

An Assessment of Financial Risk on Growth of Private Middle Level Colleges in Kenya: A Case Study of Nakuru Town

Gichuki S. Njuguna¹, Kwasira Josephat², Kalio, A³

^{1,2}School of Human Resource Development, Jomo Kenyatta University of Agriculture and Technology, Kenya

³Egerton University, Kenya

Abstract: Private middle level colleges play a significant role in providing education in Kenya. The changing business environment in Nakuru Town has brought challenges in this sector and this has resulted in the emergence of new middle level colleges and closure of other private middle level colleges (PMLCs). PMLCs have therefore been left vulnerable to closure and even in some cases liquidation and eventually closure. The purpose of the study was to assess the effect of financial risks on the growth of private middle level colleges in Nakuru Town. The study specifically objected to assess the effect of liquidity risk on growth of PMLCs. As such the study was guided by two variables: liquidity risk and growth of PMLCs. The study thus adopted descriptive survey research design. The target population was limited to 45 accountants of the 45 PMLCs in Nakuru town. The study employed census survey of the target population and as such the sample was similar to the target population. A structured questionnaire was used to collect primary data which was exclusively relied on. The researcher undertook a pilot study prior to the main study in order to assess both the reliability and validity of the research instrument. Reliability was tested using the Cronbach alpha coefficient whilst validity was determined by seeking expert judgment of the University's supervisors. SPSS tool was used in electronic data processing and analysis. Data was analyzed using descriptive statistics and inferential statistics. The findings were presented in form of summary statistics. It was established that there exists a significant relationship between liquidity risk and growth of PMLCs. It was thus concluded that liquidity risk significantly affects PMLCs' growth. The study recommended that PMLCs should minimize the liquidity risk by ensuring prompt fees payment and offsetting current liabilities.

Keywords: PMLCs, Financial risks, Liquidity risks, Risk management, Growth

1. Introduction

It is noted that with the changes in global business environment, the modern world of tertiary education is undergoing enormous challenges in various aspects such as management, expansion and diversification, fiscal pressure, wide markets, demand for greater accountability, greater quality and efficiency. Therefore there is need for proper, efficient management of the institutions in order to cope with emerging challenges [7]. The financial risks that can occur in private middle colleges are enormous.

Private Middle Level Colleges (PMLCs) play a significant role in providing tertiary education in Kenya. They complement the government owned middle level colleges and Universities in providing career focused education and training programs to the post-secondary clientele. They bridge the gap between supply and demand of tertiary education in Kenya, which is created by the inability of the public institutions to meet the demand. Tertiary education institutions act as a repository and defender of culture, an agent of change in the culture, an engine for national economic growth, and an instrument for the realization of collective aspirations [5].

Financial risks are common in all organizations big or small, and the success of every business largely depends on how well financial risks are managed. If not well managed, these may lead to liquidation of companies. All organizations including PMLCs operate in highly competitive markets and cannot grow or compete without taking risks. One of these

risks is the liquidity risk which, when present constraints the institutional operations. However, it is important to understand the eminent risks and putting in place mechanisms to ensure business continuity and growth.

2. Statement of the Problem

Private middle level colleges play an important role in the provision of qualified manpower essential in the implementation of Kenya's Vision, 2030. They supplement the existing public education system, by absorbing those students that complete the KCSE level of education but are unable to attain the University entry marks. In addition, private middle level colleges also admit students who are eligible for university admission and who seek others professional and academic qualifications which are not provided by such universities. This number continues to increase with the introduction of free primary and free day secondary education system. To be able to accommodate the growing number of secondary school leavers, the middle level colleges need to provide expanded infrastructural facilities and the human resource to remain not only relevant in providing alternative training but also to gain a competitive entrepreneurial advantage within the educational sector.

However, the ability of these PMLCs to provide training opportunities to students who demand the opportunities is uncertain. It has been reported [11] that the PMLC industry faces a number of risks that if not managed well may result in liquidation of such colleges. Efficient risk management requires proper understanding of the potential risks affecting

the industry in question. One of the aforementioned risks is the liquidity risk. Notably, in Kenya financial risk surveys are carried out by the central bank of Kenya focusing only on commercial banks and insurance companies regardless of other sectors such as education that have potential financial risks facing them. It is with this in mind that the current study sought to investigate the financial risks, specifically liquidity risk, facing PMLCs, factors predisposing them to the risks, the management strategies applied and their effects on the growth of these colleges in Nakuru town, Kenya.

