
Examining the Effect of Risk Prevention Practices on Financial Competitiveness of Savings and Credit Co-operative Societies in Kirinyaga County, Kenya

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Abstract

Despite the existence of SASRA regulation, many SACCOs are experiencing challenges related to risk management system. This study sought to investigate risk prevention practices adopted by SACCOs in Kirinyaga County to enhance their financial competitiveness and help them overcome the risk management system related challenges. The specific objective of this study was to determine the risk prevention practices employed by deposit taking SACCOs in Kirinyaga County. The study is premised on Financial Theory. The study adopted a descriptive research design that helped in describing the phenomena of risk prevention practices in SACCOs. Information was collected from 23 SACCOs operating in Kirinyaga County. Primary data was collected from the top management of the SACCOs using a questionnaire. The study established a positive and significant relationship between risk prevention practices and the financial competitiveness of SACCOs within Kirinyaga County. The coefficient of determination was at 83.1%, an indicator that the explanatory variable explained more than eighty percent of variance in the financial competitiveness of SACCOs in Kirinyaga County. The p-value and regression coefficient generated after running the regression model for risk prevention practices was ($\beta = 0.471$, $p = 0.012$). The study concluded that risk prevention practices plays an important role in influencing the financial competitiveness of SACCOs. The implementation of risk management strategies in all the SACCOs in order to improve the financial competitiveness is recommended.

Keywords: Risk Prevention Measures, Financial Competitiveness, Planning, Forecasting and Compliance.

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INTRODUCTION

Tremendous development has been witnessed in the business world since 1940. The concept of risk management has gradually gained popularity across sectors ranging from the insurance sector to the financial sector (Parvaneh, 2014). With uncertainties in business, competitive organizations around the world are striving to develop risk management models that will enhance their financial competitiveness. Since 1990s, commercial organizations, mainly SACCOs have dedicated their effort to minimize risks associated with their

business, thus enhanced the competitiveness of their firms in terms of profits, diversification, customer loyalty and employee satisfaction (Liangrong, 2013).

Business enterprises operating in the 21st Century are not exempt from unpredictable changes caused by change in political, economic, social, technological, ecological and legal policies (Linda & Niswah, 2016). With increased competition, changes in consumer needs, influence of globalization and labor market dynamics, both profit and non-profit oriented firms have to develop frameworks of minimizing risks associated

with business ventures (Barrese, 2015). Organizations operating in developed and developing countries are continuously reviewing their risk management strategies to enhance their competitiveness (Ballantyne & Ryan, 2013).

According to SASRA (2015), SACCO's regulations are meant to improve the competitiveness of SACCOs by setting financial and operating standards equal to the deposit taking business conducted by SACCOs. It's ultimately expected to drive efficiency and enhance the level of savings in the SACCOs societies as envisaged in the financial sector strategy in vision 2030. SACCOs regulations and performance relate in that the laws are meant to set specific requirements on the tools used to measure performance (PEARLS), leading to a direct relationship. Frigo (2011) argues that while there have been several reform initiatives in SACCOs subsector in the past, the introduction of a SACCOs Societies Act of 2008 is a recognition of the unique financial intermediation function that SACCOs play in the economy.

With the commencement of the implementation of the third medium-term (2018-2022) of Vision 2030 Economic blueprint, which emphasizes the need to leverage on SACCOs to mobilize savings for economic development, risk management and proper regulation would be vital in achieving this objective. Langat (2011) asserts that Kenya being one of the developing countries, tremendous economic changes have been witnessed. Activities of SACCOs have contributed significantly to social and economic developments thus reduced poverty levels. With increased interest rates, majority of Kenyans have shifted from Commercial Banks to SACCOs due the favorable lending conditions. Although several SACCOs are performing well financially, it is evident that some challenges are experienced due to high risks associated with the management of business portfolios.

