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Corporate Governance and Firm Efficiency in The Long-Term Insurance Market in South Africa

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Abstract

This paper examined the effect of corporate governance mechanisms on the technical efficiency in the South African long-term insurance industry using data on 73 long-term insurers from 2007 to 2014 in a two-stage data envelopment analysis (DEA) analysis. In the first stage, firm efficiency is estimated using the DEA bootstrapping technique of Simar and Wilson (2007), which corrects for biases associated with non-parametric techniques. In the second stage analysis, the truncated bootstrapping regression technique is employed to examine the effect of corporate governance on the estimated efficiency scores. The corporate governance variables used were board size, board independence, audit committee size, CEO tenure and audit independence, while controlling for firm size, reinsurance usage and leverage.

The findings indicate that long-term insurers in South Africa operated at approximately 21% of their optimal capacity which suggests high levels of inefficiency in the provision of life insurance services. The results of the second-stage analysis identify board size, non-executive directorship, CEO tenure and audit independence as the significant corporate governance indicators that impact on efficiency over the study period. In addition, firm size, reinsurance usage and leverage were also observed to be significantly related to the estimated efficiency scores.

The findings suggest that non-executive directors are not as effective as expected, which may be due to a myriad of reasons, such as under-representation on sub-committees, a lack of relevant skills, experience or financial expertise. Insurers should use more stringent criteria to screen potential non-executive directors and provide training and regular updates to adequately capacitate the non-executive directors with the necessary skills and knowledge. The positive relationship between CEO tenure and efficiency suggests that frequent CEO rotation is not advisable.

Keywords: Corporate Governance ǀ Efficiency ǀ Long-term insurance ǀ South Africa