EFFECT OF LIQUIDITY RISK MANAGEMENT PRACTICES ON FINANCIAL PERFORMANCE OF FIRMS LISTED AT THE NAIROBI SECURITIES EXCHANGE

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DECLARATION

I hereby declare that this project is my own work and effort and that it has not been presented in any other university anywhere for an academic award.

Signature: ……. Date: ……

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This research project has been submitted for examination with our approval as the candidate's University Supervisor.

Signed …… Date……..

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DEDICATION

I dedicate this study to my parents and Husband for the provision of requisite resources for my education and especially for their guidance on importance of pursuing a master's of Business in Finance.

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I thanks all persons who contributed to my achievement of this course. The formulation of this research project has been a long and challenging process, I wouldn't have succeeded without their support.

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ABBREVIATIONS

ASEA	African Securities Exchanges Association
EASEA	East African Securities Exchanges Association
NSE	Nairobi Securities Exchange
ROA	Return On Assets
ROE	Return On Equity

ABSTRACT

Financial performance in business is assessed using liquidity risk management practices. The importance of liquidity risk management practice to a firms' performance gives directions on the aspects that governs the cost-effectiveness of a firm. Studies done before has not focused on the impact of liquidity risk management practices on profitability. Therefore, the present research studied the influence of liquidity risk management practices on result of finance of firms registered at the Nairobi Securities Exchange. The purpose for this research was to determine the influence of liquidity risk management practices on performance of monetary of firms registered at the Nairobi Securities Exchange. Financial statements was used to collect data from Nairobi Security Exchange and data analysis involved conducting multiple regression analysis. The research indicated that market risk positively affected the performance of finance of non-financial firms registered. The research examined that operational risk and credit risk were not insignificant in influencing financial performance of non-financial companies. The research advocates for non-financial firms to come up with mitigation measure against market risk to grow their financial performance because it was revealed that an upsurge in market risk positively affected the performance of finance. The research additionally commends a necessity for non-financial companies registered on the NSE to conduct risk analysis in order to undertake appropriate measure to counter the operational risk and credit risk so as to positively affect their performance of financial.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Risk is depicted to be state where there is existence of a likelihood of divergence from a preferred result that is anticipated or hoped for or rather a state where by there is existence of disclosure to misfortune (Gallati, 2003). According to the studies of Kannan and Thangavel (2008) they entail exposure to be an ambiguity or a peril. Hence risk can be depicted as the undesirable impact on productivity from numerous diverse causes of ambiguity. From the research of Kannan & Thangavel, (2008) they accord that however the degree of risks and its forms that a firm can be exposed to, they are also affected by various aspects which include the convolution of the business activities and its volumes, its size amongst others hence alleged that banks are wholly countenance by market, operations, credit risks, liquidity, the legal or rather regulatory risk and finally reputation risks.

According to the studies of Raghavan, (2003) he highlights the management of risk is essentially managing it before risk manages. Although there has been the emergence of new commercial banks or the Deposit Money Banks particularly in the market penetration approach and its development of products, it has brought the emergence of additional risks which the banks are anticipated to handle and prevail over. Extreme and defectively managed risks leads to deficits hence jeopardizing the security of bank depositors. Risk is viewed as a vital and a predestined feature in whichever business activity in the market economy as fulfilled from the existence of finance literature. Hochhauser, (2004) argued that business grow mainly through the encounter of risk since the higher the risk, the greater the expected return and therefore a business unit ought to strike a trade-off amongst the two.

1.1.1 Liquidity Risk Management Practices

Liquidity risk management practices entails analysis of balance sheet to estimate prospect cash flows and ways funding needs can be achieved. The former encompasses recognizing the funding market that the SACCO can assess, comprehends characteristics of the markets, assessing SACCO present besides forthcoming usage of market and observing indication of sureness attrition. To control liquidity situations, firms ought to concentrate at both the long term position and prone to great investors (Navdeep, 2014).

Capability of a firm to convene to its financial obligations as and due to their maturity with no hindrance of the usual operations of the company is designated as liquidity. Therefore liquidity can examined both operationally and structurally (Quach, 2005). The symphony of the balance sheet can be referred to structural liquidity whereas cash flow measures are referred to operational liquidity.

The exterior or interior interferences due to the relative magnitude and frequency to the activities of business from occurrence of risk events furthermore diverge transversely in firms varying from their erudition of the interior risk measurement standards and methods that control it and also the nature of the activities. According to studies of Power, (2004) he accords that companies ought to have adequate capital reserves to facilitate losses that occur unexpectedly or make from insurance even though they are obliged to produce projected revenues to sustain a net margins that absorbs risks that are anticipated due to expected internal malfunctions. Hence this ensures that shortfalls do not facilitate negative financial performance of the firm.

The foremost causes of collapse of the insurance companies and their distress in finance is due the great easiness for investment risk, the deprived management of liquidity, under reservations and the underpricing of goods, complexities due to fast growth or development into activities that are not core and finally authority and management issues (Standard and Poor's, 2013). Therefore it is vital that insurance companies manage these aspects hence making them be hindered from bankruptcy and their collapse in finance.

Liquidity ratio can be referred as the sum of money companies and supplementary private entities have in their dispense at any occasion for the reimbursements of their debts (Black, Wright and Bachman, 2008). When accessing the financial statements of a company and endeavoring to ascertain its viability, liquidity ratios are of great significance since the greater the liquidity ratio of a firm the richer it is. Companies with a low liquidity but high debt levels are more probable to collapse and have investments that are more risky.

There are two kind of risks associated to liquidity risks which include the risk that a firm becomes incapable to guarantee itself of enough financial support sue to the shortfall in the new premium income triggered by declines which include decline in the financial position, great calamities that cause the outflow of finances, a huge lot of cancellations due to the inclination of the surrender value, being insufficiently capable to maintain the cash flow or capital liquidity risk due the compulsory selling of assets at prices that are low hence the incurring of losses and also risk disruptions amongst others. According to the research of Black, Wright & Bachman, (2008), this uncertainties' in the market makes it unfeasible to trade and hence forcing the firm to

the employing of transactions at prices that are distinctly more detrimental than the usual market liquidity risk.

1.1.2 Financial Performance

The extent where by the financial goals are being or as been attained is defined as the financial performance. It is the procedure for accessing the outcomes of a company's set guidelines and ventures in fiscal terms. From the studies of Alirezea, Parviz & Sheikhi, (2012), it's used to evaluate the general financial vigor over a duration of time and is capable for the comparison of related entities transversely in similar industries or to evaluate sectors or firms in aggregation.

