Risk Management Practices And Financial Performance Of Commercial Banks In Kenya

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ABSTRACT

In the contemporary world risk management and financial performance in financial institutions especially commercial banks has gained momentum. Using KCB, this study investigated the effects of risk management techniques on the financial performance of commercial banks. The study was informed by network theory, expectation theory, and enterprise risk management theory. The study employed descriptive research design. The study's population consisted of 460 management personnel from KCB Headquarters and its Nairobi County branches. The target group consisted of 46 middle and upper-level managers from KCB in Nairobi County. Since the study's target population was so small, a census technique was employed. The study employed a semi-structured questionnaire to collect data. The data collection tool's validity and reliability were assessed. Both descriptive and inferential statistics were computed using SPSS Version 27.0. The moral implications were considered. The results showed a strong positive relationship between organizational effectiveness and risk transfer. Furthermore, it was shown that risk avoidance contributed very little to the success of the company. Nevertheless, it was found that risk control had very little negative effect on the functioning of the company. Furthermore, it was discovered that risk retention considerably increased organizational performance. Lastly, government regulations had no impact because the association between the predictors and response variable remained same. The report recommended that KCB should put in place robust risk transfer and retention policies in order to enhance organizational financial *performance. In order to safeguard banks from risks related to the banking sector, the report also recommended that the Central Bank of Kenya offer policy interventions in the form of strategic risk management technique.*

Keywords – Risk Transfer, Risk Prevention, Risk Control, Risk Retention, Government intervention, Financial Performance,

INTRODUCTION

Risk management practices refers to the process through which organizational management determines how to mitigate and effectively handle risks associated with business operations. It serves as a fundamental element in realizing the organization's vision and enhancing its performance. According to Al Zaidanin (2021) an organization's perspective on strategic risk management practices determines the kind and extent of the risks it faces in response to the challenges and opportunities. The effects of risk and uncertainty on most businesses have been substantial. Hence, businesses need to keep an eye on these practices and exert some degree of control in its environment related to risk, uncertainty and the consequences they may produce.

Organisational performance, as defined by Tahir (2020), refers to quantification of outputs in respect to inputs used. This infers that it entails a quantification of outputs in view of resources that have been expensed to earn the outputs. According to Abdul (2019), organizational performance helps to shape the actions and behaviours of the organizations.This author further noted that organizational performance is measured through customer satisfaction, cost reduction, cost efficiency, social responsibility, quality of services among others. This study focused on customer satisfaction, cost reduction and social responsibility. To attain such performance, organizations must effectively use their resources through effective dealing on risks right from establishing the

existence of risks to control of risks (Harari et al., 2017). Where robust risk mitigation strategies are put in place, firms experience improved performance (Sorle, 2019). This is because risk planning has become an integral aspect of business management. Inefficient mitigation of risk is a sensitive driver of business regardless of the size of the entity. Therefore, an organization may lessen the effect of risks and take up business chances in a highly competitive business world through adopting strategic risk management practices and improve its performance.

LITERATURE REVIEW

EMPHIRICAL LITERATURE REVIEW

According Macharia and Kiiri (2018) evaluated the success of construction projects in public secondary schools in Murang'a county, Kenya, as well as the efficacy of the risk transfer method. The purpose of this study was to investigate how risk transfer techniques affected the construction project performance of public secondary schools in Kenya's Murang'a County.

A judgmental or purposive sampling technique was utilized in conjunction with a descriptive research design to choose public secondary schools in Murang'a County for study participation. Primary data gathered by means of questionnaire administration were employed in the study. The information was then distilled and subjected to both descriptive and inferential statistical analysis. The usage of frequency tables, standard deviation, mean, and mode is part of descriptive statistics.

