# EFFECTS OF RISK MANAGEMENT ON FINANCIAL STABILITY OF STATE CORPORATIONS IN KENYA: A SURVEY OF TOURISM FUND (TF) AND KENYATTA INTERNATIONAL CONVENTION CENTRE (KICC)

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## ABSTRACT

Financial stability plays an important role in economic growth and leads to sustained development. As such, financial stability is gradually emerging as a distinct policy function Garry J. Schinasi (2006). A large number of studies on risk management have been carried out on performance of banks and insurance but little has been studied on effects of risk management on financial stability in State Corporation in Kenya. This study aimed at addressing the challenge of ever emerging risks within the State Corporation. The study, therefore, would fill the gap in knowledge about the possible existence of a relationship between risk management practices and financial stability in State Corporations in Kenya and the nature of the relationship. The aim of the study was to determine the effect of risk management on financial stability of state corporations in Kenya. This study was quantitative in nature and employed an explanatory research design. This was because the study intended to provide an understanding of the relationships among the research variables. The study concentrated on only tourism sector state corporations because it was expected that the players had the relevant and accurate information needed in this study. This study used a purposive sampling design to select 2 state corporations in the tourism sector from a total of 187 state corporations. Descriptive and inferential statistics were used to analyze information generated from respondents. In order to ensure ethical considerations were maintained, the identities of respondents filling the questionnaires were kept anonymous by not requiring them to indicate their names on the questionnaires. The study found out that in financial risk management; credit default risk management facilitate financial stability in the corporation, the process of financial risk management is continuous in state corporations, and that state corporations have put in place measures to mitigate liquidity risk. The respondents further indicated that financial risk management could be improved through diversification, investing sooner than later and learning about Investments. The study revealed that in terms of operational risk management; Controls were in place to evaluate the efficiency of operational risk management in the state corporation, People risk was a continuous risk in state corporations, a lot of organization resources had been directed to information technology risk management, Operational risk is highly appreciated in the state corporations. It was also noted that through operational risk management, a corporation could carry out risk-audit activities, assessments of operational risks and prepare recommendations for risk mitigation. It was noted that majority of the respondents were of the view that in terms of marketing risk management; Foreign exchange risk is one of the most complex areas of risk management in state corporations in Kenya, financial stability in state corporations can be improved by management of interest rate risk, market risk management is a continuous process in the organization and current approaches to equity risk management in state corporations are fit for purpose. The study found out that strategic risk management is crucial for success of any state corporation, strategic

risk management process enhances financial stability, Corporate governance risk management in place are satisfactory and the organization is quick and flexible to identify and tackle innovation risks. The study also found out that financial risk management, operational risk management, market risk management and strategic risk management influenced financial stability in state corporation ($r^2$ = 73.9%). In conclusion, the proposed framework of the study was able to demonstrate strong explanatory power with financial risk management, operational risk management and strategic risk management emerging as a stronger predictor of financial stability in State Corporations in Kenya.

***Key Words:*** *risk management, financial stability, state corporations, Kenya, Tourism Fund (TF) and Kenyatta International Convention Centre (KICC)*

## INTRODUCTION

Financial stability is a condition in which an economy's mechanisms for pricing, allocating, and managing financial risks; credit; liquidity, counterparty and market are functioning well enough to contribute to the performance of the economy. The three important aspects involved in comprehensive assessment of financial stability include identifying the plausible and systemically important sources of risks and vulnerabilities that could pose challenges to financial stability in future; an appraisal of the potential costs, that is, the ability of the financial system to cope, should some combination of these identified risks and vulnerabilities materialize; and forming a judgment about the individual and collective strengths and robustness of the constituent parts of the financial system; institutions, markets and infrastructures. In addition, aspects such as; taking steps to counteract risks and vulnerabilities and/or strengthening the financial system and/or its constituent parts if there is a chance that certain risks and vulnerabilities could overwhelm the financial system and the resulting costs are considered to be too great crisis management and resolution arrangements. Safeguarding financial stability, therefore, has become an increasingly dominant objective in economic policymaking as it has all the essential characteristics of a public good. Nearly 50 central banks and other international agencies such as the International Monetary Fund IMF now publish regular reports on financial stability. It can be summarized that financial stability is key in state corporations since it facilitates proper functioning of the financial system and economic growth in the long run. Therefore financial stability is the ability of a state corporation to maintain an efficient finance system that is able to absorb shocks that result from various types of risks (Schinasi, 2005).

Risk is defined as possible events whose unfavorable consequences are difficult to accept or are even unacceptable (Tsai, 2012). It is also defined as the uncertainty associated with a future outcome or event (Banks, 2004). Further, risk is a concept that denotes a potential negative impact to an asset or some characteristic of value that may arise from some present process or future event (Douglas & Wildavsky, 1982).

Rejda (2008) defines risk management as the process through which an organization identifies loss exposures facing it and selects the most appropriate techniques for treating such exposures. Risk management is the identification, analysis, and treatment of an economic entity's exposures to loss. In this time of increasing technology and complexity, there are more things that can go wrong, i.e. more exposures to loss (Corbett, 2004). In risk management, a prioritization process must be followed whereby the risk with the greatest loss and greatest probability of occurrence is handled first and risks with lower loss are handled later (Stulz, 2003).

There is however, no specific model to determine the balance between risks with greatest probability and loss and those with lower loss, making risk management difficult. Banks (2004) notes that the key focus of risk management is controlling, as opposed to eliminating, risk exposures so that all stakeholders are fully aware of how the firm might be impacted. Risk management enables an organization progress toward its goals and objectives in the most direct, efficient and effective path. In this modern era of doing business, the focus is to maximize the use of available resources and to deliver targets consistently in a sustainable manner. Therefore risk management can assist state corporations achieve financial stability through effective management, early identification of risk prune areas and management of the same to prevent financial crisis.