The performance of a firm financially can be measured from the accessing of its profitability levels, liquidity and solvency. The profitability of a firm shows the degree to which profits from its aspects of production hence financial performance can be computed through this. The analysis of profitability is centered around correlation amongst the funds and expenses and profitability levels in relation to volume of venture in trade by the application of profitability ratios (Zenios et al., 1999). Return On Assets (ROA) and Return On Equity (ROE) are the frequent units used to compute profitability. According to Sichigea, (2011), he highlights that one can appraise the financial performance of the firm by examining its profitability levels.

The indication that a firm is capable to honor its debts through the sell of its assets is referred as solvency measures and gives the information as regards to whether it's able to operate despite the endurance of a huge financial crisis. Solvency computes the sum of the resources borrowed and employed in the business in relation to the sum

of owners' equity capital that have been devoted in the business as a sign of the security of the creditors interest in the firm (Quach, 2005).

1.1.3 Liquidity Risk Management and Financial Performance

Ifeacho (2014) did a study in South Africa that focused on the results of the banking sector from 1994 and exposed that entirely bank precise constructs are statistically important at predictable stages for both Return on Equity (ROE) and Return on Assets (ROA) equations. Precisely, research showed that asset quality which is determined by assets to capital employed ratio, management quality which is established by functioning profits per employee ratio and liquidity measured by quick ratio had a positive relationship with bank performance that was in line with a priori theoretical expectations. Nevertheless, the leverage ratio that is used to determine capital sufficiency indicates an astonishing significant negative association with ROA, while its association with ROE is positively significant as predictable.

Indeed, authors have highlighted affirmative link between liquidity risk management and performance in finance and degree to which physicians are engaged with the organization (Macinati & Rizzo, 2016; Spurgeon et al., 2011). Liquidity risks among others are the capability of a bank to finance the amplification of assets and attain its requirements as they fall due with no encountering of intolerable losses (Njogo, 2012). The elementary function of banks in maturity is the revolution of deposits which are short-term to loans that are long-term facilitates banks to intrinsically exposed to liquidity risk.

According to Zahangiralam & Masukujjaman, (2011), the management of effective liquidity assists in making certain to the cash flow compulsions which are tentative

due to them being pretentious by exterior events and supplementary agent activities, the risk in interest rate which consist of risk endured through the bearing assets such as bonds or loan from the unpredictability of interest rates, legal risks due to the implementation of contracts or unfavorable judgments that interrupts the conditions and operations of the banking companies, reputational risk which is any risk that has a probability to devastate the investor value and makes its negative in the public which include the deficits in revenues, the decline of customers and partners, litigation, decline in the share prices and inability to employ talent.

Acid test is defined as the initial test of an insurer to be capable to congregate its financial obligation (Barney, 2007) and tests of a firm has adequate assets that are short term exclusive to them selling their inventory for the coverage of abrupt liabilities. Deprived liquidity leads to the loss of investment and therefore the occurrence of a poor financial performance which makes the insurer to vend assets impulsively hence covering the claims. An insurer is obliged to have a positive cash flow at all times since its essential for the survival of the entity. Having sufficient cash at your presence makes it possible for employees, creditors amongst others to be compensated in good time. And individual or a business becomes insolvent when it cannot facilitate itself due to insufficient cash and when this condition exceeds it becomes a probable candidate of bankruptcy. Investment grades of a firm's bond portfolio are the various features that are key to a company as numerous high and medium risk bonds lead to volatility therefore meager financial health.

The foremost causes of collapse of the insurance companies and their distress in finance is due the great easiness for investment risk, the deprived management of liquidity, under reservations and the underpricing of goods, complexities due to fast

growth or development into activities that are not core and finally authority and management issues (Standard and Poor's, 2013). Therefore it is vital that insurance companies manage these aspects hence making them be hindered from bankruptcy and their collapse in finance.

1.1.4 Firms Listed in the Nairobi Securities Exchange (NSE)

Nairobi Securities Exchange is a leading African Exchange, based in Kenya which is the fastest rising economies in Sub-Saharan Africa. Founded in 1954, NSE has a six decade heritage in listing equity and debt securities. It presents a world class trading facility for local and international investors looking to gain exposure to Kenya and Africa's economic growth. NSE demutualized and self-listed in 2014. Its Board and management team are comprised of some of Africa's leading capital markets professionals, who are focused on innovation, diversification and operational excellence in the Exchange.

The NSE has a significant goal in the growing of the economy of Kenya since it facilitates people to invest and save and also assisting international and local companies' in their access to cost-effective capital. Capital Markets Authority of Kenya has control over the NSE. Nairobi Stock Exchange is a partner to the World Federation of Exchange, the creator associate of African Securities Exchanges Association (ASEA) and East African Securities Exchanges Association (EASEA). The NSE is a member of the Association of Futures Market and a significant other in the led SSE initiative of United Nations.

1.2 Research Problem

According to Kumba, (2011) the financial performance of firms are highly influenced by liquidity and therefore the emergence of liquidity investments which assist in the settlement of claims moreover if when the revenue from underwriting cannot cover thus claims hence making numerous companies to rely on cash flow from operations in liquidity management.

Firms have retorted to the perceptible opportunities and globalization intimidation through the diverse global production practices that prejudice financial performance and distinct kinds of risk. The management of this inclined level of complication has been facilitated through management practices. Risk management practices have been identified as a key exercise to manage challenges and achieve superior financial performance. According to Ellis, Shockley & Henry, (2011) firms are significantly investing in risk management tools which include mitigation execution and contingency planning so as to control the diverse kinds of risks they are encountered with.

The main goal of an organization is to amplify the shareholders return signifying the financial performance and it frequently appears at the cost of inclining the risk. The comprehensive firm risks include the liquidity risk, market risk, foreign exchange risk, country, operational, credit and bankruptcy risks (Njogo, 2012). Those risks that make the company to underperform has facilitated for risk management.

Numerous researches has been carried out on risk management by organizations in Kenya but minimal studies done in the influence of liquidity risk management practices on the non-monetary firms' financial results of that are registered at the

Nairobi Security Exchange. Mwangi (2010) made a study concerning the effect of the practices of risk management on the financial performance which highlighted that risk management and the concerned practices are vital for the financial performance and operation of these commercial banking institutions. The research accorded that various risk management practices are more considerable to the financial performance which include the existence of a risk management policy and the incorporation of risk management in the facilitation of a company's aims were viewed to have a direct effect on the financial performance of the firm. The study hence seeks to fill the gap in knowledge about the possible existence of a relationship between liquidity risk management practices and financial performance by firms listed in the Nairobi Stock Exchange in Kenya.

