from focus group discussion. The outcome of the focus group discussion revealed that the premium setting practice did not take into account the increase in cost of spare parts and labor which is a phenomenon currently experienced on a weekly and sometimes on daily basis.

It was also noted that claim costs are sometimes exaggerated purposely to unfairly benefit customers as well as the staff involved in facilitating this unwanted practice. Changing parts that were not damaged by the accident as if they were damaged was cited as an example in this regard. It was also said that Branch Offices were issuing motor comprehensive policies for vehicles that have no spare parts in the local market. Thus, even though such vehicles were repairable at a lesser cost had spare parts been available, there were situations where the company would be forced to incur exaggerated claim costs by entertaining claims on total loss basis

On the other hand it was mentioned that the main cause for the motor account to register losses was price cutting which emanated from cutthroat competition prevailing in the insurance industry. In this regard, it was believed that fighting this problem by one company alone is not simple as such unless mutual agreement is reached by all companies. Until such time, avoiding acceptance of risk prone vehicles for comprehensive cover like Min Buses, Isuzu Buses, and Isuzu Trucks was suggested to be the best solution.

Similarly it was commented that premium rate of the company for motor insurance is relatively on the high side which restricted the company to accept as many number of vehicles as possible and enjoy the benefits of the law of large numbers which is the basic theme in insurance. Had the premium rate been relatively lower, the company would have insured more number of vehicles and the loss would have been spread among many such vehicles and, thus, the motor account would have been profitable.

It was also suggested that the major factor that contributed for the negative performance of motor account was delay in settlement of claim. Whenever there is delay in settlement of claim, it is obvious that clients would be forced to incur costs in the form of loss of use. The more the processing time, the more aquatinted the client would be with the staff. As a result they would be tempted to corrupt the staff, the consequence of which is increasing cost of claims.

Moreover, the discussion noticed that the frequency and severity of accidents in respect of Isuzu Trucks and Toyota minibuses was alarming and, therefore, immediate underwriting measures should be taken in this regard.

In general, the focus group discussion identified the following factors as causes for the unprofitability of motor class of business during the periods from 2008/2009 to 2010/2011:-

- Inadequate pricing
- Payment of fraudulent claims
- Acceptance of vehicles for comprehensive cover that are usually involved in an accident frequently (i.e. ISUZU Buses, ISUZU Trucks, Minibuses)
- Delay in settlement of claims
- Failure to enjoy the benefits of the Law of Large numbers

Therefore, the company will have to take appropriate corrective measures so as to make the motor class of business profitable. It is believed that except price adjustment that would be taken in consideration of the prevailing competition in the industry, all other factors could easily be rectified through the action to be taken by the company management.

4.2.4 Service Excellence that persuade customers to pay relatively higher premium compared with other

Service Excellence is believed to be the best method of retaining existing customers and attracting some others. In order to know how claimants evaluate the company from this perspective, a very brief questionnaires was designed and distributed to clients that appeared in the office of the cashier to collect cheques from 5th May, 2014 to 15th May, 2015. I managed to get response from 11 such respondents. In terms of sex only one respondent is female while all the remaining are male. With regard to educational background, 4 of them are below 12th grade, 2 have completed 12th grade, one is diploma holder, and the last 4 are first degree holders.

The aim of this specific study was to know whether or not customers are satisfied with claims service of the company and also to know the reactions of customers to slight price increase (i.e. not exceeding 10%). Accordingly, 6 of respondents (54%) confirmed that they are satisfied with the services and 5 of them stated that they will tolerate the 10% increase and continue their business relationship with the company. One of the respondent, however, declined to comment on this issue. On the other hand, the remaining 5 respondents responded that they are not satisfied with the claim service of the Company.

From this sample study, it can be concluded that the claims service of the Company was not yet attained the satisfactory level. Under such circumstances, therefore, an attempt to increase price of motor insurance will have an impact to erode client base of the Company. Thus, before taking such an action, the Company has much to do in improving claims management.