Regression analysis, on the other hand, is used inferential statistics to analyze quantitative data. Because of the risk transfer strategy's maximum beta coefficient value of 0.265, it was shown to have a minimal effect on construction project performance. The risk transfer technique has a significant effect on the success of construction projects in secondary schools, according to an examination of research findings. Furthermore, there is a favorable association between performance and the risk transfer technique according to the correlation analysis. This study makes a compelling case for more investigation into the effects of risk management on the performance of construction projects in the education sector in public secondary schools, colleges, and institutions in other countries. However, the previous study had a specific focus on the construction sector, but the upcoming study would have a specific focus on commercial banks. However, the findings were inconclusive and could not be applied in commercial institutions. There is a discrepancy in context, as these studies emanate from different sectors.

Singh et al., (2020) did a study to investigate the impact of risk prevention practices in Indian construction enterprises. The study used a descriptive research strategy and built questionnaires from the ground up. It used a structured questionnaire to collect data. The study surveyed 152 participants, including managers, team members, supervisors, and general managers from three different construction companies. The data analysis was done using SPSS version 23.0. The results showed that the three construction companies influenced the outcome of the construction projects through risk prevention techniques such safety inspections, safety systems, contingency, and a thorough work plan. Furthermore, the results of the study showed non-traditional methods of risk prevention. However, this study did not have any support from theories, while the current study will be supported by three theories. There is a theoretical framework gap, since the former study did not have any support from theories, while the current one is grounded into theories.

In another study, Okumu and Wanjira (2018) studied the risk prevention practices and performance of Kenyan insurance companies. The study used a descriptive research approach, and the sample population comprised of 18 auto-insurance providers. It interviewed 44% motor insurance industry staff members and management were interviewed using a combination of simple random sampling and selective sampling. Data collection in this study was accomplished through the use of self-administered questionnaires. Descriptive statistics and content analysis were then used to make sense of the information gathered.

Pimchangthong and Boonjing (2019) assessed the effect of risk control procedures on IT project performance in a different study. Using a descriptive research approach, 200 IT experts who work as project managers, managers, and analysts were interviewed for the study. Using the questionnaires, the researcher was able to obtain answers from the study participants on both closed- and open-ended topics. To analyze the data, descriptive statistics were employed. multiple linear regression, independent Sample t-test, one-way ANOVA, and at the 0.05 level of statistical significance. According to this study, risk management is a key factor in high performance. This study, however, concentrated on IT initiatives for businesses, whereas the current study will concentrate on commercial banks, which run differently.

Ubani et al.'s (2018) study examined the impact of risk management techniques in Nigeria's construction industry. The survey's respondents included consultants, clients, and contractors in the construction sector. A case study research methodology was employed in the study. There were 84 respondents to the poll, making up the sample size. In order to gather the data required for the study, questionnaires were distributed to fifteen distinct construction companies. After taking into account the possible losses and costs associated with alternative risk management strategies, construction enterprises adopted risk retention via active

retention by obtaining self-insurance, according to an analysis of the data gathered using SPSS version? The findings of this study provide more evidence in favor of the hypothesis that risk retention enhances the performance of construction companies.

Aimable et al. (2020) studied in Rwanda to find out how risk control techniques improved the effectiveness of building projects made feasible by RBSS multi-story building projects. The population of the study, which employed a descriptive research design, was made up of 291 project teams dispersed throughout 4 administrative regions. A total of 169 individuals were selected at random to take part in the research. This study's methods for gathering and analyzing data included in-depth interviews, a review of pertinent literature, and questionnaires with preset answers. The analysis found that the construction company has both a crisis management plan and a disaster recovery plan in place in the event of natural disasters like hurricanes. The study found that projects whose managers retained some of the associated risks performed better.

Naktari (2018) studied the impact of humanitarian risk control measures on nongovernmental organizations in West Pokot. The study used a descriptive research approach, and the population included all West Pokot-based humanitarian NGOs. Structured questionnaires containing both open-ended and closed-ended questions were used in the research. The study used content analysis and descriptive statistics to make sense of the information gathered. The research found that NGOs have implemented contingency plans to deal with the financial, operational, and strategic risks they faced. The research also found that the NGOs put into place elaborate disaster recovery and crisis management procedures.