State Corporations are state owned entities established under the State Corporations Act, chapter 446 of the laws of Kenya. They were formed to provide strategic and essential services to the Kenyans such as electricity, railway transport and port services. According to Kenya gazetteof April 2015 there are 119 parastatals. According to Odoyo Fredrick S (2014) the initial thought of setting up these organizations was noble, but most of the political leaders at the time were capitalists and the vision got lost along the way. Influential individuals turned to these enterprises with a single desire to reap maximum personal benefits at the expense of the rest of the public. This led to mismanagement and therefore massive losses. To stem some of these losses, an attempt was made to shed off some of the government shareholding to private investors by issue of shares through the Nairobi Stock Exchange. However, as it is seen in the management of such firms, as National Bank of Kenya and Kenya Commercial Bank, the government still maintains a substantial shareholding, this creates avenues to reward loyalty by political elites of the day. A case in point is the Kenya Meat Commission (KMC), which collapsed in the early 1990s and it was only in 2006 that it was revived by the government which pumped in KSH 500 million. Therefore it is important that such risks are identified early and management of the same is done to avoid financial instability which leads to their collapse and huge losses on the government and economy as a whole. Therefore risk management is the ability of state corporations to identify and manage the various types of risks effectively to avoid collapse due to financial instability.

**Kenyatta International Convention Centre (KICC)**

The Kenyatta International Convention Centre (KICC) is a State Corporation established under the Tourism Act of 2011 which came into operation on 1ˢᵗ September 2012. It is a meeting venue in Nairobi; its mandate is national in nature, to promote the country as a destination most preferred for business travel and MICE tourism. M.I.C.E has been recognized as one of the four key products to be developed under the Kenya Vision 2030, under the economic pillar. Kenya is Africa's second best international MICE destination, its Won consecutively in the ICCA (International Congress and Convention Association) 2012, 2013 country and city rankings. In order for KICC to achieve its goal it should be financially stable hence this research will focus on how risk management can affect its financial stability.

**Tourism Fund**

Tourism Fund is a state corporate established under the Tourism Act; 2011 which came into operation on 1st September, 2012 vide special issue Kenya Gazette Supplement No. 93 of 24th August, 2012. The Fund is the legal successor to Catering and Tourism Development Levy Trustees (CTDLT). Trustees had been in existence since 1972 and operated under the umbrella of the Hotels and Restaurants Act, Cap 494, Laws of Kenya which was repealed when the Tourism Act; 2011 came into effect. Catering Levy Trustees (CLT) was established in 1 9 7 2 as a corporate body under section 18 of the Hotels and Restaurants Act (Cap. 494, Laws of Kenya). In 1997, through the Finance Act, the name of the Organization was changed to Catering and Tourism Development Levy Trustees (CTDLT), to accommodate additional mandates. CTDLT charged a 2 % levy on all gross sales in hotels and restaurants on account of food, drinks and all other services. The levy was used to finance training, marketing of Kenya as a preferred tourist destination and developing standards for testing the skills required by the tourism industry.

The mandates of CTDLT Board of Trustees were; To collect, control and administer the catering training & tourism development levy Fund; To establish, equip and control such establishments for the training of persons for employment in the hotels and restaurants as the Minister may approve; To Establish and develop national standards for testing skills required by the tourism Industry and to make such payments out of the fund as may be necessary to enable the CTDLT market and promote Kenya as a tourist destination both locally and internationally. However the need to develop and sustain a competitive tourism industry against local, regional and global challenges; the national reform agenda; and the urgency for a sustainable organizational growth, necessitated the transformation of CTDLT to the Tourism Fund through the enactment of Tourism Act 2011. The new Tourism Fund has an expanded mandate that includes diversification of its resource base from Levy Collection to facilitate financing of key tourism activities. In order for Tourism fund to achieve its goal it should be financially stable hence this research will focus on how risk management can affect its financial stability.

## STATEMENT OF THE PROBLEM

Financial stability plays an important role in economic growth and leads to sustained development. As such, financial stability is gradually emerging as a distinct policy function Garry J. Schinasi (2006). State corporations are in the core business of managing risk in accordance to the International Organization for Standardization (ISO) under standard ISO 31000. The Greek crisis had started out as a fiscal crisis and ended as a liquidity problem in the banking sector threatening to turn into a solvency problem Bank of Greece Annual Report (2009). This shows how lack of risk management can result to crisis that may in the long run cause financial instability in state corporations in Kenya. High interest rates do not only discourage further borrowing, but also makes it difficult for existing debtors to repay their loans Collins and Wanjau (2011). In this way, increase in risk of non-performing loans may cause financial instability in financial institutions. Kurawa and Garba (2014) found out that credit risk management as measured by capital adequacy variable has a significant positive effect on financial performance. Therefore state corporations in Kenya should manage risks facing them for a positive impact on their performance which in the long run facilitates financial stability. A large number of studies on risk management have been carried out on performance of banks and insurance but little has been studied on effects of risk management on financial stability in State Corporation in Kenya. This study aimed at addressing the challenge of ever emerging risks within the State Corporation. It attempts to critically examine the various practices through which State Corporation manage the risks that they faced, and determine any relationship between their risk management and financial stability. The study, therefore, would fill the gap in knowledge about the possible existence of a relationship between risk management practices and financial stability in State Corporations in Kenya and the nature of the relationship.

## GENERAL OBJECTIVE

The aim of the study was to determine the effect of risk management on financial stability of state corporations in Kenya.

## SPECIFIC OBJECTIVES

1. To determine the extent to which financial risk management influence the financial stability of state corporations in Kenya.

2. To establish the extent to which operational risk management influence the financial stability of state corporations in Kenya.
3. To examine the extent to which strategic risk management influence the financial stability of state corporations in Kenya.

4. To examine the extent to which market risk management influences the financial stability of state corporations in Kenya.

## THEORETICAL REVIEW

### Contingency Planning Theory

Contingency planning (CP) also known as business continuity planning is a crucial element of risk management. The fundamental basis of Contingency Planning (CP) is that, since all risks cannot be totally eliminated in practice, residual risks always remain. Despite the organization's very best efforts to avoid, prevent or mitigate them, incidents will still occur. Particular situations, combinations of adverse events or unanticipated threats and vulnerabilities may conspire to bypass or overwhelm even the best information security controls designed to ensure confidentiality, integrity and availability of information assets (Hisnson & Kowalski, 2008). CP is defined as the totality of activities, controls, processes, plans. It is the act of preparing for major incidents and disasters, formulating flexible plans and marshaling suitable resources that will come into play in the event, whatever actually eventuates.

