
Effect of corporate risk management disclosure on financial performance of non-financial service firms listed at Nairobi Securities Exchange, Kenya

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Abstract: The Kenyan investment community and other stakeholders lag behind America, Europe and Australia in terms of their willingness and ability to cross-examine sustainability reports for risk and financial modelling. This study consequently aimed at assessing the effect of corporate risk management disclosure on financial performance of listed firms in Kenya. Content analysis of sampled listed companies' annual reports was undertaken to examine risk management disclosure practices. Casual research design was employed to determine the cause-effect relationship between risk management disclosure and financial performance. Target population of the study was 61 listed companies. The sample size was 32 listed companies. Coefficient of skewness was used to test the normality of data. Homoscedasticity and auto-correlation assumptions of the regression model were tested. Risk disclosure was found to have a positive but with no significant difference on mean financial performance. However, there is a strong significant relationship between risk disclosure and financial performance.

Keywords: risk management disclosure; financial performance; non-financial firms; NSE.

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1 Introduction

Risk management aspect involves measures taken to ensure business continuity despite unforeseen risks characterising today's corporate world. There has been an increasing need for information by various stakeholders and hence transparency in the company's reporting. This has led to increased popularity of corporate sustainability disclosure (Hossain et al., 2006). There is increased stakeholder awareness of sustainable business development as way of increasing financial performance in the long run. Voluntary reporting has got no standards and only few initiatives exist such as Global Reporting Initiative (GRI), Accountability 1000 (AA1000) and Social Accountability 8000 (SA8000) which can considerably take some time for companies to implement (Sidorova and Gurvitch, 2012). In this regard therefore, companies may provide only positive information for superficial purposes to be used as a Public Relation tool for continued revenue into the foreseeable future as they seek to remain legitimate in the eyes of their diverse stakeholders.

Stavropoulos et al. (2011) argue that when profitability is high and the company achieves a high margin of profit, the managerial groups may be motivated to disclose more information in order to show off good reputation to the consumers, shareholders, investors and other stakeholders. On the other hand, if the profitability is low or the company suffers losses, they may disclose less information in order to cover the reasons for such losses or declining profits. It is therefore motivating to study the effect of sustainability disclosure on financial performance (Stavropoulos et al., 2011).

A number of financial scandals have been witnessed recently in quoted companies both in local and international scene. In the early 2000s, a number of high profile corporate accounting scandals resulted in some investors, company personnel and other stakeholders suffering significant losses. These scandals resulted in demands for a greater emphasis on corporate governance and in general risk management. On the local arena, collapse in banks such as chase bank and imperial banks has resulted into strict measures of risk management. Companies listed in Nairobi stock exchange are expected to have effective and efficient risk management framework to provide reasonable assurance about the achievement of the entity's objective.

Profitability can be measured employing different indicators although; there has been no consensus on an effective measure(s). There are three measures that have frequently been used in the majority of the studies on this subject. Proxies of profitability are return

on revenues, return on total assets and return on equity (Stavropoulos et al., 2011). ROE was used by the researcher as the dependent variable representing profitability for a period of five years, of the selected 20 listed firms which is calculated as the ratio of the net income (income after tax) and equity capital. ROE measures the profitability of a company by revealing how much profit a company generates with the funds invested by shareholders. The researcher will adopt a time frame of five years as used by (Samy et al., 2010) to smooth the effects of managerial manipulation and disparate accounting policies.

The NSE is the only security exchange in Kenya and dates back to 1954. It is a member of the African Stock Association. The stock market is a vital tool for economic development since it provides listed companies a platform to raise long term capital and provide investors with a platform for investing surplus funds. According to Olweny and Kimani (2011), the NSE is a major component of the financial sector and helps contribute towards economic growth through diversification, mobilising idle savings and availing them to companies for optimal utilisation.

Risk management disclosure is beneficial to companies. The disclosure increases the transparency of the company and this is a public relations tool for the company. It also helps to increase a company's access to capital because they convince the providers of capital that they are competitive and low risk takers. More so, data gathered in the reporting process may be useful as it will help company innovate, reduce waste and increase efficiency. Reporting increases employee loyalty and productivity, reputation and consumer trust and also enables companies to predict and manage risk better. However, every benefit has got a challenge. The major challenge is the associated cost and resultant increased transparency of the reporting firm which might lead to scrutiny.