Yet, Ali et al., (2019) carried out a study on risk retention strategies and project performance in the construction industry. The study sought to determine how construction handled risks in Pakistan. The study used a descriptive research approach, and its participants were actual construction workers, managers, and teams. The study sampled 40% participants using structured questionnaires, and the results were analysed statistically with descriptive and inferential statistics. While inferential statistics was conducted using correlation analysis, which shows a positive relationship between risk retention measures and project performance, descriptive statistics were represented by mean and standard deviation in tables.

THEORITICAL LITERATURE

2Enterprise Risk Management Theory

ERM is a risk management philosophy that promotes and encourages the measurement and management of significant risk facing a particular institution as a whole as opposed to the management of each risk independently. Its primary objective is to unify several departments responsible for handling risks into a single, cohesive system. When it comes to analyzing and responding to a wide variety of risks facing a firm, the ERM risk management framework places an emphasis on the participation of senior corporate leaders and staff. The concept behind this term is to involve all members of a business in strategic risk management procedures, not just a chosen few. The ERM highlights the importance of having clear policies and processes in place for dealing with possible risks. As per Olson and Wu (2010), the theory also validates that by implementing explicit rules that outline risk appetite, strategic goals, tolerance, and systematic processes, businesses can improve their ability to identify, analyze, and handle risks.

Creating a culture of strategic risk management practices, where everyone has a voice and is held responsible for handling risks, is another key component of the method. ERM procedures increase long-term viability, stakeholder confidence, and competitive advantage (Cormican, 2015). Despite its origins in the management of corporate risks, the ERM theory has found widespread application in the banking sector. According to Drumll (2001), the banking industry has a high failure rate due to the financial risks linked with the banking industry, hence it is essential to adopt the ERM concept.

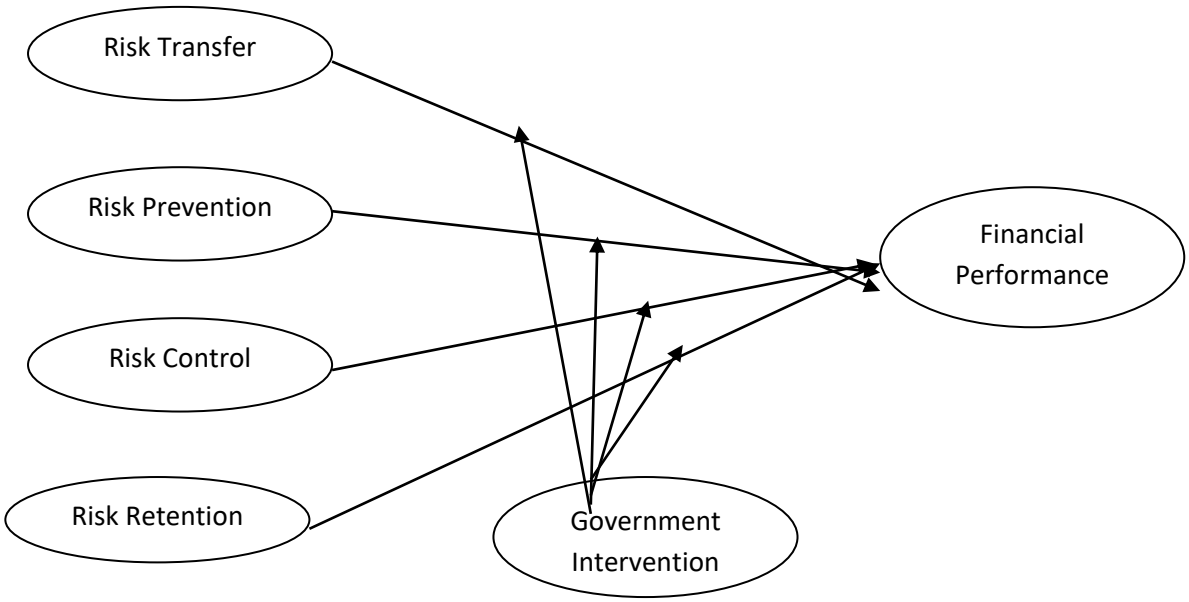
Therefore, this theory was pertinent to this study because it focused on the strategic risk management practices of commercial banks, and these failures were thought to occur as a result of a failure to identify, mitigate, and control risk across the entire organization. This therefore was therefore important towards the current study as it tended to encourage the management to look at the organization as one unitary unit and collaborate all the units towards addressing the risks that the organization faces (Drumll 2001).