1.3 Research Objective

The objective of this study was to determine the effect of liquidity risk management practices on financial performance of firms listed at the Nairobi Securities Exchange.

1.3.1 Specific Objectives

The specific objectives of this study were:

i. To determine the effect of operational risk on financial performance of firms listed in Nairobi Securities Exchange.
ii. To examine the effect of credit risk on financial performance of firms listed in Nairobi Securities Exchange.
iii. To establish the influence of market size on financial performance of firms listed in Nairobi Securities Exchange.

1.4 Value of the Study

The findings of this research help scholars to supplement the existing information on the influence of liquidity risk management practices on financial management. This will include the effect of the study variables. The study output was a basis of invaluable literature among the study variables on theories and policies that inform them. Theorems comparable to Agency theory and stakeholder theory are probable to benefit from the outcome of this study. The study intended methodology on regression model was valuable to researchers who might be intense on analyzing complex associations among the dependent and various independent variables.

From this research, the Nairobi Security Exchange regulators understand ways of involvement to risk management practices on lending by firms listed in Nairobi Security Exchange would be adhered to therefore aligning firms to these aspects and managerial practices to prevent risk and improve financial performance. This study is significant to the firms, listed in the Nairobi Security Exchange regulators as it offer great significance to both practical and theoretical perceptive. Theoretically, it enhance the entire understanding of risk management practices and their effect on financial performance.

The study is valuable to the Central Bank as the dictatorial agency might need formulate policies concerning the intensification of risk management practices by firm in Nairobi Securities Exchange. It therefore assist in the improvement of liquidity risk management procedures and hence the adoption of effective strategies to advance the firms the performance of the firm financially through risk management processes. Therefore making firms to advance and lead to their growth in businesses and sustain a competitive advantage.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter shows information from the literature in the same field of study. The specific areas presented are theoretical literature, and empirical literature, and summary of literature reviewed.

2.2 Theoretical Review

The research reviewed the subsequent theories: agency theory, stakeholders' theory and optimal capital structure theory.

2.2.1 Agency Theory

This study was guided by Agency theory by Ross (1973) as it widens the scrutiny of the company to embrace the partition of ownership and power as well as givimg incentives to the management. According to Stulz, (2003) the approach of management towards the intriguing of risks and its hedging have been significantly influenced through the field of corporate risk management agency. In his theorem also accords that the reason as to why firm indulge in numerous risks and not complying to positive net value projects is due to the probable disparity of interest amongst the shareholders, management and the debtors owning to the asymmetries in the allotment of earnings.

Stulz (1984) initially recommended a basis for the interest of management of risks by the managers of an organization as they are reputed to be operating on behalf of the proprietor of the firm and hence concerned with the anticipated profits and the allocation of the returns of the firm about the projected value. They are obliged to

evade from risks and hence reduce the unpredictability of the returns of the firm. Agency costs are salvaged through the management of risks by the proprietors of the firm and hence minimizing the inconsistency in the return of the firm and therefore focusing on the goal of wealth maximization when the managers work together with the investors.

Few research show a negative effect on execution of corporate risk management due to the motivation of the managerial factors (Faff and Nguyen, 2002; Geczy et al., 1997; MacCrimmon & Wehrung, 1990). However Tufano (1996) in his studies established a positive evidence in the examination of mining of gold in US. Fiscal policy assumptions were verified in the research of the financial theory as both theorems have the same forecast in this study. Conversely, more of the empirical evidence appears to be against the assumptions of the agency theory.

A significant consideration to the management of risk as a response to the disparity amongst the motivation of managers and the interest of the proprietors is greatly presented in the agency theory. The managers and shareholders have diverse interest to the company and the aims to the management of risk differ among the diverse stakeholders. Managers are concerned with low risk and return investments while the shareholders prefer high risk and high returns. The necessity for risk management to support the interest of both the shareholders and the managers for the contribution of the financial performance of the firm is highlighted in the agency theorem.

2.2.2 Stakeholder Theory

Freeman, (1984) initiated the Stakeholder theory as a decision-making instrument and has developed into a theorem of the firm with great descriptive prospective. The key

determinant of corporate policy that the theory converges on is the equilibrium of the interest of the stakeholders. According to the studies of Cornell and Shapiro, (1987) the delay of inherent contracts theory commencing from employment to supplementary contracts with the inclusion of finance and sales are the major capability to risk management. However a number of industries especially the high-tech and services, the reliance of the consumers in the firm to be capable for the continual supply of services in the future significantly contribute to the firm's value. Nevertheless, the inherent claims value is greatly receptive to the anticipated costs of financial distress and insolvency.

According to Klimczak, (2005), the value of the firm appreciates due to the minimization of expected costs from the enforcement of corporate risk management practices. Hence the stakeholder theory initiates an innovative insight into the probable basis for the management of risk. However this has not been directly tested. Smith and Stulz, (1995) provides an analysis of the financial distress assumption while Judge, (2006) attempts to give indirect evidence. The theorem has a considerable effect to management of risk research as it is significant to tackle the trust of the customer and the financial distress in insurance companies. Small companies should intensify their interest risk management practices as they are more probable to financial problems.

The necessity for management of risk in insurance companies and its significance in the improvement of the firm's value is highlighted in the stakeholder's theory. Nevertheless the manipulation of risk management on the performance of the firm financially and consequential correlation amongst the two variables are not specified apart from signifying that management of risks intensifies the value of the company.

2.3 Determinants of Financial Performance

Existing literature reveals an influence of liquidity risk management practices on the performance of finance. This includes competition, interest rate and profitability. Studies employing different methodologies have been carried out on those determinants across the world.

2.3.1 Competition

The extent of competition in firms has been approached in diverse criteria's by economists over time. The initial approach was endeavored to deduce the behaviour of the completion and the firm's performance from the industry's market structure. The approach was majorly linked with Bain (1956) quoted in Hochhauser (2004).The deliberation of the market share and the numeracy of companies are alleged for the firms aggressive performance. The more a firm is concentrated by the market share, the more probable it is to employ in anticompetitive behaviors unlike the undersized firms. A small quantity of the big firms can collide to form a cartel and control prices and conditions leaving the small marginal firms to accept this leadership in prices. This structure conduct performance approach gives the managers with a suitable yardstick when decree on the mergers aggressive impact.