Statement of the Problem: According to the Central Bank of Kenya Report (2015),

72% of SACCOs operating in Kenya are experiencing deteriorating financial competitiveness due to risk management issues. It was revealed that stiff competition and the influence of technology were some of the aspects that have contributed to decreased profits among SACCOs. Kiptoo (2015) also established that inability of the SACCOs to predict business uncertainties were associated with lack of appropriate risk management models to mitigate financial risks. Similarly, Langat (2011) concurs that SACCOs operating in Kenya are more likely to be financially competitive by developing risk management strategies to minimize cases of loan default and non-compliance of SACCOs to set regulations and standards by the Central Bank of Kenya. SASRA Supervision Report (2018) also revealed that non-performing loans among Deposit taking SACCOs increased to Ksh. 5.27 billion in the year 2018 from Ksh. 4.92 billion in the year 2017 due to lack of appropriate risk management strategies among other reasons.

It is observed that SACCOs in Kenya are not financially competitive. Issues of managing credit risks, high default cases among borrowers and non-fulfillment of obligations from customers have remained an uphill task among SACCOs in Kenya, necessitating them to develop risk management practices. By extension, from the findings of previous studies, it's noted that little has been done concerning risk preventive practices and financial competitiveness among SACCOs in Kenya. It is observed that conceptual and contextual gaps are evident from previous empirical studies. For instance, a study conducted by Kiptoo (2015) was limited to SACCOs in Nairobi; a study by Chen and Pan (2012) was confined to SACCOs in Taiwan; a study by Ballantyne and Ryan (2013) was confined to manufacturing firms and a study by Lagat (2011) was concerned with different variables like internal audit, communication and technology. Therefore, it is against this background that this study will seek to examine risk preventive practices and financial competitiveness of savings and

credit co-operative societies in Kirinyaga County, Kenya.

Objective of the Study: The study was guided by the following objective: to examine the effect of risk preventive practices on the financial competitiveness of deposit taking SACCOs in Kirinyaga County

This study is premised on the Financial theory, which suggests that risk management can smooth variability in firm value (Chen & Pan, 2012). The theory proposes that risks should be redistributed to those better equipped to handle them. Industrial companies are unlikely to have a comparative advantage in bearing foreign-exchange risk, interest-rate risk or commodity risk. Risk can also be redistributed by hedging: buying and selling derivatives thus decreasing the variance of the expected value of the firm.

Tarasi *et al.* (2013) identifies three major costs associated with higher variability in cash flow: higher expected bankruptcy costs, higher expected payments to stakeholders and higher expected tax payments. If risk management can smooth variability on expected payments to stakeholders thus this automatically increases the firm value. As for tax payments, risk management works in the simple way as to manage taxable income so to ensure that the largest possible proportion of corporate income falls within the optimal period in the business cycle (Okello, 2014). This theory applies to the current financial organization and helps to stamp out differences in an organization by smoothening risk management to achieve firms' value. If followed, it reduces the risk and controls the indicator of fraud.

Nyagah (2014) also revealed that event identification, risk assessment, objective setting, and information communication had negative effects on the financial performance of a firm while risk response, internal environment, and control activities had positive effects on the financial performance of a firm. However, the findings of the study were confined to pension management firms in Kenya but not SACCOs. On the other hand, Odhiambo (2012) observed that credit

risk is the potential that a borrower fails to meet the obligations on agreed terms. There is always scope for the borrower to default from his commitments for one or the other reason resulting in crystallization of credit risk to the SACCOs. These losses could take the form of outright default or alternatively, losses from changes in portfolio value arising from actual or perceived deterioration in credit quality that is short of default. However, the findings of the study were limited to corporate governance in SACCOs and failed to address risk management issues.

Nkuru (2015) noted that liquidity risk is the potential for loss to an institution arising from either its inability to meet its obligations or to fund increases in assets as they fall due without incurring unacceptable cost or losses. He further argues that deposits or contributions generally have a much shorter contractual maturity than loans and liquidity management needs to provide a cushion to cover anticipated deposit withdrawals. Firms should track the impact of pre-payment of loans & premature closure of deposits so as to realistically estimate the cash flow profile. However, the findings of this study were limited to SACCOs in the Agricultural sector in Meru County and concentrated on issues that affected the growth of SACCOs and ignored risk management.

Hamdu and Adriana (2016) revealed the better the organization understands its inherent risks the greater confidence it will develop in order to pursue opportunities. The effectiveness of risk management improves accountability among stakeholders, thereby enhancing the effectiveness of corporate governance and strategic competitive advantages. Integrating risk management activities and documentation of the risk management process could have a greater contribution to the identification of business opportunities and facilitates the distribution of knowledge and best practices. Ultimately, integrated and effective risk management is expected to lead to sustainable resource allocation to improve the performance of the organization. However, it was observed that

the study was too general since it focused on companies but not SACCOs in Kenya.