3. Objectives

3.1 General Objective

To assess the financial risks on the growth of middle level commercial colleges in Nakuru town, Kenya

3.2 Specific Objective

To analyze the relationship between liquidity risks and the growth of private middle level colleges in Nakuru town, Kenya

4. Research Question

What is the relationship between liquidity risks and the growth of private middle level colleges in Nakuru town, Kenya?

5. Conceptual Framework

The conceptual framework outlines the relationship between the independent variable (liquidity risks) and the dependent variable (growth of PMLC). The framework is as shown in Figure 1.

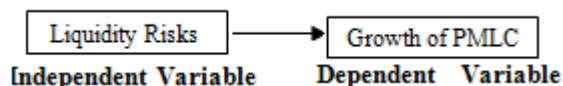


Figure 1: Conceptual Framework

The study hypothesizes that the liquidity risks which are a component of financial risks affect the growth of PMLCs.

6. Literature Review

In this section, theories and empirical studies touching on financial risks and growth of PMLCs are reviewed.

6.1 Theoretical Literature

Pertinent theories are delved into and discussed in the context of the current study.

6.1.1 Enterprise Risk Management Theory

The model was developed by the Committee of Sponsoring Organizations of Treadway Commission (COSO) in year 2004. For a long time, COSO had issued internal control integrated framework to help businesses and other entities assess and enhance their internal control systems. That

framework has since been incorporated into policy, rule, and regulation, and used by thousands of enterprises to better control their activities in moving toward achievement of their established objectives. Following the growing needs for a more comprehensive framework for risk management, COSO in 2001 initiated a project, and engaged Price Water House Coopers, to develop a framework that would be readily usable by managements to evaluate and improve their organizations' enterprise risk management. This was later named as the Committee of Sponsoring Organizations Enterprise Risk Management (COSO ERM). This was meant to provide key principles, concepts, a common language, a clear direction and guidance on risk management.

COSO enterprise risk management integrated framework expands on internal control, providing a more robust and extensive focus on the broader subject of enterprise risk management. The framework is designed on assumption that, all entities face uncertainty and the challenge for management is to determine how much uncertainty to accept as it strives to grow stakeholder value. Further, it assumes that, uncertainty presents both risk and opportunity, with the potential to erode or enhance value. Enterprise risk management encompasses: aligning risk appetite and strategy, enhancing risk response decisions, reducing operational surprises and losses, identifying and managing multiple and cross-enterprise risks, seizing opportunities and improving deployment of capital.

These principles in enterprise risk management help management achieve the entity's performance and profitability targets and prevent loss of resources. Enterprise risk management consists of eight interrelated components derived from the way management runs an enterprise and also integrated with the management process. These include internal environment, objective setting, event identification, risk assessment, risk response, control activities, information and communication and monitoring. However, this model of risk management has its own challenges.

The COSO ERM framework is based on individual decision making. The challenges result from the realities that human judgment in decision making can be faulty, decisions on responding to risk and establishing controls need to consider the relative costs and benefits. Two or more people and management have the ability to override enterprise risk management decisions. Secondly, the eight components may not function identically in every entity.

6.1.2 Agency Theory

Agency theory extends the analysis of the firm to include separation of ownership and control, and managerial motivation. In the field of corporate risk management agency issues have been shown to influence managerial attitudes towards risk taking and hedging [10]. This theory explains a possible mismatch of interest between shareholders, management and debt holders due to asymmetries in earning distribution, which can as a result in the firm taking too much risk or not engaging in positive net value projects. Consequently, agency theory implies that defined hedging policies can have important influence on the earnings of the firm. Conflicting interest in the

agency relationship between managers and shareholders motivate the use of derivatives. Most senior managers have a highly undiversified financial position because they derive substantially from their employment by the firm.

