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Mergers and Acquisitions: A Panacea to under Capitalisation Challenges Faced by Zimbabwe Non Life Insurance Companies in the Multicurency Era

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Abstract:
This paper analyses challenges being faced by short term insurance companies in Zimbabwe in meeting the regulatory minimum capital requirements. The economic meltdown and the subsequent hyperinflation that besieged Zimbabwe from 1998 to 2008 left an indelible dent on the insurance consuming public's confidence in the industry. The insurance graveyard for the period spanning from 1998 to 2008 is littered with failed strategies which were implemented in an effort to keep the sums insured close to market or replacement values of the subject matter of insurance. The balance sheets of insurance companies were also progressively eroded over the period. The adoption in 2009 of a multicurrency system consisting of a basket of currencies, namely, the United States of America dollar, the British Pound, the South African Rand, the Euro and the Botswana Pula among others as legal tender in business transactions in the country brought the much need relief and economic stability which had eluded policymakers for a whole decade. However, under the new economic dispensation insurance companies must meet and maintain a minimum regulatory capital to support their underwriting activities. The companies are now facing serious challenges in complying with the new regulations and some have since had their operating licences cancelled by the Insurance and Pensions Commission (IPEC). This paper recommends mergers and acquisition and proactive capital management strategies to save the industry from collapse and ensure that it continues to play its critical role in the socioeconomic development of Zimbabwe.

Keywords: *Insurance, minimum capital requirements, IPEC, mergers and acquisitions, capital management strategy*

1.Background

The Zimbabwe insurance sector was not spared by the economic meltdown that ravaged the country from 1998 to 2008. According to the Zimbabwe Insurance Survey (2007) capital bases of insurers were progressively eroded over the period from US$600 million in 1998 to an estimated US$2 million in 2008. The insurers' woes were compounded when Zimbabwe adopted the multicurrency system in February 2009. The change-over from the Zimbabwe dollar to a multicurrency system brought the much needed economic stability and sanity that had eluded policymakers for years. However, the system was not backed by significant inflows of foreign currency either from exports or foreign direct investment and the whole economy is now reeling under a liquidity crunch (Biyam, 2010). The industry capacity utilization that had on average sunk to as low as below 10% of installed capacity in 2008 has been on steady rise since 2009. However, economic activity remains over all subdued as most sectors are having challenges in securing lines of credit to kick start their operations. Capacity utilization for the manufacturing sector, the major consumer of insurance services in Zimbabwe, is shown in figure 1 below:

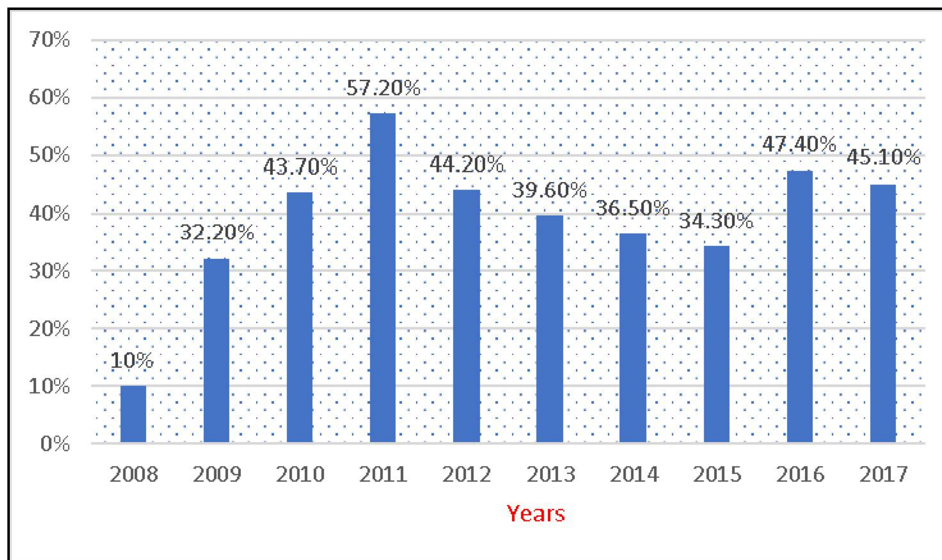

Figure 1: Capacity utilisation in the manufacturing sector of Zimbabwe: - 2008 - 2017
Source: Adapted from CZI State of the Manufacturing Sector Surveys