The very word 'contingency' implies that the activities and resources that will be required following major incidents or disasters are contingent (depend) on the exact nature of the incidents and disasters that actually unfold. In this sense, CP involves preparing for the unexpected and planning for the unknown. The basic purpose of CP is to minimize the adverse consequences or impacts of incidents and disasters. Therefore state corporations in Kenya can manage their risks to minimize impacts of incidents so as to achieve financial stability through reducing contingency and maintaining an efficient financial system.

### Risk Management Theory

Risk management is the identification, assessment, and prioritization of risks followed by coordinated and economical application of resources to minimize, monitor, and control the probability and/or impact of unfortunate events or to maximize the realization of opportunities (Wenk, 2005). Effective risk management can bring far reaching benefits to all organizations, whether large or small, public or private sector (Ranong & Phuenngam, 2009). These benefits include, superior financial performance, better basis for strategy setting, improved service delivery, greater competitive advantage, less time spent firefighting and fewer unwelcome surprises, increased likelihood of change initiative being achieved, closer internal focus on doing the right things properly, more efficient use of resources, reduced waste and fraud, and better value for money, improved innovation and better management of contingent and maintenance activities (Wenk, 2005).

According to Dorfman (2007), ensuring that an organization makes cost effective use of risk management first involves creating an approach built up of well-defined risk management practices and then embedding them. These risk management practices include financial risks management practices, operational risk management practices, governance risk management practices, and strategic risk management practices. This theory links to the current study in that

State Corporation can achieve financial stability through effective use of risk management practice.

## Enterprise Risk Management Theory

According to Tseng (2007), Enterprise Risk Management (ERM) is a framework that focuses on adopting a systematic and consistent approach to managing all of the risks confronting an organization. Gordon et. al. (2009) on the other hand define ERM as the overall process of managing an organization's exposure to uncertainty with particular emphasis on identifying and managing the events that could potentially prevent the organization from achieving its objective. ERM is an organizational concept that applies to all levels of the organization. In conducting ERM, the following are listed as some of the areas or aspects of the organization that a risk manager need to look into namely: the people, intellectual assets, brand values, business expertise and skills, principle source of profit stream and the regulatory environment Searle (2008). This will help state corporations in Kenya to balance the two most significant business pressures; the responsibility to deliver succeed to stakeholders and the risks associated with and generated by the business itself in a commercially achievable way. By doing so, the risk manager is constantly aware of the risks it faces and therefore constantly monitors its exposure and be positioned to change strategy or direction to ensure the level of risks it takes is acceptable, this will facilitate financial stability and economic growth.

## Capital Asset Pricing Theory

William Sharpe (1964) published the capital asset pricing theory (CAPM). Parallel work was also performed by Treynor (1961) and Lintner (1965). CAPM extended Harry Markowitz's portfolio theory to introduce the notions of systematic and specific risk. CAPM decomposes a portfolio's risk into systematic and specific risk. Systematic risk is the risk of holding the market portfolio. As the market moves, each individual asset is more or less affected. To the extent that any asset participates in such general market moves, that asset entails systematic risk.  Specific risk is the risk which is unique to an individual asset. It represents the component of an asset's return which is uncorrelated with general market moves Lintner (1965). No matter how much we diversify our investments, it's impossible to get rid of all the risk. As investors, we deserve a rate of return that compensates us for taking on risk.

The capital asset pricing model (CAPM) helps us to calculate investment risk and what return on investment we should expect."  It took nearly a decade after the introduction of CAPM for investment professionals to begin to view it as an important tool in helping investors understands risk. The key element of the model is that it separates the risk affecting an asset's return into two categories. The first type is called unsystematic, or companies-specific, risk. The long- term average returns for this kind of risk should be zero. The second kind of risk, called systematic risk, is due to general economic uncertainty. CAPM states that the return on assets should, on average, equal the yield on a risk-free bond held over that time plus a premium proportional to the amount of systematic risk the stock possesses Markowitz (1952).  The treatment of risk in the

CAPM refines the notions of systematic and unsystematic risk developed by Harry.Markowitz in the (1950). Unsystematic risk is the risk to an asset's value caused by factors that are specific to an organization, such as changes in senior management or product lines. For example, specific senior employees may make good or bad decisions or the same type of manufacturing equipment utilized may have different reliabilities at two different sites. In general, unsystematic risk is present due to the fact that every company is endowed with a unique collection of assets, ideas and personnel whose aggregate productivity may vary Markowitz (1952). State corporations can achieve financial stability by diversifying unsystematic risk that are specific to a firm and could result to a crises and collapse of the corporation.

*Independent Variables*                                                    *Dependent Variables*
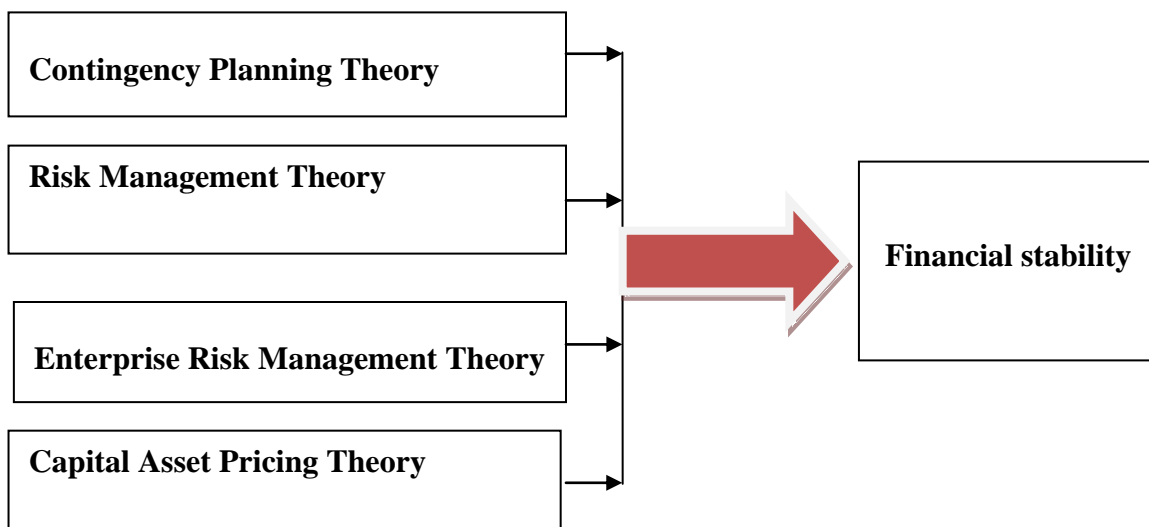