A study by Blundell-Wignall, Atkinson and Lee (2008) suggested a substitute method to competitive behaviour and scrutinized the cost structures and revenue of corporations, using the outline of flawless competition as the reference position. Firms industry that operates under circumstances of a perfect competition are not capable to tackle the amplification in costs hence making them to forward the whole augmentation of the input costs in output prices and revenue making the output to be unaltered. In the monopolistic condition in equilibrium by distinction, an increase in

the prices of input which can include administration costs and wages it brings an outcome in the declination in outputs and an increase in prices a small amount than the cost increase making a reduction of the total revenue. This makes the marginally profitable firms to evade the industry.

When firms cluster they are capable to produce a variety of products. Through the diversification of products, a downward sloping demand curve is created for the insurance products through selling costs and advertisement. The numerous rivals in the market make the firm to trust its proceedings and will not rapid the corrective measures. According to Brigham & Philip, (2004) the penetration into the market is comparatively simple and the involvement of price fixation or market sharing is almost impossible. The long-run equilibrium output in the monopoly competition is achieved through when the standard cost is peripheral to the average revenue curve. This makes firms not to achieve profits because the long-run average cost is in equilibrium with the price.

According to the studies of Schich & Kikuchi, (2004) the dominance of acquisitions and mergers amongst insurance carriers and agencies is the most considerable trend in the industry. The great investment returns that are a documentation to profits have made possible to the numerous carriers to an accumulative substantial conflict chest assigned for acquisition. Consequently, large insurance firms are expanding more while the smaller agencies are being required to come together in clusters. Additionally, networks have become more aggressive in an endeavor to progress their negotiating position with carriers whose anxiety for a premium that is profitable have progressively inclined. All of these have a great effect on consumers.

2.3.2 Interest Rate

From the studies of Hoyt, (1994) an interest rate is viewed as the cost of borrowing money. Due to insurance companies making an assurance or a guarantee to the insured at the period where the policy is sold, they are not liberated to amend the fixed rates or agreed in the sale consequently as a result of an outcome. This characteristic of insurance renders them capable to the risks due to the changes in interest rates. The collected premiums attained are invested by the insurance companies hence the earnings attained from this investment is highly dependable on the interest rates. Staking & Babbel, (1995) accords that a decline in the interest rate brings a slow investment revenue growth rate hence the impact on the performance of finance of the insurance companies. A further shortcoming due to the fluctuation in interest rate is the cost of borrowing.

Majority of the insurance companies are made profitable due to the increase on the interest rate due to the profits being attained on a float which is essentially the period between when the premiums are collected and at the time of claims payment (Schich, 2008). During this period, the insurers invest the premiums hence the inclination f the interest rates give a high returns on the bonds which is a type of asset though high degrees lesser the worth of bonds presently in their collection. Great home insurers have a greater significance than the small vehicle insurers.

Companies are unable to offer high interest rates to their clients or the insured and as a consequence to facilitate the high levels of profitability due to the downfall in the market interest rates. This suggestion was experimented in Taiwan for a duration of period on the downfall of the market interest rates for insurance companies. A model to scrutinize the correlation among the profitability of 12 local insurance companies

and their market interest rate was studied (Flannery's, 1981 and quoted in Yang, 2007). The outcome highlighted that the consequence of interest rates changes on insurance companies are highly dependable upon on how the profits are computed and it considerably differs on the profit indicator used.

The outcome is not perceptible with no notable manipulation of interest rates on the profits that is when the insurance sector is viewed wholly. Yang (2007) continues to accord that the degree of variations in rates of interest does not affect the rate of profitability directly, the profit operating margin, the operating profit rate and the net profit of the 12 sampled insurance companies in exception to the instance of the profitability indices for Central insurance, Life Insurance and Cathay Insurance which are impressive to the length of observation. In the occurrence of the fluctuations in market interest rates, three outcomes are analyzed which are the profits from the new assets of the insurance companies and the two other outcomes are the cost of liabilities and those of insurance companies being of great importance hence signifying that market interest rates have a great manipulation on profits on new assets of the insurance companies. It was accomplished that in the study of nine insurance companies in the sampling of profits of new assets it was shown that it was higher as in comparison to the cost of liabilities hence signifying that companies have profits on new assets as they amplify rapidly hence the steady inclination on the operating net profits of the concerned insurance companies.

2.3.3 Profitability

The attainment of profits is the main determinate as to whether to invest or not by any firm. According to Santomero and Babbel, (2007) he asserts the two main constituents

of profit for any other insurance company is the investment of income and the underwriting/premium income. Underwriting income is achieved through the issuance of policies. Through the averaging of the growth rates of premiums of a number of years one can ascertain the development drifts. Rising premium income is a “catch 22” for insurance firms. If one wants the growth rate to surpass the average of the industry, you ought to ensure that the high growing rates are not attained at the expense of being tolerant to high risk customers. In the other hand, if the premium income of a company relates to growth at a sluggish degree it might be particular for looking for high quality insurance opportunities. The key feature one has to put in mind is that high premium collection do not account for high profits.

The increase of the competitive pressure mutually with artificially low interest rates featured from the preceding couple of years makes produces a persuasive motivation to employ these criteria’s so as to make the investors contended. The extreme debt leverage has a considerable effect for a company when the market demand depreciates; this was reveled at the progress economic downturn. It in return generates exceeding risks for a company in difficult periods. These hardwork becomes influensive as the profit levels continues to depreciate as additional reserve buybacks or the debt leverage will be essential to facilitate a return on the market equity hence amplifying the exposure of the company to unpredictable downfalls in the financial market crisis or the demand of the consumer. The turn down of the ROE is mostly agonizing to consider as the influence on the stock performance and therefore the financial results would be instantaneous. From the studies of Hagel, Brown & Davison, (2010) he highlights that risks less abrupt and experimental hence the comprehensible enticement for the avoidance of instant pain.

Numerous investors and economic analysts are likely to major on the return on equity as their main appraisal of the firm results (Hagel, Brown and Davison, 2010). ROE centers on shareholders of return of the company hence making it fast and simple to comprehend the metric nonetheless, it can led to the emergence of significant uncertainties'. When the shareholders are not keen, it can avert the concentration from the essentials of business and bring up the emergence of unpleasant shocks. Firms can employ financial strategies so as to sustain a strong ROE for certain duration and conceal declining performance in the essentials of business. The growing debt leverage and stock buybacks financed through the accrued cash can assist to facilitate a company's ROE even in despite of the insufficiencies of the operational profitability.