Enterprise risk management (ERM) theory is a framework that helps organizations identify, assess, and manage risks that could impact their objectives and goals. ERM theory is based on several assumptions, including the idea that risks are inevitable and that organizations must proactively manage them to achieve success. ERM theory also assumes that risks can be managed through a structured approach that includes risk identification, assessment, prioritization, response, and monitoring (Drumll 2001).

While ERM theory has been widely adopted by many organizations, it has also faced some criticism. Some critics argue that ERM theory is too focused on process and not enough on outcomes. Others argue that ERM theory is too complex and difficult to implement effectively. There have also been instances where ERM theory has failed to prevent major risks, such as the global financial crisis of 2008 (Drumll 2001). Despite these criticisms and failures, ERM theory has also been successful in many instances. For example, ERM theory has helped organizations in the healthcare industry to identify and manage risks related to patient safety and quality of care. ERM theory has also been useful in the banking industry, where it has helped banks to identify and manage risks related to credit, market, and operational risks (Drumll 2001).

In recent years, there have been revisions to ERM theory to address some of the criticisms and challenges associated with the framework. One of the most significant revisions has been the inclusion of strategic risk management, which focuses on identifying and managing risks that could impact an organization's strategic objectives and goals. Other revisions include a greater emphasis on risk culture and risk governance, as well as the use of technology to improve risk management processes (Drumll 2001). This theory anchors the dependent variable and the independent variable.

Conceptual Framework



Independent Variables **Intervening Variable** **Dependent Variable**

DATA ANALYSIS AND PRESENTATION

Correlation Analysis

Correlation analysis refers to a measure of the degree of relationship between the variables. The statistical relationship between risk transfer, risk prevention, risk control and risk retention and financial performance at 5% level of significance, was determined using the IBM statistical package for social sciences (SPSS) version 27.0.

Correlation Analysis

Correlations Analysis		1	2	3	4	5
Financial Performance	Pearson Correlation	1				
	Sig. (2-tailed)					
	N	43				
Risk Transfer	Pearson Correlation	.653**	1			
	Sig. (2-tailed)	0.002				
	N	43	43			
Risk Prevention	Pearson Correlation	.455*	.823**	1		
	Sig. (2-tailed)	0.019	0			
	N	43	43	43		
Risk Control	Pearson Correlation	0.104	-0.29	-0.11	1	
	Sig. (2-tailed)	0.505	0.059	0.482		
	N	43	43	43	43	
Risk Retention	Pearson Correlation	0.329*	0.025	0.205	.571**	1

	Sig. (2-tailed)	0.000	0.002	0.007	0	
	N	43	43	43	43	43

** Correlation is significant at the 0.01 level (2-tailed).

* Correlation is significant at the 0.05 level (2-tailed).

The Table presents correlation coefficients (r) and p-values for the relationships between four strategic risk management practices (risk transfer, risk prevention, risk control and risk retention) and organizational performance. Based on the illustration above, risk transfer has the strongest positive significant relationship with financial performance as r (0.653); p = 0.002. Followed by the risk prevention also with a positive significant relationship with organization performance as r (0.455); p = 0.019; followed by risk retention which has a positive significant relationship with organization performance with r 0.329); p+0.000 and finally risk control which has no significant relationship with financial performance with r (0.104); p=0.505.