4.2.5 Incurring unnecessary acquisition costs

A study conduct by Demetriou (2002) in Cyprus indicated that Insurance Companies paid 24% of their gross premium income as acquisition cost in the form of commission payment to intermediaries. The maximum commission rate paid by NICE for motor insurance was 12.5%. Thus, it can be said that the Company did not incur excessive acquisition cost in respect of motor insurance. However, the research revealed that there were situations whereby the Company was unnecessarily incurring acquisition costs in connection with businesses that would have been registered as direct business. This happened where the Branch Managers, who ought to generate direct business, intentionally register direct businesses in the name of intermediaries with unethical intent of sharing the commission therein with Agents. This was ascertained by interviews conducted by telephone with the underwriters of all Branches operating in Addis. The interview result revealed that most Branch Mangers except few were engaged in such unethical practice. The reason for such malpractice is mainly associated with failure of the Company to put control mechanisms in place to at least bring the problem down to the minimum level possible.

This malpractice was one of the causes that contributed for the negative performance of motor insurance.

4.2.6 Excessive charge of the motor account by un-proportional management expenses

According to accounting practice of the Company, underwriting surplus from each class of business is determined by dividing 80% of the annual general and administrative expense to each class of business in proportion to the gross writer premium. As motor comprised the highest share in the portfolio mix, the major portion of the management expense would be charged to motor account. Although, the premium income generated from one motor policy is greater than the premium generated from Fire or Marine policies in many cases, the time spent to process one motor policy is almost similar with that of the time spent to process one Fire or Marine Policy.

Thus, from this point of view charging the motor account by management expenses in proportion to the premium generated from motor business is not justifiable. Even charging the revenue account by 80% of the annual general expense is too much. Therefore, this accounting practice is also believed to have contributed to the negative performance of the motor account.

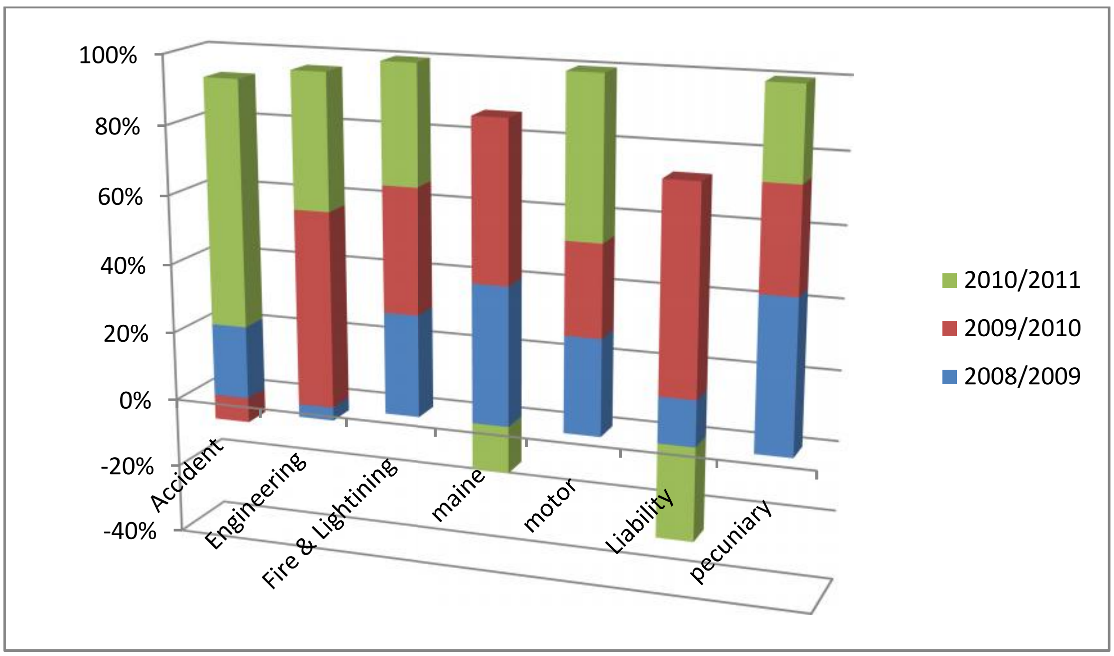
The impact of the accounting practice on motor account is well explained under table 10.