**Figure 1: Theoretical Framework**

## EMPIRICAL LITERATURE

Safeguarding financial stability has become an increasingly dominant objective in economic policymaking as it has all the essential characteristics of a public good (Schinasi, 2005). Current risk management system based on the Basel II aims to promote financial stability (BCBS, 2006). This study will seek to carry out an analysis of the effects of risk management on financial stability of state corporations in Kenya.

### Financial risk management

According to Insurance Europe (2013) financial risks involve two major factors; the deteriorations in the macroeconomic capacity as a result of political or economic crises both in national and international settings. As these kinds of risks arise from an imbalance in the system, they are also known as market or system risk; Unsystematic risks which commonly arise from the internal structure of a company and are defined by factors such as management quality,

integrity of the financial structure, and the ability to be competitive. These two types of risks combined are called the total risk. Risk management models define and classify the risks, measure and assess the risks and the creation of a risk map in order to reduce these risks. The following processes involve continuous risk tracking and regular reports to the risk management department. Insurance companies, when holding assets in the form of foreign currencies in order to meet their obligations, are exposed to foreign exchange risk. This type of risk results from the fluctuations in exchange rates. This practice creates a threat in terms of foreign exchange rate when the company is indebted in foreign currencies. Insurance companies take foreign exchange risks into consideration as part of their assessments for the next twelve months when calculating their minimum capital requirements.

The foreign exchange risk is a factor not just insurance and reassurance companies but any company must take into consideration. The researcher agrees that state corporations in Kenya should take foreign exchange risk in consideration hence reduce likelihood of financial risk. Mercelo (2011) found out that Financial Risk Management is crucial for success of any Insurance firm. Billion dollars loss by Nick Leeson that broke the Barings bank, the US$1.5 billion loss by Robert Citron at Orange County, the US$1.1 billion loss by Toshihide Iguchi at Daiwa Bank, the US$2.6 billion loss by HamanakaYasua at Sumitomo Corporation and the US$691 million loss by John Rusnak at Allied Irish Bank are just some of the key examples of failures and scandals that have generated anxiety within the global banking and financial services environment. The risk anxiety generated by these events has led to the proliferation of new categories of risk and new models for managing these risks (Power, 2004). Financial risks are almost similar across industries hence also in state corporations in Kenya, financial risk management should be crucial (Ciborra, 2006).

According to Giddy and Dufey (2006), foreign exchange risk is the impact of the unpredictable exchange rate changes on a company. The foreign exchange risk cannot be eliminated altogether yet, there are several solutions in order to minimize its impact. The foreign exchange risk is especially an important issue for international companies. The research showed that the profits of international companies were affected by the fluctuations in the exchange rates (Popov & Stutzmann, 2003). The researcher agrees that state corporations dealing with international business should take into consideration foreign exchange risk and manage it.

Financial risk management practices fall into three major categories; credit risk, liquidity risk and market risks (Kithinji, 2010). These financial risk management practices may influence the financial stability of any state corporations. According to Tapiero (2004), financial risk management refers to the practice of creating economic value in a firm by using financial instruments to manage exposure to risk, particularly credit risk and market risk. Similar financial risk management requires identifying its sources, measuring it, and plans to address them (Conti & Mauri, 2008). State corporations in Kenya have potential to financial risk and if properly managed financial stability can be achieved.

## Operational risk management

The Basel II defines operational risk as the risk of direct or indirect loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk thus recognizing it as a subset of operational risk. In particular, the events that have resulted from the above failures and scandals have now been put into a category of risk referred to as operational risk; a label that is intended to allow for risk visibility, particular risk management, and regulatory intervention. The Basel II accord (2001) which gave significance and visibility to operational risk in its consultative document defines this category of risk as the risk of direct or indirect loss resulting from inadequate or failed internal processes, people and systems or from external events. The aim of the Basel consultative document is to enhance operational risk assessment efforts and to encourage the banking and financial services industry to develop methodologies and collect data related to managing operational risk. In reality, however, the concept of operational risk transforms internal control into risk management, with a focus on deeper ways of analyzing and managing internally generated risk (Power, 2004); Ciborra, 2006).

Though operational risk may be intuitively appealing to regulators and other stakeholders, it is an elusive and problematic concept. According to Power (2004), new risk management in which the imperative is to make visible and manageable essentially unknowable and incalculable risk. That is, the events that come under the ambit of operational risk lack rich historical numeric data sets and exist only at the limits of manageability. Yet anxiety about what appears to be a nebulous concept is growing and has in some cases led to radical re-organisation of some banks and financial institutions. For this very nature of the concept of operational risk poses empirical challenge to researchers. Rather than investigating what operational risk is, the emphasis should be on how it is that people come to establish particular events or objects as operational risk (or as potential sources of operational risk). There has been a tendency to conceptualize operational risk in technical rational objective ways (De Fountnouvelle et al. (2003) Chavez-Demoulin et al. (2006). Above concepts are supported in this study and stat corporations in Kenya should take operational risk management for financial stability.

## Market risk management

A recent literature has arisen that takes a contrary "competition-stability" view. Boyd and De Nicolo (2005) contend that more market power in the loan market may result in higher bank risk as the higher interest rates charged to loan customers make it harder to repay loans and exacerbate moral hazard incentives of borrowers to shift into riskier projects. The higher rates may also result in a riskier set of borrowers due to adverse selection considerations. It is also possible that a highly concentrated banking market may lead to more risk taking if the institutions believe that they are too big to fail and are more likely to be explicitly or implicitly protected by the government safety net. Some recent empirical work is consistent with this view.