Mang'ana, Nyaboga, Momanyi and Makone (2015) revealed that poor risk management could jeopardize the company's relationship with its stakeholders. The company's day to day operations are related to its customers, suppliers and other partners. They all are external and the company has little control over them. The failure in risk management could severely affect the perception of these important elements. This results in higher contractual costs with its stakeholders. Suppliers and customers may engage in a negative bargaining process in every transaction that could ultimately increase transaction costs with them. Companies need to give appropriate concern for improving the risk management system in order to satisfy their counterparts such as customers and suppliers thereby, a fair and win-win commercial engagement could be reached with all company's counterparts.

Conceptual Framework

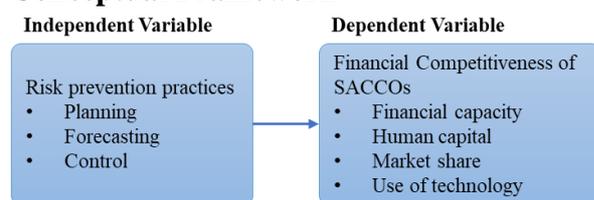


Figure 1: Conceptual Framework

METHODOLOGY

The study adopted a descriptive research design as it not only enables the description of the phenomena of interaction between the variables under study but also how they influence the competitiveness of the SACCOs in Kirinyaga County. The descriptive research design also enables deductive reasoning when putting the problem under investigation into perspective. The descriptive research design. The target population of the study was the top management of the SACCOs in-charge of decision making. Due to the size of population the study resorted to a census where all the 115 Top Managers of the deposit taking SACCOs were administered with a questionnaire. Both descriptive and inferential statistics were utilized to analyze

the data collected through the structured questionnaire. The reliability of the research instrument was tested using Cronbach Alpha Coefficient which returned a value of 0.95. According to Cooper and Schindler (2014) the Cronbach Alpha lies between 0 and 1, and a value greater than 0.5 is acceptable. The research ethics and norms were ensured through confidential handling of data as well as voluntary participation of respondents. The research instrument also underwent evaluation through the Committee of Ethics under National Commission on Science, Technology and Innovation (NACOSTI).

RESULTS

There were 115 questionnaires distributed to the selected respondents. The response rate stood at 75 per cent. Majority of the respondents indicated that they had worked for between 4-6 years in the SACCOs and this represented 32.2 per cent of the study's population. The majority of the respondents were credit managers at 21.8 per cent followed closely by the financial managers at 20.7 per cent. In terms of developing a risk management policy, it was established that 56.3 per cent of the SACCOs participating in the study had a risk management policy. The relationship between risk prevention practices and financial competitiveness was computed utilizing the Pearson Correlation Coefficient. This returned a coefficient of ($r = 0.74, p = 0.006$). The results indicate that there is a strong positive relationship between risk prevention practices and financial competitiveness.

Descriptive Statistics: The Table 1 presents the descriptive statics for the indicators of risk prevention practices. From Table 1 "My SACCO always complies with set regulations by SASRA" had the highest mean at 3.03 while the element "My SACCO conducts customer surveys to minimize risks" had the lowest mean value. In terms of dispersion, the element with the highest variability was "Managers of my SACCO are sensitive on preventing financial risks" at standard deviation value of 1.09 while "My SACCO has developed strategies to curb intense competition" had the lowest variation

value of 1.01. Majority of the elements were negatively skewed except the elements “My SACCO has developed strategies to curb intense competition” and the element “My SACCO has integrated technology in

managing customer information”. In terms of kurtosis the element with the highest value was “Managers of my SACCO are sensitive on preventing financial risks” with a value of -0.426.