Table 10: Underwriting surplus by class of business before management expense

Item No.	Class of Business	2008/2009	2009/2010	2010/2011
1	Accident	1,407,914.18	(474,028.42)	4,741,556.68
2	Engineering	(100,905.00)	1,509,616.47	1,042,645.91
3	Fire & Lighting	1,228,811.72	1,510,909.77	1,432,984.67
4.	Maine	2,717,344.63	3,154,185.08	(911,313.99)
5.	Motor	2,705,476.83	2,580,637.90	4,468,259.96
6.	Liability	745,887.39	3,367,846.53	(1,525,622.45)
7.	Pecuniary	1,533,387.00	1,041,618.81	909,176.69

Source: *NICE Financial Records and Own Computation (2008/2009 to 2010/2011)*

Chart 3: Underwriting surplus by class of business before management expense



Source: *NICE Financial Records and Own Computation (2008/2009 to 2010/2011)*

As can be noted from the table, motor account continuously registered positive underwriting surplus before management expenses were accounted. Therefore, this is a clear indication that the motor account was excessively charged by management that obviously, contributed for its negative performance during the years from 2008/2009 to 2010/2011.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

5.1 Conclusions

The research attempted to investigate the reasons for the negative performance of motor account of National Insurance Company of Ethiopia (S.C) for the fiscal period from 2008/2009 to 2010/2011 in line with different aspects and, in conclusion, it was noted that inadequate pricing, underwriting practice with respect to risk selection, inefficient claims management practice, unnecessary acquisition costs, and accounting practice in connection with apportionment of management expenses have all contributed for the undesired results of motor class of business.

Details are presented as follows:-

5.1.1 Inadequate Pricing

The maximum combined ratio for motor private during the periods under discussion was 102.77% while the minimum was 86.30%. This reveals that on the average private motor registered underwriting surplus. However, the surplus was not sufficient to cover additional administrative and general expenses and leave some amount of benefit to shareholders. Moreover, if Branch Office comply with directive issued in connection with setting of minimum premium (1.85% in case of private vehicles) as much as practicable, the profitability of Private Motor Insurance would be much improved as explained under item 4.2.1.5 of this paper.

Underwriting surplus of commercial motor was negative through all the year under consideration. The main reason for this unfavorable performance was mainly attributed to price cutting which could be explained by the average rate applied in respect of Motor Commercial Vehicles. As evidenced under table 5, the average premium charged during the periods under discussion ranged from 1.2% to 1.36%. This is quite below the premium rate of 2.15% set by the company. Had the minimum premium rate been charged whenever motor commercial policies were issued, the picture would have been completely changed as indicated under table 8. The loss ratio and combined ratio computed on the basis of minimum premium ranged from 48.32% to 64.29% and 58.38% to 77.08% respectively.

As clearly summarized under table 3, motor buses contributed a very insignificant amount of surplus to the overall profitability of the company. The combined loss ratio of motor buses ranged from 92.85% in 2009/2010 to 97.48% in 2008/2009. Likewise, most members of the focus group discussion suggested that ISUZU Buses and Toyota Minibuses are very prone to accident and frequently involved in an account. Therefore, as an alternative avoidance of such vehicles to accept for comprehensive cover would improve the performance of the motor bus account.