This study assumes that financial risks in colleges can be explained by the agency theory in that, the risks emanate from the operations. The risks in colleges could be as a result of managerial capacity, strategic decision making by the board, debts and debts management especially in managing fees collections. Similar to the agency theory the impact of risks in colleges can be mitigated or minimized through efficient risk management policies to guide operations and interventions. The synergy in risk projections and the efficiency in risk management would therefore result to better organizational performance.

6.2 Empirical Literature Review

The researcher analyzed the studies bordering on liquidity risks and growth of PMLCs. This is in line with the study objectives.

6.2.1 Liquidity Risk

Liquidity risk is defined as the ability to fund increases in assets and meet obligations as they come due [3]. Within this definition is an assumption that obligations will be able to be met at reasonable cost. Liquidity risk management, nevertheless, seeks to ensure organizations' ability to continue to doing this. This involves meeting uncertain cash flow obligations, which depend on external events and on other market reactions. An increase in interest rate would trigger credit risk as it leads to liquidity problems. Some firms are argued to employ derivative instruments to manage their liquidity risk exposures and thereby reduce volatility of a firm's cash flows and firm's value while other firms use derivatives to speculate and to take advantage of arbitrage opportunities.

Effective liquidity risk management estimates future cash flow requirements under both normal and stressed conditions. This presents a challenge even under relatively benign market conditions, as it requires the ability to draw information from various operations of the institution and assess the impact of external events on the availability of funding liquidity. This challenge increases, however, during stressed conditions, as the assumptions underlying liquidity risk may change – notably through changes in counterparty behaviour and market conditions that affect the liquidity of financial instruments and the availability of funding. These factors give rise to a different and significant set of challenges for firms in assessing their liquidity risk and for supervisors in the evaluation of risk management and controls.

It is argued that liquidity risks have an effect on the profitability of Kenya's sugar companies and as such the firms should ensure that they are financially stable so that there is smooth running of all organization's operations. Their findings returned a significant, negative correlation when liquidity risk and firm's profitability are related. They interpreted the findings to mean that the firms which were rated high on liquidity were rated low on profitability. As

such, the level of a firm's liquidity affects its profitability. The scholars had established that the higher the probability of a firm experiencing financial distress, the greater the reduction in the overall performance of that firm.

6.2.2 Financial Risk and Growth of PMLCs

Performance of firms is a multidimensional construct. Some studies have used return on sales, return on assets and return on investment as measurement of firm performance. The survival of firms in foreign countries is an important indicator of venture success [4]. Prior studies have found empirical evidence that the survival of firms correlates positively with financial measures of performance [1]. Most studies on the relationship between risk and performance have been conceptual in nature, often drawing the theoretical link between good risk management practices and improved performance. It is further stressed that the importance of good risk management practices is to maximize firms' value. In particular, it is suggested that effective enterprise risk management (ERM) has a long-run competitive advantage to the firm compared to those that manage and monitor risks individually. It is, therefore suggested that companies manage risks strategically by viewing all the risks together within a coordinated manner. In relation to this good risk management practices are associated with the elimination of costly lower-tail outcomes.

More importantly, good risk management is said to be highly relevant in providing better returns to the shareholders. In addition, prudent risk management by institutions is the hallmark to avoid financial distress that could lead to a full blown financial crisis. In relating risk management practices and performance, several studies have documented negative effects of increased capital requirements on bank performance. Other studies drew a link between good risk management practices with improved financial performances [10]. In particular, these studies proposed that prudent risk management practices reduce the volatility financial performance, namely operating income, earnings, firm's market value, share return and return on equity. It is further proposed that ensuring best practices through prudent risk management result in increased earnings.