2 Theoretical underpinning

2.1 Enterprise risk management theory

Enterprise risk management (ERM) is a framework that focuses on adopting a systematic and consistent approach to managing all of the risks confronting an organisation (Tseng, 2007). Aspects of the organisation under this theory are: the people, intellectual assets, brand values, business expertise and skills, principle source of profit stream and the regulatory environment (Searle, 2008). This enables the risk manager to be aware of all risk and devise ways to manage them risk management disclosure.

Effective risk management is fundamental to the business activities and a key component of the delivery of sustainable returns to its stakeholders (KCB, 2013). The responsibility and accountability for risk management resides at all levels (KCB, 2013). Reporting firms may be better able to predict and manage risks emanating from sustainability-related dimensions of business (EY, 2013). According to KCB (2013), risk management policies are established to identify and analyse the risks faced by the firm, to set appropriate risk limits and controls and to monitor risks and adherence to limits. Risk is classified into various categories namely: credit risk is the risk of suffering financial loss, should any of the customers, clients or market counterparties fail to fulfil their contractual obligations to the firms. Secondly; liquidity risk is the risk that the firm will not be able to meet its financial obligations as they fall due. This risk can arise from mismatches in the timing of cash flows from revenue and capital and operational

outflows (KPLC, 2013). Thirdly; Market risk is the risk that the fair value or future cash flow of financial instruments will fluctuate because of changes in foreign exchange rates, commodity prices and interest rates (EABL, 2013). Currency risk arises primarily from purchasing imported goods and services directly from overseas or indirectly via local suppliers and foreign borrowings. The company is exposed to foreign exchange risk arising from future commercial transactions and recognised assets and liabilities that are denominated in a currency other than the functional currency of the company (KPLC, 2013). Interest rate risk is the risk that the company's financial condition may be adversely affected as a result of changes in interest rate levels. Equity risk: the risk that the fair value of cash flows of a financial instrument will fluctuate as a result of changes in equity prices (PAIC, 2013). Reputational risk is the risk that the actions of a business for example the treatment of clients, employment equity and social responsibility are injurious to its reputation and brand (PAIC, 2013). Management of risks that the company faces may be important for the long term viability and sustainability of business.

3 Financial performance

Financial performance is the general measure of how well a firm uses its resources to generate profits. It was measured using accounting measures of profitability. A company should earn profits in order to survive and grow over a long period of time (Pandey, 2005).

3.1 Return on equity

The return on equity measures the return earned on the common stockholders' investment in the firm (Gitman, 2007). The higher the returns the better of are the owners. ROE is the most important ratio in financial analysis. According to Pandey (2005), the earning of a satisfactory return is the most desirable objective of a business and the ratio of the net profit to owner's equity reflects the extent to which this objective has been accomplished. This ratio is of great importance to present as well as future shareholders and to management whose core duty is maximising owners' wealth. Without profits, a firm could not attract outside capital and more so even investors (Gitman, 2007).

4 Research design

Research design is the framework, organisation, or configuration of the relationships among variables of a study and the plan of investigation used to obtain empirical evidence on those relationships (Cooper and Schindler, 2011). The study employed casual research design. The design is applicable because it reveals the cause and effect relationship between variables (Cooper and Schindler, 2011). The design was therefore employed to determine the effect of risk management disclosure on financial performance of listed companies in Kenya.

5 Location of the study

The study was carried out in Kenya on the companies listed on the NSE. The NSE is located in Nairobi, the capital city of Kenya. It is a mandatory requirement for joint stock companies to publicly disclose their financial statements and annual reports. The researcher examined the annual reports since they are easily available and are principally the means by which corporations communicate (Amiruddin, 2007).

6 Data collection

The researcher used secondary data. Secondary data was collected from annual reports and financial statements from selected listed firms at the NSE. The annual report is a secondary source of data. A period of five years was considered specifically for the years (2009–2013) for the purpose of this study since it signalled the start and steady rise of sustainability disclosures and therefore convenient for the collection of relevant and reliable data.