2.4 Empirical Studies

In relation to liquidity, Atkinson and Lee (2008) found a relationship which was positive between liquidity and financial performance of insurance companies. The past studies are not consistent; consequently, this study will reconcile them as well as established the extent to which these aspects influencing financial results of firms registered at Nairobi Securities Exchange in Kenya.

In a study by Salman (2004) on Islamic ways of monetary and related liquidity risks, the environment of banking sector disclosures them to liquidity risk along with the major aspects that are prone to the financial organizations and also from the financing and operational procedures. Maturity incongruity can be a possible basis of liquidity risks amongst other aspects like the rate of incapability to convert assets into liquid cash on demand without experiencing losses and unexpected call for deposits in the side of liabilities.

A study by Ogol on liquidity risk management in Micro Finance Institutions indicate that trends in market that involve drive of unbalanced sources of funding may surge liquidity risk. Instable financing in this circumstance denotes the entire sale funds, internet banking and brokered certificate of deposit. The occurrence of an operational electronic banking system has enabled swapping of financing by depositors resulting to a more complex liquidity management podium (Ogol, 2011).

In the research by Adeusi, Adebisi, Akeke and Oladunjoye (2013) centered on the interrelation of risk management practices and the results of finance in banks in Nigeria. Through the employing of a panel secondary data for 10 banks and for duration of four years, an inverse correlation was among the financial performance of banks and uncertain loans, it was found out that the capital asset ratio was positive and had a great significance. It highlights that the great management of resources by banks bring the high performances hence the conclusion of a considerable correlation among the banks performance and management of risk. Therefore, the necessity for banks to perform discreetly in the management of risk so as the investors to be secure.

The enchanting of extreme risk to advance performance was accorded Bruner, (2010) where he highlighted that there was decline in real risk-free interest rates to in the past low levels hence leading to the increase of credit in vicious search for capitulation between the investors. Therefore the main financial predicament in the entire universe can be accredited to inordinate aspiration (to return excellent return to their owners) by decision makers and the board thereby taking excess risk to boost stock prices. The 2007 economic crisis in 2007 and 2009 financial catastrophe in the Nigerian banking business are instances.

A research was done by Ogoli (2012) on the impact of credit risk management on financial performance of commercial banks in Kenya. This study used descriptive survey design. The population was 23 insurance firms whose mandate was on life insurance. This study revealed that the foremost three risks experienced by insurance firms were regulation and de-regulation risk, competitor risk and industry economics risk respectively. This research found out that competitor risk was characterized by organizations competing for the controlled market that was not supported by the deteriorating economic situation. As a result of the reality of risks to company strategy, this research advocated that insurance firms further enhance the setting out of strategic planning tools that enable the organizations an outside-in standpoint of the strategic planning process.

In a research done in Kenya by Ongore and Kusa (2013) on the causes of financial results of commercial banks in Kenya. The researcher used Generalized Least Square on panel data and linear multiple regression model. The findings revealed results in finance in commercial banks would be determined mostly by board and administration judgments and macroeconomic aspects had inconsequential influence. The findings revealed weak association between risk management and financial performance. The literature review did not indicate clearly the relationship of liquidity risk management and outcome of finance. This research pursued to find out the consequence of liquidity risk management practices on monetary results of corporations registered at the Nairobi Securities Exchange.

A research by Njoroge (2013) on the strategic risk management practices by AAR Insurance revealed reputation risk as the most significant risk facing the company. This study employed case study research design. The target population comprised of

40 senior management and middle level staff at AAR Insurance Kenya Limited drawn from the department of finance, underwriting and operation. The research recommended that the Board should continue taking ownership and driving the risk agenda across the business. It was also recommended that the organization should emphasis on new emergent risk types for example operational risks, reputation and IT security while not losing emphasis on the traditional risks such as credit and market risks. AAR should also define Risk Management framework and program that permits effective reporting and consolidation of data.

A study by Fredrick (2014) was focused on the influence of liquidity risk management on monetary results of banks in Kenya revealed that liquidity risk management had a negative effect on performance of financial of commercial banks. Credits from commercial banks had a 14.2 effect. This borrowings was to help the banks realize a shorter liquidity need (Emma et-al, 2009).

2.5 Conceptual Framework

Conceptual framework demonstrates collaboration amongst independent and the dependent variables in the research. It graphically or diagrammatically conceptualizes the relationship between variables in the study (Mugenda & Mugenda 2003). In this study the independent variables were; operational risk, market risk and credit risk while the dependent variable was financial performance. The conceptual frame work is presented in the Figure 2.1.