In accounting literature, return on equity (ROE) is considered to be the most important ratio in the suite of financial performance ratios as this measure drives the share price [6]. It relates the increase in the value of the business during the year to the total value of the business at the end of the year. The Piotroski score is a well-known method in investment finance to assess the strength of a firm's financial position. Piotroski used simple accounting based on the fundamental analysis strategy of firm performance [9]. He argued that investors can benefit from trading on various signals of financial performance and that an array of financial ratios created from historical financial statements can accurately predict future changes in earnings. He used nine fundamental signals to measure three areas of the firm's financial condition: profitability, financial leverage/liquidity and operating efficiency as these are easy to interpret, understand and have a broad appeal as summary performance statistics. In terms of profitability of firms, the Piotroski score focuses on aspects of return on assets (ROA)

as it provides information on the firm's ability to generate funds. In terms of efficiency, the Piotroski score focuses on aspects of asset turnover and an improvement in asset turnover signifies greater productivity from the asset base which can arise from more efficient operation or improved market conditions for firms.

The effect of financial risks on profitability of sugar firms in Kenya has been studied. Financial risks are pointed out by these scholars to include liquidity risks among others. According to their study findings, as a firm manages its risks more efficiently the chances of loss are minimized hence higher profitability is realized. Essentially, profitability is associated with the growth of an organization. They rightfully argued that financial risk management practices are essential to the sugar industry that operates in dynamic and competitive environments like in Kenya.

7. Research Methodology

The study adopted descriptive research design. Descriptive designs are concerned with describing the characteristics of a particular individual, group, frequency of occurrence [2]. Descriptive studies describe the state of affairs as they exist. It is stated that descriptive research determines and reports things the way they are [8]. The study sought to describe the financial risks in private middle level colleges, their manifestations, causes, effects to the performance of colleges and remedies that can be put in place.

Target population in this study comprised of 45 accountants of the 45 private middle level colleges in Nakuru town. A census survey of all the 45 accountants was carried out. This implied that the sample and the target population were the same. Census method was the most preferred method due to the fact that not only does it eliminate the sampling bias, but it also gets rid of the sampling error. The study used a semi-structured questionnaire to collect data from the respondents. A pilot test was carried out prior to the final study in order to determine both the reliability and validity of the research instrument. Reliability was tested using the Cronbach alpha whereby all aspects of individual variables that attained $\alpha \geq 0.7$ threshold were considered to be reliable. On the other hand the content validity of the instrument was determined by seeking expert judgment of the University supervisors.

7.1 Data Processing and Analysis

After all data had been collected, the researcher conducted data cleaning, which involved identification of incomplete or inaccurate responses, which were then corrected to improve the quality of the responses. After data cleaning, the data was coded and entered in the computer for analysis using the Statistical Package for Social Sciences (SPSS Version 21.0). The data was analyzed using both descriptive and inferential statistics.

7.2 Research Findings

Data for the study was collected by administering questionnaires to 45 accountants from each of the 45 private PMLCs in Nakuru town. Out of the questionnaires issued,

41 were filled correctly and returned which translated to a response rate of 91.1%.

7.2.1 Liquidity Risk versus Growth of PMLCs

Liquidity risks were hypothesized to be related to fees payments and ability of the college to pay short term liabilities. To establish this, pertinent data was analyzed with the view of determining the frequency and modes of fees payment. The frequency and modes of fees payment were anticipated to describe the liquidity risks exposed to middle level colleges under study. Finally risk level presented by each factor was computed as a product of frequency of occurrence and magnitude of loss.

a) Frequency of Fees Payment

As Table 1 indicates, in 68.3% of the colleges, fees were paid on semester basis while in 29.3% it was paid on monthly basis. Many private middle level colleges in Nakuru town had a preference of charging fees on a semester basis. This implies that fees payments were broken into short term payment period spread across the year rather than lump sum. Payment of fees in shorter period ensures that parents/ guardians are able to pay the school fees with ease as compared to lump sum payments which would be more strenuous to them resulting to higher default.

Table 1: Frequency of Fees Payments

	Frequency	Percent
Monthly	12	29.3
Semester	28	68.3
Other	1	2.4
Total	41	100

b) Modes of Fees Payment

It was found that in 75% of the colleges studied, the mode of payment was either in cash or in cheques. Both payment modes returned 37.5% response rate each. This is indicated in Table 2.