Boyd, De Nicolo, and Jalal (2006) and De Nicolo and Loukoianova (2006) both find that the Z-index, an inverse measure of bank risk, decreases with banking market concentration (measured using the Herfindahl-Hirschman index or HHI), implying that the risk of bank failure rises in more concentrated markets. In addition, Schaeck, Cihak, and Wolfe (2006) implement a logit model and duration analysis and find that more competitive banking systems (measured using the Panzar and Rosse H-statistic) have lower likelihoods of bank failure and a longer time to crisis, and hence are more stable than monopolistic systems. Note that the two strands of the literature need not necessarily yield opposing predictions regarding the effects of competition and market power on stability in banking. Even if market power in the loan market results in riskier loan portfolios, the overall risks of the banks need not increase. If banks enjoy higher franchise value derived from their market power, they may protect this value from the higher loan risk with other methods. Specifically, they can offset the higher risk exposure through more equity capital, reduced interest rate risk, sales of loans or credit derivatives, a smaller loan portfolio, or other risk-mitigating techniques. Thus, when a bank charges higher rates for business loans and has a riskier loan portfolio, the bank may still choose a lower overall risk. This argument suggests that it is important in studies of the effects of market power on bank risk that dependent variables are chosen to reflect both loan risk and bank risk, thereby distinguishing whether one or both of the theories may be operative simultaneously.

While some previous research used the Z-index as an inverse proxy for overall bank risk, other papers focused on nonperforming loans, which only measure loan risk. No prior study to our knowledge has estimated the effects of market power or measures of competitiveness on both loan risk and overall bank risk using the same model. Few studies have also investigated the effect of competition on banks' capital ratios. Schaek and Cihak (2007) show that banks tend to hold higher capital ratios in more competitive environments in the context of European banking. Market risk management is important to all state corporations in Kenya and should be active in order for them to achieve financial stability.

## Strategic risk management

The field of strategic risk has become of increasing interest to organizations and researchers alike in the years post-Enron and in the wake of the ensuing Turnbull risk management requirements. Strategic risk is generally defined as being any risk (threat or opportunity) that materially affects the ability of an organization to survive (STRATrisk, 2005). All organizations are vulnerable to strategic threats to varying degrees despite their greatest efforts to manage them; a Deloitte Research study of the 21000 largest international organizations found that nearly half had lost up to 20% of their market value over a month long period in the last decade, with the value losses often taking longer than a year to be regained (Kambil, Layton and Funston, 2005).

When strategic threats occur, the results are devastating and long lasting. The key characteristics of strategic risk is that they are often caused by Low-frequency, high-impact risks (Kambil, Layton & Funston, 2005). Thus, there is an increased probability that the threat that destroys the company is one that has never occurred before and therefore is not predicted by risk management systems based on historical data. For this reason, an essential element of a robust strategic risk management system is the inbuilt capacity to recognize the development of these types of risk quickly and respond to them, and the ability to do this is directly related to the existing levels of environmental and system complexity, uncertainty and managerial cognition.

Strategy can be defined as the direction and scope of an organization over the long term, which achieves advantage in a changing environment with the aim of fulfilling stakeholder expectations (Johnson, Scholes & Whittington, 2005). Strategy is achieved through decision-making about strategic choices, which is characterized by "complexity arising out of ambiguous and non-routine situations with organization-wide rather than operation-specific implications" Strategic risk emerges from strategic decision-making because the future is uncertain and therefore all outcomes of strategic choice will be accompanied by varying degrees of uncertainty. Clearly then, the decision-making process at a strategic level within the organization has an important impact on exposure to risk. If strategic decision-making was a straight forward, rational process based on order, rational choice and intentional capability, then the management of strategic risk would be an objective, quantifiable process that should result in the same outcome regardless of who carries it out. Therefore all state corporations should embrace strategic risk management to achieve financial stability (Johnson, Scholes & Whittington, 2005).
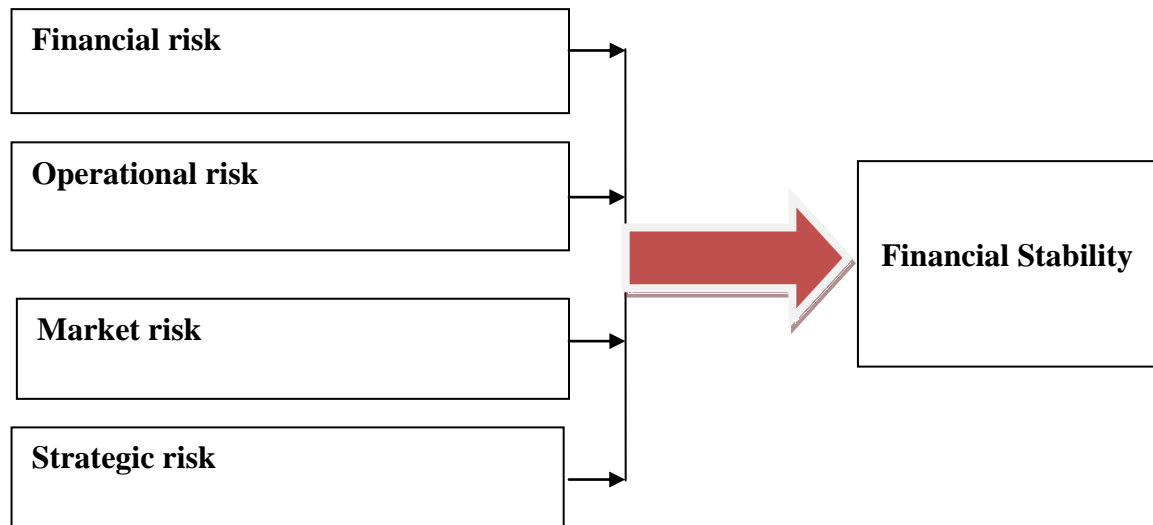
## CONCEPTUAL FRAMEWORK

Smyth (2004) defines a conceptual framework as a framework that is structured from a set of broad ideas and theories that help a researcher to properly identify the problem they are looking at frame their questions and find suitable literature. The conceptual framework of the study will consist of independent variables; financial risk management practices, operational risk management practices, governance risk management practices, and strategic risk management and a dependent variable; the financial stability of state corporations.