Table 1: Risk Prevention Practices

Statement	Mean	Std. Deviation	Skewness		Kurtosis	
	Statistic	Statistic	Statistic	Std. Error	Statistic	Std. Error
Managers of my SACCO been forecasting financial risks in order to implement the befitting risk prevention mechanisms.	2.9885	1.09432	.296	.258	-.426	.511
My SACCO always complies with set regulations by SASRA	3.0345	1.07236	.278	.258	-.408	.511
My SACCO conducts customer surveys to minimize risks	2.8391	1.03287	.266	.258	-.615	.511
My SACCO has adopted an integrated technology in managing customer information	2.8506	1.10526	-.014	.258	-.936	.511
My SACCO has developed planning strategies to curb intense competition	2.8506	1.01762	-.099	.258	-.576	.511

The results of the study are consistent with those of Nyaga (2014) who established that continuous implementation of strategies for minimizing risks are vital in improving the financial competitiveness of SACCOs. Nyaga (2014) study established the need to conduct risk identification processes as well as conducting surveys as a method of preventing losses occurring from unattended or unknown risks. The findings of this study are consistent of those of Nkuru (2015) who established that risk prevention strategies implemented in an organization is one way of enhancing the performance of the SACCO.

Regression Analysis: The study objective was to determine the effect of risk prevention practices on financial competitiveness of SACCOs in Kirinyaga County. Regression analysis was carried out to determine the statistical relationship between risk prevention practices and financial competitiveness.

Table 2 represents the regression model on risk prevention practices against financial competitiveness. As presented in the table, the R and R² values are provided. The R² value referred to as the coefficient of determination. The R² value indicates how much of the total variation in the dependent

variable, financial competitiveness can be explained by risk prevention practices. In this regression, 86.8% in the dependent variable can be explained by risk prevention practices instituted by the organizations.

Analysis of Variance (ANOVA) was also established for the relationship between risk prevention practices and financial competitiveness. The study made use of one way ANOVA to gain insight on the relationship between the independent variable and the dependent variable. The results represents how well the independent variable predicts the dependent variable. The value of F significance is less than 0.001 which indicates that the regression equation is a good fit for the risk management data. The beta coefficients for risk prevention practices against financial competitiveness was as determined below. The p-value was 0.000 which is less than 0.05, hence risk prevention practices contributes statistically significantly to the model. The study therefore, concludes that risk prevention practices has a significant effect on financial competitiveness and thus has a significant positive relationship with the competitiveness of the organization

Table 2: Risk Prevention Practices

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.932 ^a	.868	.846	.54572
a. Predictors: (Constant), Risk Prevention Practices				

ANOVA ^a						
Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	17.330	1	17.330	46.151	.000 ^b
	Residual	31.917	85	.375		
	Total	49.247	86			

a. Dependent Variable: Financial Competitiveness

b. Predictors: (Constant), Risk Preventive Practices

CONCLUSION AND RECOMMENDATION

The study examined the effect of risk prevention practices on the financial competitiveness of SACCOs in Kirinyaga County. It was established that the risk prevention practices had a positive association with financial competitiveness. The regression coefficient of Risk Prevention Practices stood at 0.471 which was statistically significant as its p-value was less than 0.05. This, therefore, indicated that a unit increase in Risk Prevention Practices would result to a 0.471 increase in financial competitiveness of SACCOs in Kirinyaga County.

The results of the study are consistent with those of Nyaga (2014) who established that continuous implementation of strategies for risk prevention are vital in improving the financial competitiveness of SACCOs. Nyaga (2014) study established the need to conduct risk identification processes as well as conducting surveys as a method of preventing losses occurring from unattended or unknown risks. These findings are consistent with Nkuru (2015) who established that risk prevention strategies implemented in an organization acted as performance enhancers in SACCOs.

From the study findings we conclude that risk prevention practices is a major determinant of financial competitiveness of SACCOs in Kirinyaga County. As the

multiple regression results revealed, risk prevention practices had a significant effect of 0.471 on financial competitiveness. It therefore indicates that risk prevention practices factors including planning, forecasting and strategy if well implemented contributes to financial competitiveness of the SACCOs. The ability of the organization to implement risk preventive strategies is able to forestall any kind of losses that may arise in the SACCOs.

The risk prevention practices applied in the course of running an organization is very vital for its financial competitiveness. The management of SACCOs should be able to plan ahead and institute the right strategic measures for the success of the SACCOs projects. It is also in line to carry out forecast of future scenarios in the event certain occurrences in the external environment may affect the organization. This helps the SACCOs to undertake risk mitigation measures to stem any kind of losses that may occur.

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