It can be concluded that there exists a positive significant relationship between the independent and dependent variables since the P-Values are less than the chosen significant level of 5 %. The implications could be that risk transfer (eg. Insurance) seems to seem to be particularly effective in enhancing financial performance. This might be due to the ability to shift financial burdens associated with risks to external parties. Risk prevention strategies, such as training and safety measures, can also positively impact performance, but perhaps to a lesser extent than risk transfer. Risk retention might be a viable strategy in certain cases, but it's important to carefully assess the potential consequences of retaining risks. Risk control strategies, such as implementing procedures and policies, might not have a significant impact on financial performance in this specific context. This could be due to various factors, such as the nature of the risks being controlled or the effectiveness of the control measures. These findings are in accordance with Macharia and Kiiri (2018) who assessed the effectiveness of the risk transfer strategy and performance of construction projects in public secondary schools in Murang'a County, Kenya. The study found a positive relationship between risk transfer approach and performance indicates a positive relationship with a p value of 0.000. Similarly, Singh et al., (2020) found a positive correlation between risk prevention practices and construction firms' performance in India.

Additionally, Pimchangthong and Boonjing (2019) determined that risk control practices positively influenced performance of IT projects with R2 0.866.

Regression Analysis

A linear regression analysis was performed to determine the effects of risk management practices on organization performance.

Regression Model Outputs

This study sought to determine the effects of strategic risk management practices on the financial performance of commercial banks, a case of KCB, Nairobi County. The dependent variable was organization performance while the independent variables are risk transfer, risk prevention, risk control and risk retention. Table below presents the Model Summary, ANOVA statistics and regression coefficients.

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.760a	0.511	0.528	0.50801
2	.637b	0.406	0.326	0.44665

a Predictors: (Constant), Risk Retention, Risk Transfer, Risk Control, Risk Prevention
b Predictors: (Constant), Risk Retention, Risk Transfer, Risk Control, Risk Prevention, Government Regulations

The R-value, which was 0.760, from of the model summary demonstrated the basic correlation between the performance of the organization and information technology hardware, software, and asset management. This suggests that risk transfer, risk retention, risk control, and risk prevention have a very favorable link with the success of the organization.

The R-squared value of 0.511 indicated the extent to which risk transfer, risk retention, risk control, and risk prevention accounted for the variance in the performance of the organization. The Adjusted R-Squared value was 0.528, or 52.8%. This means that risk transfer, risk retention, risk control, and risk prevention account for 52.8% of the variance in the performance of the organization, while other variables not included in the current study account for 47.2% of the variation. With an R2 of 0.866, Pimchangthong and Boonjing (2019) found that risk control procedures had a beneficial impact on IT project performance.

Analysis of Variance (ANOVA)

The researcher used the ANOVA test to determine the influence that risk transfer, risk prevention, risk control and risk retention have on organization performance in a regression study. The ANOVA results are indicated in

Analysis of Variance

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	2.627	4	0.657	2.545	.002b
	Residual	9.807	38	0.258		
	Total	12.434	42			
2	Regression	5.053	5	1.011	5.066	.001c
	Residual	7.381	37	0.199		
	Total	12.434	42			

a Dependent Variable: Organization Performance
b Predictors: (Constant), Risk Retention, Risk Transfer, Risk Control, Risk Prevention
c Predictors: (Constant), Risk Retention, Risk Transfer, Risk Control, Risk Prevention, Government Regulations

Source: Survey Findings (2024)

The probability of observing a value greater than or equal to F value of 2.545, whose P (value) is 0.000, is shown in Table above ANOVA results. This suggests that the regression model is a good fit for the data and statistically predicts the outcome variable, making the study statistically significant. The F test statistic's P-value is less than 0.005, which is strong evidence of the model's goodness of fit. As a result, we reject the null hypothesis and come to the conclusion that financial performance is greatly impacted by risk transfer, prevention, control, and retention.