Financial risk management focuses on when and how to hedge using financial instruments to manage costly exposures to risk. Operational Risk Management is a decision making tool to systematically help identify operational risks and benefits and determine the best courses of action for any given situation. Strategic Risk Management is a process for identifying, assessing and managing risks and uncertainties, affected by internal and external events or scenarios that could inhibit an organization's ability to achieve its strategy and strategic objectives with the ultimate goal of creating and protecting shareholder and stakeholder value. Governance describes

the overall management approach through which senior executives direct and control the entire organization.

*Independent Variables*                                                   *Dependent Variables*

| Financial risk |
| --- |

| Operational risk |
| --- |

                                                                              | Financial Stability |

| Market risk |
| --- |

| Strategic risk |
| --- |

**Figure 2: Conceptual framework**

## RESEARCH METHODOLOGY

### Research Design

A research design is a framework for specifying the relationship among the study's variables and outlines procedures for every research activity Uma (2006). Different epistemological schools divide quantitative and qualitative paradigms. Qualitative methods involve a systematic inquiry primarily based on the fact that knowledge about humans is not possible without formulating their experiences. According to Bryman (1988), qualitative researchers study things in their natural settings. On the other hand quantitative method or positivists rely on more remote inferential empirical materials Denzin and Lincoln (1998). According to Creswell (1998), one should use qualitative and quantitative if the research topic needs to explored, as in this study; if there is a need to present a detailed view of the research topic and finally one should chose qualitative and quantitative research if they will be studying individuals in their natural setting. This does involve going out to the setting or field of study, gaining access and gathering material. This study was quantitative in nature and employed an explanatory research design. This was because the study intended to provide an understanding of the relationships among the research variables. Explanatory research was used for understanding phenomenon in terms of its likely causes. Explanatory research implies that the research in question is intended to explain, rather than simply to describe; the phenomena studied Maxwell & Mittapalli (2008). Most social scientists seek causal explanations that reflect tests of hypotheses. Causal effect occurs when variation in one phenomenon, an independent variable, leads to or results, on average, in variation in another phenomenon, the dependent variable Somekh & Lewin (2005).

## Target population

A population is a set of people, services, elements, events, group of things or households that are being investigated Ngechu (2003). A population therefore entail all the individuals that fit specifically for being sources of the data required addressing the research problem. Target population consists of all members of a real or hypothetical set of people, events or objects from which a researcher wishes to generalize the results of their research while accessible population consists of all the individuals who realistically could be included in the sample Borg & Gall, (2007). This study target population comprised of 2 state corporations namely; the Tourism Fund and Kenyatta International Convention Centre which had a total of 342 staff. The study concentrated on the two state corporations because the players had the relevant and accurate information needed in this study.

## Sampling Size

According to Polit & Hungler (2000) sampling involves process of selecting a sub-section of a population that represents the entire population in order to obtain information regarding the phenomenon of interest. A sampling frame is a list of population from which a sample is drawn Leary (2001). It is the source material or device from which list of all elements within a population that can be sampled is drawn (Särndal, Swensson & Wretman, 1992) and may include individuals, households or institutions. It's a published list in which or a set of directions for identifying a population (Gall, Gall & Borg, 2007). Kothari (2005), a representative sample should be at least 30% of the population. 103 respondents were considered appropriate for this study. The sample of 30% constituted the population of the study which is a threshold of the recommendation as provided by Cooper and Schindler (2003). The study used a purposive sampling approach to determine the sample of the study. According to Mugenda and Mugenda (2003) purposive sampling is a sampling technique that allows a researcher to use cases that have required information with respect to the objectives of the study. This study used a purposive sampling design to select 2 state corporations. The 2 state corporations studied had shown great growth in the recent past with the big events held in the country including TICAD, UNCTAD and WTO, therefore more diverse activities and risks involved hence highly relevant for this research.

## Instrumentation

Schwab (2005) defines questionnaires as measuring instruments that ask individuals to answer a set of questions or respondent to a set of statements. According to Dawson (2002), there are three basic types of questionnaires; closed ended, open-ended or a combination of both. Closed-ended questionnaires are used to generate statistics in quantitative research. As these questionnaires follow a set format, and as most can be scanned straight into a computer for ease of analysis and greater numbers can be produced. Open-ended questionnaires are used in qualitative research, although some researchers quantify the answers during the analysis stage. The questionnaire does not contain boxes to tick, but instead leaves a blank section for the

respondent to write in an answer. Whereas closed-ended questionnaires might be used to find out how many people use a service, open-ended questionnaires might be used to find out what people think about a service. As there are no standard answers to these questions, data analysis is more complex. Also, as it is, opinions which are sought rather than numbers, fewer questionnaires need to be distributed. However, many researchers tend to use a combination of both open and closed questions. That way, it is possible to find out how many people use a service and what they think about that service on the same form. Many questionnaires begin with a series of closed questions, with boxes to tick or scales to rank, and then finish with a section of open questions for more detailed response. The researcher collected primary data with the help of a questionnaire because a large amount of information could be collected from a large number of people, in different geographical locations, in a short period of time and in a relatively cost effective way. The questionnaire had close and open ended questions. The respondents were expected to indicate their level of agreement using a five point scale namely; Strongly Agree, Agree, Neither Agree or disagree, Disagree and Strongly Disagree.