The imprecision cast by Figure 1 above is not so good for the economy in general and the insurance sector in particular. Insurance is a risk transfer mechanism available to corporates, manufacturing companies and downstream industries included. The subdued activity in the manufacturing sector has also seen a stagnation in the volumes of business generated and underwritten by non-life insurance companies in Zimbabwe. Figure 2 below shows performance of the non-life insurance companies in terms of gross written premiums (GPW) from 2008 to 2016:

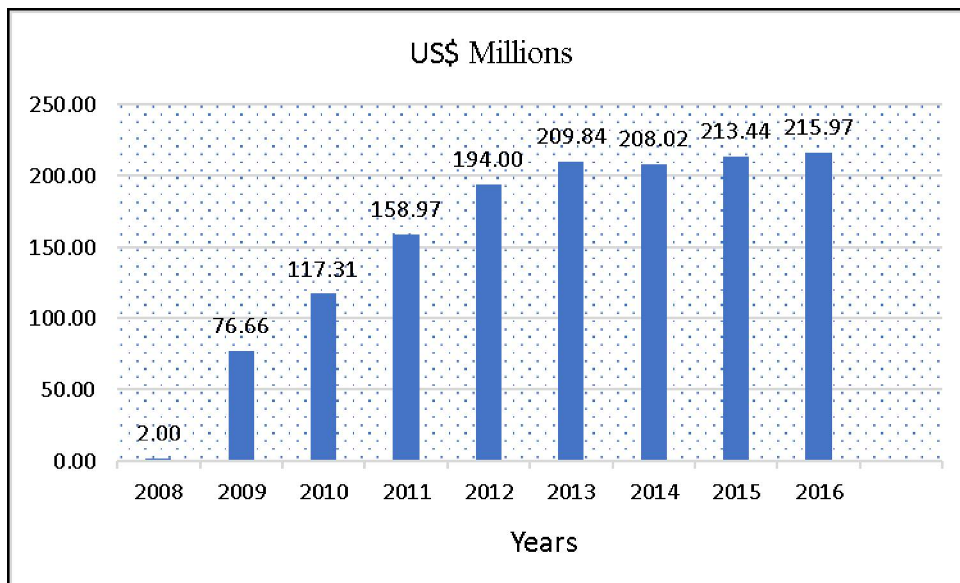

Figure 2: Gross Premiums Written by Non-Life Insurance companies:-2008-2016
Source: Adapted from IPEC Reports

A worrying trend in the PEC reports for the above period is the oligopolistic nature of the market where 75% of business is underwritten by only 5 companies of the 20 registered players in the sector. Another trend is the composition of the business. It has since 2009 remained skewed towards motor and fire business with the other nine classes of insurance business contributing the balance. According to IPEC (2017) in the year ended 31 December 2016 the high risk motor insurance business contributed 43% while fire insurance contributed 22% to the total gross premium written. The profitability of the non-life insurance companies is for the period 2009 to 2016 shown in figure 3 below:

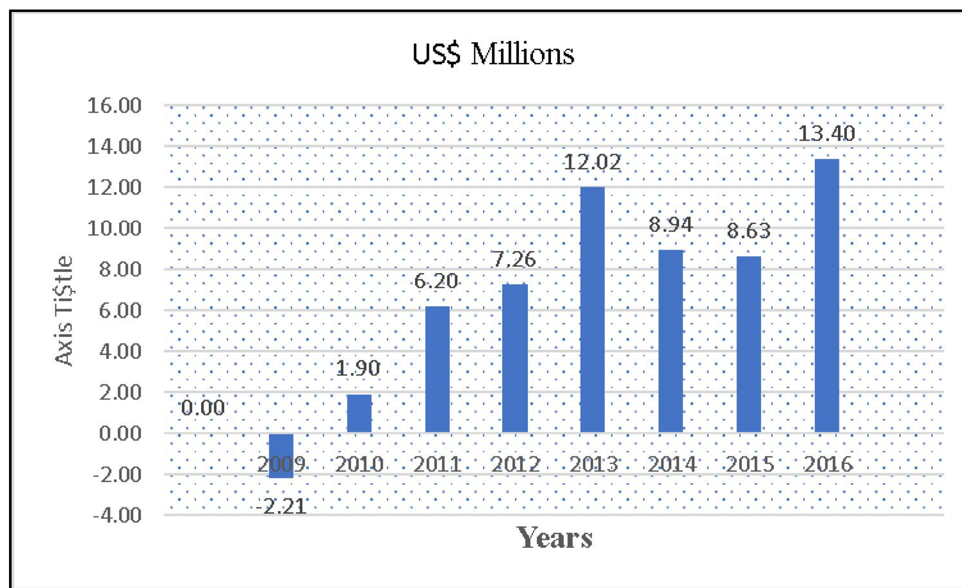

Figure 3: Profitability of Non-Life insurance companies in Zimbabwe: 2009-2016
Source: Adapted from IPEC Reports

Figure 3 above shows that from a loss of $2.21 million recorded in 2009 profitability in the industry have been growing in leaps and bounds. Although performance is in the positive territory, 75% of the profits are attributable to 5 of the 20 registered players. The other 15 are either registering insignificant profits or straight losses consistently.

Despite evidence of mediocre performance by the generality on the non-life insurance companies, IPEC, the regulator has periodically reviewed the minimum capital requirements upwards for the players. In 2009 it was set at US$300000 and has progressively increased over the years to US$2500000 in 2017 as per Statutory Instrument 95 of 2017. Some players over the period have failed to comply with set regulatory minimum capital levels and had their licences withdrawn by the regulator. Since 2009 some eight companies have closed shop, namely, Jupiter, SFG, KMFS, Heritage, Altfin, Suremed, Brownstone and Excellence (IPEC reports). Admittedly insurer default only savers to further erode confidence of the consumer in an industry yawning for much needed growth and profitability.

The Zimbabwe non-life insurance market remains small hen compared to other African states. According to the African Barometer Zimbabwe contributes 2%The Association of Kenya Insurers (2017) states that non-life insurers in Kenya wrote business worth US$1.2308 billion for the year ended 31 December 2016. The premium written in Kenya amounts to 8

2. Literature Review

According to Vaughan and Vaughan (2014) regulation is necessary in the insurance sector in order to protect policyholders. Protection is required against insolvency and unfair and deceptive practices by insurance companies. Gubisic and Leadbetter (2007) note that policyholder confidence in the property and casualty insurance industry is fundamentally based on the belief that insurance contracts will be fulfilled and eligible claims paid. Regulators in various jurisdictions are keenly interested in insurance company capital management and ultimately policyholder protection. In Zimbabwe the transaction of insurance business is regulated by the Insurance and Pensions Commission (IPEC). According to Statutory Instrument 95 of 2017, IPEC currently requires that a non-life insurance company shall have a minimum unencumbered capital requirement for registration or ongoing operations equal to two million five hundred thousand United States dollars. The deadline for compliance was set at 31 December 2017. Gubisic and Leadbetter (2007) add that capital is the money, property, and invested assets which collectively represent the wealth of an insurance company. The authors add that regulatory capital is a critical metric by which the solvency of an insurer is assessed. Regulatory minimum capital is a moving target that must be continuously reviewed in line with developments in the marketplace. For example in Zimbabwe , IPEC has cited the need to enable direct insurance companies to retain more of the premium written and promote their organic growth and ultimately increase the protection of policyholders as compelling reasons for continuous reviews in minimum capital requirements. For the quarter ended 30 September 2017 8 of the 20 registered players in the sector had compiled with the remainder working towards compliance. Previous capital reviews have seen some players losing the operating licences. The current review is no exception and comes against a devastating liquidity crunch. Raising additional capital from the financial markets hence may be a challenge.