As shown under table 4, motor cycles account was performing well throughout the years under discussion. For example, the loss ratio ranged from 6.12% to 35.63%. The combined ratio, on the other hand, ranged from 26.38% to 53.66% which is still very much attractive result. Even though this category of motor insurance is very much profitable, the total amount of premium earned during the three years ranged from Birr 123,838.27 to 168,605.23 revealing that the product was not well marketed or rather neglected. Thus, having understood the reality, the management should work hard in promoting this product and raise the volume of premium generated from Motor Cycles category of the motor class.

5.1.2 Underwriting Practice Related to Risk Selection

In order to know whether or not Branches were accepting for comprehensive cover vehicles that were excluded from providing such cover by directive, 44 settled files were examined in depth. Fortunately, the examination revealed that no claim was lodged in respect of vehicles excluded from extending comprehensive cover. As indicated under table 9, 11 Fiat Trucks were involved in an accident causing a claim cost amounting to Birr 2,511,661.46. The Fiat Trucks included different models including 682 N3, Fiat 300 PT, Turbo 190.30,that do not regularly involve in an accident. Even though they involve in an accident, the cost of repair (claim cost) is not that significant compared with other types of vehicles. The table also explains this situation. For example, the Company incurred claim cost of Birr 2,511,661.46 for 11 Fiat vehicles that encountered accident. The claim cost for 7 Nissan UD Trucks was, however, Birr 3,372,421.46. Thus, the examination of files indicated that ISUZU Trucks (NPR, FSR) were frequently involved in accident bringing huge claim costs to the Company. Similarly, Nissan UD Trucks register recurrent claims with exorbitant claim costs. From the focus group discussion it was also noted that many have commented on the issue of avoiding acceptance of ISUZU Trucks (NPR, FSR) for comprehensive cover.

Therefore, the Company would benefit more if underwriting measure is taken to avoid acceptance of both ISUZU and Nissan UD Trucks for Comprehensive cover. This is because, the profitability of motor account during the periods under consideration was also affected by recurrent accidents and sever claim costs emanated from such types of vehicles.

5.1.3 Claims Management Problem

As noted from the focus group discussion, claim costs were being exaggerated due to the reasons described below:-

- Delay in settlement of claims
- Failure to attend accident sites on time
- Changing undamaged parts as if damaged by the accident due to unethical practice.

It is usually said that Insurance Companies are selling promise. Thus, the satisfaction or otherwise of insurance customers mainly lie on the prompt claims service they be rendered by the time they lodge claims. A study conducted in UK by Alan Woof and Imran Ahmed (2010) showed that majority of customers give priority for reputation for good service followed by strong brand in selecting one Insurance Company from the other. Although evaluation of service excellence is not the main objective of this study, the service delivery process of National Insurance Company of Ethiopia S.C was explained by manly who participated in the focus group discussion to have contributed for the negative performance of the motor account. In their views delay in settlement of claim would obviously dissatisfy customers. Moreover, they suggested that customers would be tempted to seek unnecessary benefit when there is delay in settlement of claims and this would result in leakage and exaggerated claim costs. In general the whole Claims Management process should be improved to meet the required standards. This should include organization of the Claims Department and putting policies and procedures in place to avoid unnecessary claims costs.

In general, it can be concluded that the negative performance of motor class of business during the period from 2008/2009 to 2010/2011 was attributed, in one way or another, to inadequate pricing, failure to avoid acceptance of accident prone vehicles for comprehensive cover, claims management problem, failure to control unnecessary acquisition costs and un proportional charge of the motor account by management expense.

5.2 Recommendations

The researcher recommends some alternative ways pertaining to improve the negative performance of motor account.