## Methods of Data Collection

In this study, primary data on the relationship between the independent and dependent variable was collected using a structured questionnaire, since it is confidential, can be analyzed more objectively than other forms of research and is economical in terms of time and money. The questionnaires were issued to the respondents through informal self-introduction by the help of a research assistant. The questionnaires were presented to the respondents under a forwarding letter accompanied by an introduction letter from the University. Validity refers to the truthfulness of a measure; if it does measure what it is intended to measure. The reliability of a measure refers to its consistency. Researchers may refer to several different types of reliability. Measures are also reliable if they are consistent over time. Therefore financial stability was operationalized by checking whether the respondent organization is financially stable or financially unstable. Risk management was also be operationalized by checking with respondent whether risk management facilitates financial stability. The data generated by the study after fieldwork will be edited, coded then entered into a computer for processing using the Statistical Package for Social Sciences (SPSS v.22.0.0.0). A master codebook was designed to ensure that all the questionnaires were coded uniformly. According to Chandran (2004), editing of responses is intended to identify and eliminate errors made by the interviewer or respondents. Consequently, data was edited for completeness and consistency before analysis. Descriptive and inferential statistics were used to analyze information generated from respondents. Descriptive statistics refers to, simple statistical methods, which do not support or falsify a relationship but help in the description of the data. Thus, descriptive statistics enables the researcher to organize data in an effective and meaningful way. By use of percentages, frequency distributions, tables, charts, the researcher categorized the variables. Inferential statistics involve making generations, predictions or conclusions about characteristics of a sample from a population. Inferential statistics was used to establish whether a relationship exists in the larger population from which

the sample was drawn. This helps in making relevant generalizations whereby a Pearson correlation co-efficient was calculated to determine and test the correlation between the dependent variable and each independent variable.

## RESEARCH RESULTS

### Risk Management

The respondents' rating of financial risk management was between a mean score of 4.25 and 3.85 with an overall rating of agree (mean of 4.06). More specific; Credit default risk management facilitate financial stability in state corporations (mean of 4.25), the process of financial risk management is continuous in state corporations (mean of 4.15) and state corporations have put in place measures to mitigate liquidity risk (mean of 4.11). These findings conform to those of Mercelo (2011) that is financial risk management is crucial for success of any state corporation.

The respondents further indicated that financial risk management could be improved by diversification, which requires businesses and individuals to invest in a wide variety of investments. Diversification attempts to spread risk among several safe and risky investments in various economic markets. Investing sooner rather than later allows businesses and individuals to let their money work longer and potentially earns higher returns. If investment markets become extremely risky and businesses or individuals start losing money, investment decreases will only reduce earned income rather than the original principal balance. This allows individuals to cash out of extremely risky investments with little economic loss relating to their original investment. Learn About Investments; managing financial risk often requires businesses and individuals to spend copious amounts of time learning and understanding about the investment market. A portion of this time should also be spent on learning about specific investment instruments offered by companies and governments.

From the findings, the respondents agree/strongly agreed that; Controls are in place to evaluate the efficiency of operational risk management in the state corporation (mean of 4.33), People risk is a continuous risk in the organization (mean of 4.25), and A lot of organization resources have been directed to information technology risk management (mean of 4.13). On the other hand the respondents also strong disagree that Operational risk is highly ignored in the organization (mean of 1.25) thus operation risk is highly considered in the organizations. These findings conform to Power (2004) who posited that new risk management in which the imperative is to make visible and manageable essentially unknowable and incalculable risk. That is, the events that come under the ambit of operational risk lack rich historical numeric data sets and exist only at the limits of manageability.

The respondents were of the opinion that through operational risk management, a corporation could carry out risk-audit activities, assessments of operational risks and prepares recommendations for risk mitigation. Regular monitoring of its operational risk profiles and

material exposures to operational losses results in to financial stability and utilize their operational risk management practices to gain respect and appreciation of all their business lines by really understanding their issues, and being part of the overall solution.

The respondents' rating on marketing risk management to a great extent; Foreign exchange risk is one of the most complex areas of risk management in state corporations in Kenya (mean of 4.15) and Financial stability in state corporation can be improved by management of interest rate risk (mean of 3.89). on the other hand respondents strongly disagreed that; Market risk management is not a continuous process in the organization (mean of 1.33) as well as Current approaches to equity risk management in your corporation are no longer fit for purpose (mean of 1.45). The findings are supported by those of Boyd & De Nicolo (2005), that is, the more market power in the loan market may result in higher bank risk as the higher interest rates charged to loan customers make it harder to repay loans and exacerbate moral hazard incentives of borrowers to shift into riskier projects.

When asked to rate statements relating to strategic risk management, the respondents unanimously agreed/strongly agreed that; Strategic risk management is crucial for success of any state corporation (mean of 4.45), strategic risk management process enhances financial stability (mean of 4.33), Corporate governance risk management in place are satisfactory (mean of 4.25) and the organization is quick and flexible to identify and tackle innovation risks (mean of 3.85).

## Relationship between Risk Management and Financial Stability of State Corporations in Kenya

The study proposed that there exist a relationship Risk Management and Financial Stability of State Corporations in Kenya. Correlation analysis was used to establish the strength of the relationship while regression analysis was used to come up with the model for forecasting purposes. Further hypothesis test was done to check on the statistical significance of the model parameters.

Predictor variables are said to be correlated (multicollinearity) if the correlation coefficient between them is greater than 0.5. In such a situation one of variables must be removed from the model. Results indicated that there is no problem of multicollinearity (coefficients <0.5), thus all the four predictor variables could be used in forecasting Financial Stability of State Corporations in Kenya

The "R Square" (coefficient of determination) a value of 0.739, indicates a moderate level of prediction. It further indicates that 73.9% of the variations in Financial Stability of State Corporations in Kenya could be explained by the changes in financial risk management, operational risk management, market risk management and strategic risk management leaving 26.1% unexplained (error term).

**Table 1: Model Summary**

| R | R Square | Adjusted R Square | Std. Error of the Estimate | R Square Change | F Change | df1 | df2 | Sig. F Change |
|---|---|---|---|---|---|---|---|---|
| .859 | .739 | .728 | .59836 | .739 | 6.015 | 4 | 80 | .001 |

a. Predictors: (Constant), financial risk management, operational risk management, market risk management, strategic risk management

The findings in table 2 shows that the independent variables significantly predict the dependent variable, $F_{(4, 80)} = 6.015 > 2.45$, $p = .001 < .05$ (i.e., the regression model is a good fit of the data).