Table 2: Modes of Fees Payment

	Frequency	Percent
Cheque	15	37.5
Cash	15	37.5
Other	10	25
Total	40	100

The risks associated with cash payments are high especially where large collections are made. This implies that the mode of fees collection presented some risk of theft which could land the college into liquidity crisis.

c) Level of Fees Default

The researcher also wanted to understand the various levels of fees default amongst middle level colleges under study. Table 4.6 shows the results of the findings.

Table 3: Level of Fees Default

Level of fees default	Frequency	Percent
1-9%	13	31.7
10-20%	16	39
21-30%	9	22
Above 30%	3	7.3
Total	41	100

The fees default are evident in all the colleges in a varying degree, fees default also presents a liquidity risk due to variations in the projected and actual fees collections. It was discovered that most of the respondents (70.7%) opined that the level of default in fees payment was less than 20%. Only 7.3% of the colleges had fees payment default of more than 30% which would ordinarily pose a major liquidity risk on the colleges. The findings indicated that many colleges had minimized liquidity risk as compared to those that had high level of liquidity risk exposure.

d) Frequency of Liquidity Risk Experiences

Other elements of liquidity risks in colleges were identified by accountants based on how frequent they were experienced as indicated in Table 4.

Table 4: Frequency of Liquidity Risk Experiences

Liquidity Risks	Mean	Std. dev
Students failing to pay their fees	2.76	0.99
Bank failing to give credit facilities on request	2.51	1.25
Default in the payment of operating expenses	1.93	0.92
Unplanned purchasing	2.31	1.10
Soliciting credit facilities to finance college operations	2.19	1.02

According to the findings as shown in Table 4, all statements touching on frequency of liquidity risk experiences, it was established that the means were inclined towards either 3.00 (rare) or 2.00 (very rare). This is given that 1, 2, 3, 4, and 5 represent very frequent, frequent, rare, very rare, and never respectively. This was interpreted to imply that on average these factors posed only marginal liquidity risk to the middle-level colleges. Indeed most of the respondents were of the view that default in payment of operating expenses was never a liquidity risk to the colleges. This aspect alongside “students failing to pay their fees” returned standard deviations less than 1.00 which meant that the respondents held closely related views on these factors relative to liquidity risk. The standard deviation across all the statements touching on frequency of liquidity risk was relatively small (Std Dev. ≤ 1.25). This means that the opinions of the respondents were closely related.

f) Level of Loss Incurred as a Result of Liquidity Risks

Furthermore, the probable risk factors in PMLCs were evaluated on the likely level of loss they caused if they occurred. The findings are presented in Table 5.

Table 5: Level of Loss Incurred as a Result of Liquidity Risks

Liquidity Risks	Mean	Std. deviation
a) Students failing to pay their fees	3.37	1.43
b) Bank failing to give credit facilities on request	2.49	1.19
c) Default in the payment of operating expenses	2.53	1.20
d) Unplanned purchasing	2.72	1.21
e) Soliciting credit facilities to finance college operations	2.55	1.20

It was established that the loss resulting from fees default was very high according to 29.3% of the accountants and

principals; banks decline to grant credit facilities was led to low level of loss according to 33.3%, while 5.1% identified the loss as very high. Default to pay operating expenses led to low level loss according to 34.2%. Unplanned purchases led to low level loss according to 33.3% although 10.3% cited very high level of loss. Students fees default, banks failure to give credit facilities on request, default in payment of operating expenses, unplanned purchasing, and soliciting credit facilities to finance college operations were on average found to moderately (mean ≈ 3.00) lead to the colleges incurring losses due to liquidity risk. Given that the standard deviations across the aforementioned factors was greater than 1.00 was employed to imply that respondents held extreme opinions regarding these factors. The standard deviation amongst regarding level of loss as a result of liquidity risks was relatively large (Std Dev. > 1.00). As such, the respondents held extreme views in regard to the aforementioned issue.

7.2.1 Relationship between Liquidity Risk and Growth of PMLCs

The researcher sought to determine the relationship between liquidity risk and growth of middle level colleges. He was guided by the hypothesis: $H_{01}: r=0$: There is no significant relationship between liquidity risks and growth of private middle level colleges in Nakuru town. The hypothesis was tested at 0.01 significance level by computing the Pearson’s correlation coefficient between the level of liquidity risk exposure and growth of private middle level colleges. The correlation test statistics are shown in table 6.