- It is true that inadequate pricing was one factor for the negative performance of the motor account. Considering the prevailing fierce computation in the insurance industry, upward revision of premium rate may force the company to lose market share. However, the company had already set minimum premium rate in respect of private and commercial vehicles. However, the research findings revealed that the directive issued in this regard was not complied with. This was evidenced by the fact that the minimum average rate for private vehicles during the period under consideration was 1.33% whereas the minimum premium rate for private vehicles was 1.85%. Similarly the minimum average premium for commercial vehicles was 1.2% while the minimum rate was 2.15%. Therefore, strict compliance to the minimum rate would improve performance of private and commercial vehicles and, hence, the management should give due attention to the strict implementation of the directive issue in this regard.
- On the other hand, acceptance of accident prone vehicles like ISUZU NPR, ISUZU FSR, and NISSAN UD for comprehensive cover has caused the company to incur recurrent and excessive claim costs. Therefore, the company should immediately stop acceptance of such vehicles for comprehensive cover. Alternative measures like increasing premium and excess could also be looked into.
- As the study conducted in UK by Alah Woof and Imrah Ahmed (2010) indicated, majority of customers give priority for reputation for good service. When viewed from this perspective, claims management of NICE lags behind. To mention few, in many instance the movement of claim fills for payment was facilitated through close follow up of the claimants concerned. This is to mean that claim files were not processed smoothly without reminder of customers. Whenever there was delay in settlement of claims, no one is accountable. Furthermore appointments were not respected. These are among the factors that caused customers

dissatisfaction in the claims service. Thus, the management should reorganize the department in such a manner that it would provide effective and efficient claims services. This, in turn, would enable the company build reputation in its claims service.

- Moreover, the research findings revealed that the company was incurring unnecessary acquisition costs. This is because of lack of control mechanisms put in place to minimize such problems. Currently, production slips are approved and signed by only branch managers. Therefore, in order to arrest such problems, production slips should be counter-signed by an official from marketing department. Marketing department should also device a mechanism that would enable it ensure production slips are prepared in connection with businesses which are genuinely produced by intermediaries.
- Finally, the research findings revealed that the accounting practice of charging the revenue account by eighty percent of the annual administrative and general expenses as management expense, and further apportioning the management expense to each class of business, has made the motor account excessively bear the management expense. Therefore, in order to enable the company fairly assess the performance of each class of business, only administrative and general expenses related to underwriting, claims, marketing, and sales should be charged to the revenue account and further subdivided to each class of business in proportion to the annual premium income generated by each class of business.

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Appendixes

Appendix A

St. Mary's University

School of Graduate Studies

MA in Business Administration (MBA)

Dear Respondent:

First of all I would like to sincerely express my heartfelt gratitude and respect in advance to you for devoting your time and energy to complete and administer this questionnaire honestly and responsibly. The questionnaire is designed to collect necessary information to undertake a preliminary investigation on unprofitability of motor insurance in National Insurance Company of Ethiopia. Consequently, your feedback of this survey is extremely important and will be very much appreciated.

Finally, I would like to confirm you that all the information you provide in this questionnaire will be kept confidential and will exclusively be used for the research purpose.

Best Regards

1. Demographic information

   a. Gender € Male € Female

   b. Age € Below 20 years

      €20-35 years

      €36-50 years

      € Above 50

   c. Educational background

      €Below 12th grade

      €12th grade completed

      € Diploma

      €1st Degree (BA, BAC,…..)

      €2nd Degree (MA, MSC,…..)

      €3rd Degree (PHD)

      €Any other

2.

   a. Your status as claimant

      € Insured claimant

      €Third party claimant

   b. How do you evaluate our claims service?

      € Very much satisfied

€ Satisfied

€ Notsatisfied

c. If you are not satisfied with our claim service, which one is the main cause for your dissatisfaction from among the following?

€ Delay in settlement of the claim (the claims settlement was delayed beyond reasonable time).

€ Customer handling problem of the staff (miss treatment by the staff).

€ Less indemnification or compensation (the amount received is not adequate to compensate the laws sustained).

d. If you are an insured claimant and your answer 2 –b is very much satisfied, what is your stand at time of renewal if the company decides to rise the annual premium by an amount not more than 10%?

€ I will renew my policy

€ I will not renew my policy and look for some other option

Thank You!!