**Table 2: ANOVA**

| Model | Sum of Squares | df | Mean Square | F | Sig |
|---|---|---|---|---|---|
| Regression | 8.615 | 4 | 2.154 | 6.015 | .001 |
| Residual | 28.640 | 80 | .358 | | |
| Total | 37.255 | 84 | | | . |

a. Predictors: (Constant), financial risk management, operational risk management, market risk management, strategic risk management

b. Dependent Variable: Financial Stability

The established regression model was of the form:

$$Y = 0.781 + .448X_1 + .217X_2 + .172X_3 + .384X_4$$

Unstandardized coefficients indicate how much the dependent variable varies with an independent variable, when all other independent variables are held constant.

**Table 3: Coefficients**

| | B | Std Error | Beta | t | sig |
|---|---|---|---|---|---|
| Constant | 0.781 | 0.669 | | 2.662 | 0.01 |
| Financial Risk Mgmt. | 0.448 | 0.176 | 0.442 | 2.544 | 0.014 |
| Operational Risk Mgmt | 0.217 | 0.092 | 0.208 | 2.35 | 0.023 |
| Market Risk Mgmt | 0.172 | 0.070 | 0.169 | 2.453 | 0.018 |
| Strategic Risk Mgmt | 0.384 | 0.135 | 0.345 | 2.844 | 0.003 |

a. Dependent Variable: Financial Stability

$\beta_1 = .448$, for every one unit increase in Financial Risk Mgmt., Financial Stability of State Corporations in Kenya increases by 0.448 units other factors held constant; $\beta_2 = .217$, for every one unit increase in Operational Risk Mgmt., Financial Stability of State Corporations in Kenya increases by 0.217 units other factors held constant; $\beta_3 = .172$, for every one unit increase in Market Risk Mgmt., Financial Stability of State Corporations in Kenya increases by 0.172 units

other factors held constant; $\beta_4$=.384, for every one unit increase in Strategic Risk Mgmt., Financial Stability of State Corporations in Kenya increases by 0.384 units other factors held constant.

Statistical significance of the independent variables tests was used to test whether the Unstandardized coefficients are equal to 0 (zero) in the population. Using p-values at $\alpha = .05$; each predictor variable was lineally related with the dependent variable hence the predictor variables are statistically significant in the model. Thus financial risk management, operational risk management, market risk management and strategic risk management could be used to predict Financial Stability of State Corporations in Kenya.

## DISCUSSION

The purpose of the study was to determine the effect of risk management on financial stability of state corporations in Kenya. The study was guided by four specific objectives which were; to determine the extent to which financial risk management influence the financial stability of state corporations in Kenya, to establish the extent to which operational risk management influence the financial stability of state corporations in Kenya, to examine the extent to which strategic risk management influence the financial stability of state corporations in Kenya and to examine the extent to which market risk management influences the financial stability of state corporations in Kenya.

### Financial risk management

From the findings of the study financial risk management in the corporation were; Credit default risk management facilitate financial stability in state corporations, the process of financial risk management is continuous in state corporations, and the corporation has put in place measures to mitigate liquidity risk. The respondents further indicated that financial risk management could be improved by diversification, which requires businesses and individuals to invest in a wide variety of investments.

### Operational Risk Management

The study found that operational risk management; Controls are in place to evaluate the efficiency of operational risk management in the state corporation, People risk is a continuous risk in state corporations, a lot of organization resources have been directed to information technology risk management, Operational risk is highly appreciated in state corporations. It was noted that through operational risk management, a corporation could carry out risk-audit activities, assessments of operational risks and prepare recommendations for risk mitigation. Regular monitoring of its operational risk profiles and material exposures to operational losses results in to financial stability and utilize their operational risk management practices to gain respect and appreciation of all their business lines by really understanding their issues, and being part of the overall solution

## Market Risk Management

It was noted that majority of the respondents rated marketing risk management variables to a great extent; Foreign exchange risk is one of the most complex areas of risk management in state corporations in Kenya, financial stability in state corporation can be improved by management of interest rate risk, market risk management is a continuous process in state corporations and current approaches to equity risk management in state corporations are fit for purpose.

## Strategic Risk Management

The study found out that strategic risk management is crucial for success of any state corporation, strategic risk management process enhances financial stability, Corporate governance risk management in place are satisfactory and state corporations is quick and flexible to identify and tackle innovation risks.

## Forecasting Model

Regression and correlation analysis indicated that in financial risk management, operational risk management, market risk management and strategic risk management significantly influence in Financial Stability of State Corporations in Kenya, that is, 73.9% of the variation in Financial Stability of State Corporations in Kenya could be explained by the changes in financial risk management, operational risk management, market risk management and strategic risk management. It was also found that financial risk management, operational risk management, market risk management and strategic risk management were individually linearly related to Financial Stability of State Corporations in Kenya (P-value<0.05).

## CONCLUSIONS

The general objective of the study was to determine the effect of risk management on financial stability of state corporations in Kenya. The study findings revealed that state corporations have given prominence to financial risk management, operational risk management, market risk management and strategic risk management as tools of achieving financial stability. The study further concluded that the establish regression model was fit for foresting and could be used for forecasting financial stability of state corporations in Kenya.

## RECOMMENDATIONS

The study makes an important contribution in understanding financial stability of state corporations in Kenya. It further brings out the factors that influence the relationship between risk management and financial stability of state corporations in Kenya. Arising from this study, the researcher makes the following recommendations. Financial risk management should be highly supported in state corporations to avoid collapse due to financial crisis that might be as a result of credit risk. Operational risk management should be appreciated by management and more resources issued to manage people risk which respondents termed as continues risk.

Policy makers should impose regulations, compliance systems and rules in order to achieve financial stability. The state corporations should review the guidelines and policies in conjunction with risk management. It also recommended that future studies include other government parastatals and private firms. These findings will provide an increase in knowledge and a rich data base for future research, which can then be compared with the results of this study

Finally, the use of other data collection methods such as interviews would help the researchers get responses that are relatively free from bias. This is because interviews afford the researcher the opportunity to allay fears, anxieties and concerns that the respondents may have. The researcher may also offer clarification when needed and help respondents to think through difficult issues. The researcher suggests further study to focus on risk management on financial stability in ministries in Kenya.

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