Table 6: Relationship between Liquidity Risk and Growth of PMLC

Liquidity Risk		Growth
	Pearson	-.696**
	Sig. (2-	.000
	N	41

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

The results indicate that there exists a strong and negative relationship ($r = -0.696$; $p < 0.01$) between liquidity risk and growth of middle-level colleges. The inference drawn in this case is that an increase in liquidity amongst the middle-level colleges resulted in considerable decline in the growth of these colleges. The findings, therefore, led to the rejection of the first hypothesis (H_{01} : There is no significant relationship between liquidity risks and growth of private middle level colleges in Nakuru town).

8. Summary, Conclusions and Recommendations

This part presents a summary of major study findings, draws conclusions and then suggests recommendation in line with the research objectives.

8.1 Summary

Liquidity risks were associated with fees collections and ability of the college to offset its current liabilities. The risks associated with cash payments are high especially where large collections are made. This implies that the mode of fees collection presented some risk of theft which could land the college into liquidity crisis. The level of fees defaults in

colleges was moderate but posed a significant risk. It was the most experienced manifestation of liquidity risk, followed by lack of access to credit facilities from banks, unplanned purchasing and default in payment of expenses. Students' defaults in fees payment presented the highest risk level, followed by the poor access to credit facilities unplanned purchasing and credit in financing college operations tied in the third position. Fees payments were broken into short term payment period spread across the year rather than lump sum to spread the risks involved. There was significant relationship between liquidity risk and growth of middle level colleges. As the level of liquidity risk went up, growth significantly declined in private middle colleges.

8.2 Conclusions

It was concluded that liquidity risks were largely associated with fees collection and the ability of the colleges to offset their current liabilities since students' defaults in fees payment presented the highest risk level. It was further inferred that liquidity risks significantly affected the growth of private middle level colleges.

8.3 Recommendations

It is recommended that the middle level colleges should minimize the liquidity risks by ensuring prompt fees payment and offsetting current liabilities.

References

- [1] Acquaaah, M., & Yasai-Ardekani, M. (2008). Does the implementation of a combination competitive strategy yield incremental performance benefits? A new perspective
- [2] Adams, J, Khan, H, Raeside, R., & White, D. (2007). *Research methods for graduate business and social science students*. New Delhi: SAGE Publications.
- [3] Basel Committee on Banking Supervision. (2008). *Liquidity Risk: Management and Supervisory Challenges*. Basel: Bank for
- [4] International Settlements
- [5] Gaur, A., & Lu, J. (2007). Ownership strategies and survival of foreign subsidiaries: Impacts of institutional distance and experience. *Journal of Management*, 33 (1), 84-110.
- [6] Gerald, D., (1995), Sustainable Development in Higher Education: Current Practice and Future Developments. *A report for the Higher Education Academy*.
- [7] Graham. M. (2007). *Understanding Financial Statements*. Cape Town: Cape Business Seminars.
- [8] Johnstone, D, (1998). *The Financing and Management of Higher Education: A Status Report on Worldwide Reforms*. New York: State University of New York.
- [9] Mugenda O. M & Mugenda, A.G (2003). *Research methods: Quantitative and Qualitative Approaches*, Nairobi: Acts press.
- [10] Piotroski, J. (2000). Value investing: The use of historical financial statement information to separate winners from losers. *Journal of Accounting Research* 38, 1-41.

- [11] Smith, C. & Watts, R. (1992). The investment opportunity set and corporate financing, dividend, and compensation policies. *Journal of Financial Economics*, 32, 262-292.
- [12] Wang, H., Zheng, J. & Li, C. (2012), *Financial Risk Warning and Prevention of Colleges and universities*. Tangshan, China: Hebei United University.

Author Profile



Gichuki S. Njuguna has done Bachelor of Commerce (Finance Option) Kabarak University, Kenya; MBA (Finance Option) Jomo Kenyatta University of Agriculture and Technology (JKUAT), Kenya; Certified Public Accountant (CPA). He is currently the Principal of Achievers College of Professional Studies.