Independent variables

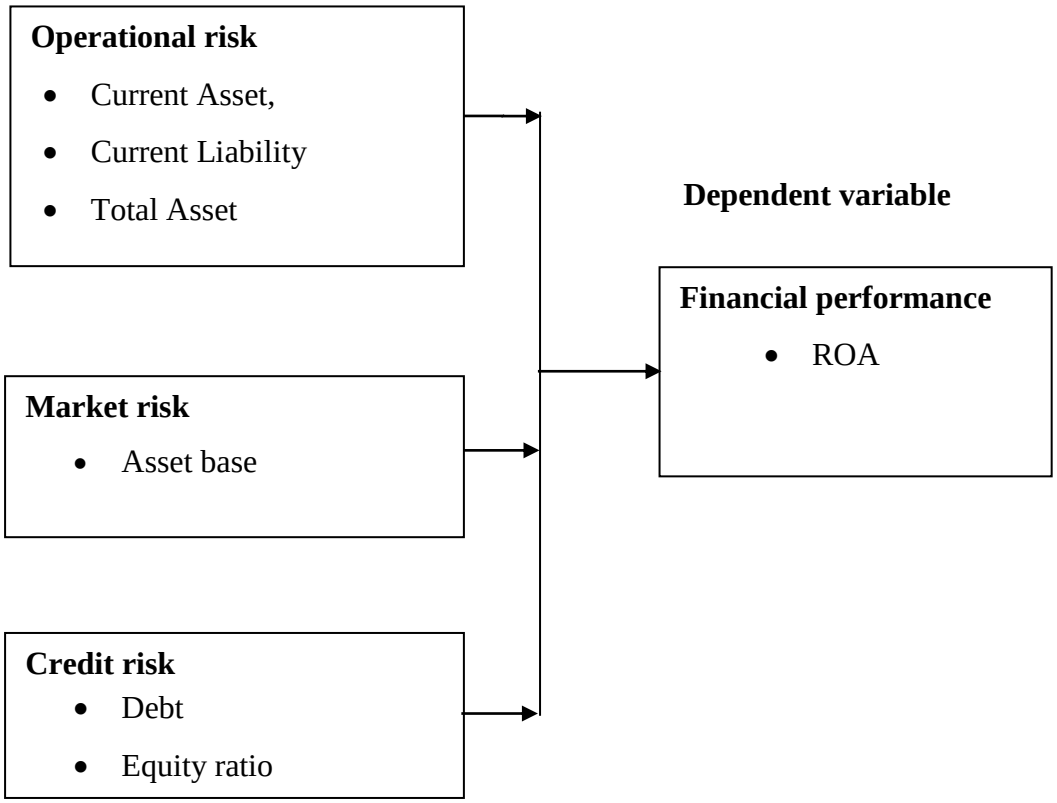

Figure 2.1: Conceptual Framework

2.6 Summary of Literature Review

The performance of finance by a firm is prejudiced by a variety of characteristics influencing it, hence the assessment of the literature highlights the reasons as to why entities should be concerned with the management of risks. A convincing rationale for management of risks by firms is studied by (Vaughan & Vaughan, 2008) where he declared the key goal of the management of risk is endurance. The management of risk gives assurance of the permanence of the firm as an operating firm, therefore making sure that it is not prohibited from achieving the other goals through the losses that might have cropped up due to pure risks.

The managers make decisions which influence the performance of finance of firms and the risks encountered by them hence emphasizing on the necessity for a suitable risk management strategy to direct the objectives and interests of management of the organization. The stakeholders also necessitate a guarantee that their interest are secured by the strategies and the management of the firm. The literature reveals the need to progress the financial performance so that it can be in equilibrium with the risks due to the operations of the firm. Therefore brings about the advancement of risk management program to congregate to the policies of the entity.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents the framework employed in data collection. It also covers research design, population, gathering of data and analysis.

3.2 Research Design

The main components of the investigation work collaboratively in effort to address the questions of the research are shown by the research design. According to the studies of Garner, (2010), it gives information from the fundamental philosophical assumptions to research design and the collection of data. Through descriptive design the research is capable to depict the existing correlation through the use of observation and interpretation techniques. The research was presented with a suitable method to illustrate the features of the variables in the study. Research that is done fundamentally ascertains for casual connections among the study variables by the analyzing of accessible phenomena and then the evaluation of data that is attainable so as to identify effective casual correlation.

3.3 Population

The total set of units whereby the assessment data are used to formulate presumptions is defined as a target population. According to Kothari, (2004) target population are those units for which the outcome of a survey intended to generalize. The study adopted a purposive sampling to include 40 non-financial firms registered in Nairobi Securities Exchange in Kenya (NSE, 2017). Kothari, (2004) accords that the collections of precise and consistent data is through a census approach. The features

of the target population that are observed ought to be strongly correlated to the features anticipated to comprehend the research.

3.4 Data Collection

Secondary data was acquired from information on profitability to be obtained from CBK supervision department monthly economic reviews, quarterly reviews and annual reports. Monthly average ratios of profitability was extracted from the financial monthly economic review reports. The data covered a period of 5 years from the year 2012 to 2016. Data on credit information sharing was obtained from CBK supervision department. Monthly total credit reports requested by the firms from the two licensed CRBs will be extracted from the reports. The data covered time of 5 years from 2012 to 2016.

3.5 Data Analysis

This research used secondary data gathered from the financial statement of the selected firm registered in Nairobi Security Exchange. Every of the risk management areas (credit risk, operational risk and market risk) as experienced by the a number of firms listed in Nairobi Securities Exchange was gotten through appropriate ratio computation using figures as contained in the financial statements. A regression model was employed to establish the existing correlation.

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon$$

Where:

Y = Financial Performance (Measured using ROA) $\mathrm{RZA} = \frac{\mathrm{PAT}}{\mathrm{TA}}$

$\mathrm{X1} = \frac{\mathrm{CA-CL}}{\mathrm{TA}}$ Operational risk (CA = Current Asset, CL = Current Liability, TA = Total Asset)

$X2 = \frac{D}{E}$ Credit risk (D = Debt, E = Equity ratio)

X_3 = Market risk - Size (Asset base)

ε = the error term

The values of X_1, X_2 & X_3 was computed from the mean score of the responses on each Likert scaled data for each non-financial industries registered in Nairobi Securities Exchange. Mean score was obtained for the respective variables for each firm, and data used for the multiple regression. The Y value is an average for the 5 year period, 2012-2016.

F-test tested for the combined significance of all the co-efficient while a t-test for significance of individual coefficient. The measure of central tendency which is the mean and the measure of variation of depression referred to the standard deviation was employ to examine the data.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This section presents the interpretation of findings from regression analysis done as well as the findings of analysis of the impact of liquidity risk management practices on results of monetary of firms registered at the Nairobi Securities Exchange. Regression was conducted on the data from 40 non-financial firms for the same time period. This study used secondary data which ranged from 2012 to 2016. The liquidity risk management practices of each firm were related on the independent variables which were three so as to examine the models.

4.2 Research Findings

The descriptive statistics and inferential analysis using multiple regression is presented in this section.

4.3 Descriptive Statistics

Table 4.1 indicates the statistics in descriptive and distribution of the constructs considered in this research: credit risk, market risk, operational risk, and financial performance. The descriptive statistic considered were maximum, minimum, skewness and kurtosis, standard deviation and mean.

Table 4.1: Descriptive Statistics (Average 2012-2016)

	Minimum	Maximum	Mean	Std. Deviation	Skewness		Kurtosis	
	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic	Std. Error
Operational risk	.2635	.2894	.282206	.0065645	-.994	.374	.321	.733
Credit risk	.2761	.3877	.325326	.0240045	.995	.374	1.396	.733
Financial performance	.1061	.1502	.119842	.0078701	1.563	.374	4.800	.733
Market risk	.2987	.5026	.406816	.0579022	-.279	.374	-.768	.733
Valid N (listwise)								

Table 4.1 shows that operational risk showed .282206 of mean and standard deviation of .0065645. Operational risk is, on average, .282206 across all the years under study. Mean value of credit risk was .325326 which denotes that it, averagely all the firms under the study period. Furthermore on average the market risk in all the five years under study was .406816 meaning that the non-financial firms listed at NSE for the period under study had market risk on an average. Further the mean for financial performance of the firms was .1502 on average meaning that the firms performed poorly financially.