7 Data collection instrument

A checklist was employed and it was the instrument for data collection. A checklist instrument outlining the criteria for identifying disclosures was designed in order to codify the sustainability information contained in the annual reports. An extensive review of prior studies was undertaken to develop a list of items that may be voluntarily disclosed by a firm. The main aim was to check for commonalities across the studies and to isolate those items that have been consistently identified as relevant and which may be disclosed by firms. For an item to be included, it must have been used in more than one previously published study. This approach was used by (Barako et al., 2006; Hossain et al., 2006). The aspects of risk considered include operation risk, credit risk, market risk, currency risk, interest risk, reputational risk, liquidity risk, risk management framework and risk management committee. A disclosure index was developed and companies with high disclosure were allotted '1' and '0' otherwise. The only consideration is whether or not a company discloses an item of sustainability information in its corporate annual report. If the total disclosure score exceeds the mean categorical disclosure rating in the annual report it took the value '1' and '0' if otherwise. The total disclosure (TD) score for a company is additive as follows.

$$TD = \sum_{i=1}^n di$$

where,

TD = total disclosure

di = a score of 1 if $TD >$ mean disclosure rating

A score of 0 if otherwise.

8 Results and discussions

Risk management had a mean disclosure of 25%.

Table 1 Descriptive statistics

	<i>N</i>	<i>Minimum</i>	<i>Maximum</i>	<i>Mean</i>	<i>Std. deviation</i>
Risk management	32	0	1	0.25	0.440

Table 2 Skewness test

	<i>N</i>	<i>Mean</i>	<i>Std. deviation</i>	<i>Skewness</i>	
	<i>Statistic</i>	<i>Statistic</i>	<i>Statistic</i>	<i>Statistic</i>	<i>Std. error</i>
Risk management	32	.25	.440	1.212	.414

Firms with high risk management disclosure are more positively skewed than those with low risk management disclosure with a coefficient of 1.212.

8.1 Correlation between ROE and risk management disclosure

Pearson correlation was used to determine the relationship between ROE and risk management disclosure.

Table 3 Correlation between risk management disclosure and financial performance

	<i>ROE</i>	<i>Risk management</i>
ROE Pearson correlation	1	0.734
Sig. (one -tailed)		.000
N	32	32
Risk management	0.734	1
Sig. (one-tailed)	.000	
N	32	32

Note: Correlation significant at the 0.05 (one-tailed)

The correlation coefficient was found to be 0.734 with p value 0.000 which was found to be statistically significant at 5% significant level. This therefore suggests a strong positive relationship between ROE and risk management disclosure. Consequently, increase in risk management disclosure will result to improved financial performance. This boosts investor confidence since those firms portray an awareness of risks facing them and how they can mitigate against such risks. These findings are consistent with Kinyua et al. (2015) who found a positive linear relationship between risk management and financial performance of state corporations listed at the NSE. The findings contradict Kambi and Ali (2016) who found a positive significant effect between financial risk management practices and financial performance of listed banks at the Nairobi Securities Exchange in Kenya.

8.2 The effect of risk management disclosure on financial performance

The study aimed at determining the effect of risk management disclosure on financial performance as depicted in Table 18. The coefficient obtained from regression was 5.661 with p-value $0.159 > 0.05$. Therefore, the null hypothesis was accepted and this implied that there is no statistically significant effect between risk management disclosure and financial performance. Accordingly, risk management disclosure has no effect on financial performance. There is no significant difference in the mean financial performance of NSE listed firms with high or low risk management disclosure ratings. This can be attributed to the fact that investors may not be interested in risk disclosure because they have other avenues to assess financial soundness of a company. Some of them include, stock market performance, severe litigations against the company, decline in market share, adverse liquidity ratios for example acid test ratio among others. There are also some models for instance Altman's Z score for predicting corporate failure. Since the Alton's corporate scandal and thereafter the enactment of Sarbanes Oxley Act in 2002, many companies have a corporate governance framework which can be as a risk mitigation framework.

9 Limitations of the study

The findings of this study may not be generalised to all non-financial services firms in Kenya. This is because listed firms have different legal and regulatory requirements as compared to non-listed firms.

10 Recommendation for further research

The study recommends that similar research could be replicated in other non-listed non-financial companies in Kenya so as to establish whether there is consistency on the findings.

11 Conclusions and recommendation

Based on the findings of the study, the author strongly recommends that company should engage in risk management disclosure since it signals a low risk profile and thus helps to attract investors.

Companies should disclose their risk management framework, risk committee composition, ways to mitigate their various financial and reputational risks. This signals sound management of the organisation and enhance business continuity. Risk management often leads to enhanced financial performance as regulatory compliance and control of risks enables the organisation to save on costs. Risks managers are able to increase the value of the firm by ensuring continued profitability of the firm through reduction in wastes and inefficiencies.

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