Appendix B

Minutes of Focus Group Discussion

Date: May 10, 2014

Time: 10:00 a.m

Venue: NICE office of the General Manager

Meeting attended by:

1.	Manager, Marketing Department	Facilitator (chairman)
2.	Manager, Claims Department	Member
3.	Manager, Main Branch	“
4.	Manager Addis Ketema Branch	“
5.	Claims Supervisor	“
6.	Underwriting Supervisor	“
7.	Researcher	Secretary

After giving brief opening remarks, the chairman invited participants to share their views about the reasons for the negative contributions of motor class of business during the periods under discussion and their reflections are summarized hereunder:-

Manager, Claims Department

He stated that the premium setting practice did not take into account the increase in cost of spare parts and labor which is a phenomenon currently experienced on a weekly and sometimes on daily basis.

He further added that claim costs are sometimes exaggerated purposely to unfairly benefit customers as well as the staff involved in facilitating this unwanted practice. Changing parts that were not damaged by the accident as if they were damaged was a case cited by him as an example in this regard. He also noted that cases were observed whereby Branch Offices were issuing motor comprehensive policies for vehicles that have no spare parts in the local market.

Thus, even though such vehicles were repairable at a lesser cost had spare parts been available, there were situations where the company would be forced to incur exaggerated claim costs by entertaining claims on total loss basis

Manager, Main Branch

She mentioned that the main cause for the motor account to register losses was price cutting which emanated from cutthroat competition prevailing in the insurance industry. In her views fighting this problem by one company alone is not simple as such unless mutual agreement is reached by all companies. Until such time, she suggested that avoiding acceptance of risk prone vehicles for comprehensive cover like Min Buses, Isuzu Buses, and Isuzu Trucks would be the best.

Manager, Addis Ketema

He commented that premium rate of the company for motor insurance is relatively on the high side which restricted the company to accept as many number of vehicles as possible and enjoy the benefits of the law of large numbers which is the basic theme in insurance. In his views, had the premium rate been relatively lower, the company would have insured more number of vehicles and the loss would have been spread among many such vehicles and, thus, the motor account would have been profitable. He further noted such practice should be exercised in respect of private vehicles.

He also suggested that in his opinion the major factor that contributed for the negative performance of motor account was delay in settlement of claim. Whenever there is delay in settlement of claim, he stated that it is obvious that clients would be forced to incur costs in the form of loss of use. The more the processing time, the more aquatinted the client would be with the staff. As a result they would be tempted to corrupt the staff, the consequence of which is increasing cost of claims.

Claims Supervisor

Stating that he shared the views of other members that commented so far on the issue, he added that the frequency and severity of accidents in respect of Isuzu Trucks and Toyota minibuses was alarming and, therefore, immediate underwriting measures should be taken in this regard.

Underwriting Supervisor

He commented that claim costs associated with Isuzu Minibuses, Isuzu Trucks, and Toyota Minibuses were frequently eroding profitability of motor account and suggested that avoiding acceptance of such vehicles for comprehensive cover would reverse the situation.

From the general discussions followed, the following points were raised as contributors for the negative performance of motor account:-

- Failure of motor inspectors to attend accident site on time and carryout preliminary damage assessment that would allow customers or towing crane operators to dismantle genuine parts from the damaged vehicle and replace such parts by damaged and/or depreciated parts (e.g. tires)
- Using hired towing vehicles rather than using own towing vehicle.
- Even though, it is not statistically proved, the system that was introduced by Roads Transport Authority in respect of issuing driving licenses.

In general, the focus group discussion identified the following factors as causes for the unprofitability of motor class of business during the periods from 2008/2009 to 2010/2011:-

- Inadequate pricing
- Payment of fraudulent claims
- Acceptance of vehicles for comprehensive cover that are usually involved in an accident frequently (i.e. ISUZU Buses, ISUZU Trucks, Minibuses)
- Delay in settlement of claims
- Failure to enjoy the benefits of the Law of Large numbers

With this, the meeting adjourned at 12:00 o'clock.