4.4 Regression Analysis

In order to examine liquidity risk management practices effect operational risk, credit risk, market risk significantly on financial performance, multiple regression was performed.

Table 4.2: Summary of Model

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.560[a]	.313	.256	.0067875

a. Predictors: (Constant), Market risk, Credit risk, Operational risk

Through checking the adjusted R squared coefficient of determination, the deviation of dependent construct owing towards variations in independent variable was revealed. From the results, the adjusted R squared was 0.313, this indicates that there was variation of 31.3% on performance of finance because of changes in operational risk, credit risk, market risk at 95% confidence interval. This reveals 25.6% variation in monetary performance of non-financial firms registered at Nairobi Securities Exchange might be because of operational risk, credit risk and market risk. The relationship between the study variables was shown by R which is the correlation coefficient. The research revealed a positive relationship which was strong among the research construct as revealed through 0.560.

Table 4.3: Analysis of Variance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.001	3	.000	5.478	.003[b]
	Residual	.002	36	.000		
	Total	.002	39			

a. Dependent Variable: Financial performance
b. Predictors: (Constant), Market risk, Credit risk, Operational risk

Table 4.3, shows that from the ANOVA the study variables, had a significance level of 0.3% that indicated that the information was appropriate for inference making on the populations parameter as the (p-value) which shows significance was smaller than 5%. The F critical was 5.143 at 5% level of significance. Subsequently the F critical

(5.143) was less than F calculated, this showed the general model was substantial and that operational risk, credit risk, market risk significantly affected financial performance.

Table 4.4: Coefficients

Model		Unstandardized Coefficients B	Unstandardized Coefficients Std. Error	Standardized Coefficients Beta	t	Sig.
1	(Constant)	.055	.047		1.183	.245
	Operational risk	.041	.175	.034	.233	.817
	Credit risk	.082	.047	.250	1.748	.089
	Market risk	.065	.019	.475	3.370	.002

a. Dependent Variable: Financial performance

The equation is thus as shown below:

$Y = 0.055 + 0.041 X_1 + 0.082 X_2 + 0.065X_3$

The findings from regression equation revealed that maintaining operational risk, market risk and credit risk to zero, performance of finance of non-financial firms was 0.055. A change of a unit in operational risk results to growth in the performance of finance by a factor of 0.041. A change of one unit in credit risk make an increase in the performance of finance at the Nairobi Securities Exchange by 0.082 and one step increase in market risk results to increase in the financial performance by 0.065.

At 95% level of confidence and 5% level of significance, credit risk was 0.089 level of insignificance; operational risk revealed a 0.817 insignificance and market risk indicated 0.002 significance level. Therefore, market risk was most significant. Generally, market risk had the highest influence on the financial performance, credit

risk and operational risk had insignificant influence on the financial performance. Market risk was revealed to significantly influence the financial performance.

4.4 Findings Interpretation

The research results revealed a change of 25.6% on performance of finance of non-monetary firms registered at NSE as a results of changes in operational risk, credit risk and market risk. Thus sows that 25.6% change in financial performance could be accounted for by market risk, operational risk and credit risk. The study also indicated a positive strong relationship between credit risk, operational risk, market risk and performance of finance as indicated by correlation coefficient being positive.

The study of alteration of the findings of the research revealed the general model showed a significance of 0.6% that showed that the information was perfect for generating conclusion on the parameter of sample as the significance was less than 0.05. The study again indicated that operational risk, credit risk, market risk significantly influences the financial performance. The resultant equation of regression was $Y = 0.055 + 0.041\ X_1 + 0.082\ X_2 + 0.065X_3$.

The regression revealed that putting operational risk, credit risk, market risk to a constant zero meant that financial performance would be at 0.055. The research indicated a positive relationship between credit, operational, market risks and results in finance. Only market risk revealed to significantly influence financial performance of non-financial firms.

The study discovery agree with the finding of Atkinson and Lee (2008) who found a relationship which was positive between liquidity and financial performance of insurance companies. As asserted by Salman (2004) did a research to relate ways of

finance of Islam and liquidity risk, mode of business in banks make it prone to banking institutions to liquidity risk and other factors that are used by financial firms and from financing and procedures that are operational. Not matching sources of risks in liquidity and other aspects like rate of incapability to change possessions into liquid cash on demand and avoiding damages and unforeseen need deposits in the side of liabilities.

A study by Fredrick (2014) that related liquidity risk management to performance of monetary of banks in Kenya revealed that the latter led to poor performance of finance in commercial banks. Solving the problems of shorter liquidity needs through borrowing from banks had the greatest impact on liquidity at 14.2%.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

The study results after interpretation led to the following conclusion and recommendations. The presentation is founded by the study objectives. The study intended to find out the effect of liquidity risk management practices on performance of monetary of firms registered at the NSE.

5.2 Summary

This research endeavored to determine the ways liquidity risk management practices affect performance of monetary of firms registered at the Nairobi Securities Exchange. Multiple regression analysis was done using information collected from financial statements. The regression revealed that changes in operational risk, credit risk and market risk caused a variation of 25.6% on financial performance. This was signaled that 25.6% variation in financial performance could be related to operational risk, credit risk and market risk. The study additionally showed a positive strong association amongst market risk and financial performance of non-financial companies as indicated by strong positive correlation coefficient. ANOVA results indicated that the general model had a significance value of 0.3% that reveal that the information was perfect for creating a inference as the p value was less than 0.05. The study also indicated that market risk expressively influences the financial performance. The resulted equation of regression was:

$Y = 0.055 + 0.041 X_1 + 0.082 X_2 + 0.065X_3.$

Regression equation indicated that putting operational risk, credit risk and market risk at a zero constant, performance of finance of non-monetary firms registered at the

NSE will be at 0.055. The research indicated a positive relationship between credit risk, operational risk, market risk and performance of finance.

5.3 Conclusion

The study outcomes of this study showed that market risk positively affected the financial performance the firms, therefore the research settles that liquidity risk management practices positively influence results of finance of firms registered on the Nairobi Security Exchange.

Findings showed that an upsurge in operational risk and credit risk and positively influence the performance in finance of firms registered at the NSE that were non-financial, hence the research settles operational risk and credit risk and positively affect the performance of finance of non-monetary firms registered at the Nairobi Stock Exchange.