According to The Geneva Association (2016 regulatory capital requirements are meant to guarantee policyholder protection even if the insurer's loss experience exceeds the assumptions made when the liabilities were assumed. The Geneva Association adds that regulators will intervene if an insurer ceases to comply with set regulatory capital levels. To this end insurers must be proactive and maintain capitals levels above the set regulatory levels. This ensures that the risk of default is

minimized. For example, maintaining a capital buffer ensures that an insurer can withstand a spike in the loss experience and still be able to meet its future claim obligations. The Geneva Association (2016) notes that in addition to maintaining a buffer capital, an insurer must also have excess capital as a strategy to minimize default on obligations to policyholders. Excess capital implies holding assets in excess of liabilities assumed and existing regulatory capital requirements. Management of an insurance company must view capital maintenance as an ongoing process to avoid unpleasant surprises in the underwriting experience. Management must make a decision on levels of capital based on their realistic assumptions about the future. Capital provision made on this basis is economic capital. From the literature review above, it can be concluded the set regulatory capital requirements for insurers should be a guide and not the ultimate. Every insurance company is unique and management must be alert to that and err of the side of caution by ensuring that their company has more capital to help it weather an unexpected loss experience. Previous studies have focused on the need to comply with set regulatory capital levels without considering the business environment. These have proffered a generic model which does not operate in all environments, for example that which subsists in Zimbabwe characterized by a liquidity crunch. This study attempts to interrogate that limitation.

3. Methodology

Stratified sampling was employed in segregating non- life insurance companies complying and those not complying with Insurance and Pensions Commission minimum capital requirements of US$2500000 as at 30 June 2017. According to IPEC (2017) as at 30 June 2017 of the 20 registered non-life insurance companies in Zimbabwe, 11 were in compliance with the set minimum capital requirements while 9 were not. A questionnaire containing both open ended and closed questions was used to collect data from senior executives of randomly selected non-life insurance companies. In addition personal interviews were conducted with the senior executives and the regulator.

4. Results and Discussion

The study revealed that legacy issues continue to adversely affect the financial stability of non-life insurance companies in Zimbabwe, nine years after the adoption of the multicurrency system. There was no smooth transition from the Zimbabwe dollar era to the new currency dispensation and as a result building assets to support underwriting activities remain a challenge for most insurers. The study revealed that complying insurers are members of a group of companies with the holding company currently listed or having been listed on the Zimbabwe Stock Exchange from 2009 to 2016 or have managed to entice a foreign investor. The listing on the public stock exchange has lightened the burden of raising additional resources when there is a capital call from the regulator. Existing legislation on indeginisation may need to be relaxed for the insurance sector of the economy in order to attract more foreign capital The study also revealed that although listing on the Zimbabwe stock exchange remains an option, under the current liquidity crunch it may not be possible as getting an underwriter for the new listing or rights issues will be very difficult. The study also revealed that most non-life insurance companies do not have proactive capital management strategies in place. In fact, most companies are maintaining just sufficient capital to enable them retain their operating licences. There is no buffer capital maintained in most cases, hence the challenges faced in either meeting unexpected losses or even complying with new regulatory capital levels, The regulator has been very patient with non-life insurance companies as the increase in the capital reviews have been very modest and compliance to same allowed on a staggered basis. However, the operating business environment has not been supportive as losses continue to be experienced and raising of additional capital from retained earnings remains a mammoth task. The study revealed that the Zimbabwe non-life insurance market is not only small but is also populated with too many players. The regulator is aware of this and has encouraged but not compelled the small non-life insurers to consider mergers and acquisitions as a compliance strategy. Mergers and acquisitions will reduce the number of risks profitably and contribute to the socioeconomic development as corporate citizens.

5. Acknowledgements

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