Regression Coefficients

Regression coefficients were used to characterize the relationship between a predictor variable and the response, with the estimates of the unknown population serving as the parameters. Table below displays the regression coefficient results.

Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.403	0.382		6.295	0.001
	Risk Transfer	0.246	0.130	0.513	1.891	0.006
	Risk Prevention	0.019	0.127	0.039	0.147	0.884
	Risk Control	-0.051	0.108	-0.088	-0.466	0.644
	Risk Retention	0.053	0.116	0.084	0.453	0.003
2	(Constant)	0.983	0.528		1.862	0.007
	Risk Transfer	0.125	0.120	0.26	1.045	0.003
	Risk Prevention	0.019	0.112	0.041	0.174	0.863
	Risk Control	-0.134	0.098	-0.234	-1.362	0.182
	Risk Retention	0.111	0.103	0.178	1.074	0.000
	Government Regulations	0.705	0.202	0.544	3.487	0.001

a Dependent Variable: Organization Performance

The analytical model is indicated as follows:

$Y=0.983-0.125X_1-0.019X_2+0134X_3-0.111X_4+0.705X_5+ \varepsilon$

The Table above displays the coefficients of risk retention, risk prevention, risk control and risk retention including the corresponding t statistics and p-values. The beta column of the standardized coefficients showed that risk transfer had strong positive relationship with financial performance ($\beta=0.246$, $p<0.05$). This implied that an increase in risk transfer in one unit increased financial performance by 0.246 units. It was also found out that risk prevention had weak positive effect on financial performance. ($\beta=0.019$, $p<=0.884$). This implied that an increase in risk prevention increased financial performance by 0.019 units. However, it was found out that risk control had weak negative effect on financial performance. ($\beta=-0.051$, $p=0.664$). Thus an increase in risk control lead to a decrease in financial performance by 0.051 units. In addition, it was found out that risk retention had strong positive effect on financial performance ($\beta=0.053$, $p<0.05$). This implied that risk retention improved financial performance as a rise in risk retention by one unit increased organizational performance by 0.053 units. Lastly, government regulations did not have any intervening effects as the nexus between the predictors and response variable remains as was before intervening.

Excluded Variable a

Model	Beta In	T	Sig.	Partial Correlation	Collinearity Statistics
					Tolerance
1 Government Regulations	.544b	3.487	0.001	0.497	0.658

a Dependent Variable: Organization Performance
b Predictors in the Model: (Constant), Risk Retention, Risk Transfer, Risk Control, Risk Prevention

Based on the findings, KCB Nairobi County's organization performance is 0.840 when variables pertaining to strategic risk management strategies are absent. This coefficient, which has a t=3.487, p=0.0%, shows that the usual uncategorized components have a statistically significant impact on organization performance when there are no other factors linked to strategic risk management methods. Organization performance will increase by 0.392 units for every unit increase in risk transfer, assuming no other factors are at play. Furthermore, an increase of one unit in risk prevention will result in a 0.275 unit gain in organization performance, but an increase of one unit in risk control will yield a 0.142 unit gain in performance. These findings are in line with Pimchangthong and Boonjing (2019) who determined that risk control practices positively influenced performance of IT projects with R2 0.866..

CONCLUSION AND RECOMMENDATION

The results showed a strong positive relationship between organizational effectiveness and risk transfer. Furthermore, it was shown that risk avoidance contributed very little to the success of the company. Nevertheless, it was found that risk control had very little negative effect on the functioning of the company. Furthermore, it was discovered that risk retention considerably increased organizational financial performance. Lastly, government regulations had no impact because the association between the predictors and response variable remained same. The report recommended that KCB should put in place robust risk transfer and retention policies in order to enhance organizational financial performance. In order to safeguard banks from risks related to the banking sector, the report also recommended that the Central Bank of Kenya offer policy interventions in the form of strategic risk management techniques.

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