5.4 Recommendations for Policy

This study advocates that there was necessity for non-financial firms to come up with mitigation measure against market risk that leads to them growing their monetary performance because it was revealed that a gain in market risk positively affected the performance in finance.

It is essential for non-monetary firms registered on the Nairobi Securities Exchange to conduct risk analysis in order to undertake appropriate measure to counter the operational risk and credit risk so as to positively influence performance in finance.

5.5 Limitations of the Study

In achieving the objectives, the study covered 5 years period as from the year 2012 to 2016. Secondary data was used and collected from the financial statements and Nairobi Security Exchange. The research was restricted to the rate of accuracy of the information got from the financial statements. The information is verifiable because it was from the financial statements and Nairobi Security Exchange, it might be disposed to these deficiencies.

The research covered a duration of 5 years from 2012 to 2016. An extended length would have taken in to account several economic significances for example recessions and booms. The study only covered non-financial firms registered at the NSE; therefore there should be a study on financial firms listed at the Nairobi Security Exchange.

5.6 Areas for Further Research

An added research should be conducted titled: effect of liquidity risk management practices on performance of finance of financial firms in Nairobi Securities Exchange since this research focused on the results of finance of non-monetary firms registered at the Nairobi Securities Exchange.

Research gap exist on the influence of liquidity risk management practices on the firms which are not registered at the Nairobi Securities Exchange on their financial performance.

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APPENDICES

APPENDIX I: DATA COLLECTION FORM

Parameters	**2012**	**2013**	**2014**	**2015**	**2016**
Operational risk					
CA = Current Asset,					
CL = Current Liability					
TA = Total Asset					
Market risk					
D = Debt,					
E = Equity ratio					
Credit risk					
Return on total asset					
Financial performance					
ROA					

APPENDIX II: DATA

Firm	Operational risk	Credit risk	Financial performance	Market risk
Kakuzi limited	.2860	.3134	.1100	.4189
REA Vipingo plantation ltd	.2812	.3027	.1231	.4121
Kapchorua Tea co.ltd	.2832	.3310	.1171	.3561
Sasini Tea Coffee ltd	.2842	.3182	.1289	.4981
Access Kenya group	.2871	.3571	.1267	.4956
Car and General (Kenya) ltd	.2876	.3116	.1162	.3712
CMC holding limited	.2635	.2761	.1061	.3889
Kenya Airways limited	.2856	.3342	.1162	.4167
Marshall (EA) ltd	.2871	.3171	.1361	.4900
Sameer Africa	.2891	.3265	.1124	.4291
Longhorn Kenya ltd	.2879	.3189	.1221	.4401
Nation Media Group ltd	.2781	.3221	.1128	.4270
Safaricom ltd	.2872	.3193	.1101	.3812
Scan group ltd	.2871	.3171	.1102	.4365
Standard group ltd	.2791	.3140	.1201	.4692
EA (serena Hotels) ltd	.2782	.3873	.1267	.3097
Uchumi supermarket ltd	.2883	.3166	.1164	.3287
Athi river mining ltd	.2802	.3220	.1201	.4192
Bamburi cement company ltd	.2861	.3132	.1167	.4282
British American Tobacco ltd	.2856	.3267	.1171	.4182
Carbacid investment company	.2761	.3382	.1212	.4192
Crown berger Kenya ltd	.2759	.3165	.1189	.4282
East Africa Cable ltd	.2822	.3189	.1172	.3081
East Africa Portland company cement	.2703	.2876	.1145	.3278
Eveready east Africa ltd	.2891	.3100	.1187	.3903
East Africa breweries ltd	.2756	.3784	.1221	.4682
Kenya oil company ltd	.2894	.3877	.1210	.3110

BOC Kenya ltd	.2874	.3262	.1502	.4802
Kenya Power and Lighting Co. ltd	.2791	.2972	.1216	.3801
Kenya electricity generating co. ltd	.2820	.3101	.1203	.4002
Kenol Kobil ltd	.2781	.3621	.1156	.3726
Umeme ltd	.2891	.3488	.1218	.4677
Total Kenya ltd	.2871	.3181	.1120	.3187
Mumias Sugar company ltd	.2872	.3172	.1218	.4108
Sameer Africa ltd	.2886	.3297	.1229	.4592
Unga group ltd	.2716	.3271	.1172	.3330
Eeaagads limited	.2691	.2984	.1245	.4127
Express Kenya ltd	.2783	.3115	.1121	.2987
Williamson tea Kenya Kenya ltd	.2875	.3564	.1322	.5026
Limuru tea company ltd	.2721	.3278	.1228	.4487

APPENDIX II: LISTED COMPANIES FOR NSC

Agriculture sector

1 KAK	Kakuzi limited
2 REA	REA Vipingo plantation ltd
3 KTCL	Kapchorua Tea co.ltd
4 SAC	Sasini Tea Coffee ltd

Commercial and services

5 ACKG	Access Kenya group
6 C & G	Car and General (Kenya) ltd
7 CMC	CMC holding limited
8 KQ	Kenya Airways limited
9 MARS	Marshall (EA) ltd
10 SA	Sameer Africa
11 LK	Longhorn Kenya ltd
12 NMGL	Nation Media Group ltd
13 SAF	Safaricom ltd
14 SCAN	Scan group ltd
15 SGL	Standard group ltd
16 TPS	Tps- EA (serena Hotels) ltd
17 USL	Uchumi supermarket ltd

Industrial an allied sector

18 ARML	Athi river mining ltd
19 BCCL	Bamburi cement company ltd
20 BAT	British American Tobacco ltd
21 CARB	Carbacid investment company
22 CBKL	Crown berger Kenya ltd
23 Eacl	East Africa Cable ltd
24 EAPCC	East Africa Portland company cement
25 EEAL	Eveready east Africa ltd
26 EABL	East Africa breweries ltd
27 KOCL	Kenya oil company ltd
28 BOC	BOC Kenya ltd
29 KPLC	Kenya power and lighting co. ltd
30 KEGL	Kenya electricity generating co. ltd
31 KK	Kenol Kobil ltd
32 UL	Umeme ltd
33 TKL	Total Kenya ltd
34 MSC	Mumias Sugar company ltd
35 SAL	Sameer Africa ltd
36 Unga	Unga group ltd

The alternative investment market segments (AIMS)

37 EAAG	Eeaagads limited
38 EKL	Express Kenya ltd
39 WTKL	Williamson tea Kenya Kenya ltd
40 LTCL	Limuru tea company ltd