International Journal of Science and Research (IJSR)
ISSN (Online): 2319-7064
Index Copernicus Value (2013): 6.14 | Impact Factor (2015): 6.391

Effect of Operational Risk Mitigation Strategies on Financial Performance of Real Estate Projects in Nairobi County: A Case of Knight Frank Limited

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Abstract: ***In the present day business context, all business entities need to prepare themselves to cope with crises unlike in an ideal world where managers would identify all possible threats that could happen to them and thus develop a contingency plan for each of these sources of crisis. Therefore, the capability of an organization to flourish in the face of risks that either bring forth opportunities or threats is a major sign of its ability to improve financial performance of the organization. This study was conducted to clearly determine the influence of Operational Risk Mitigation strategies on financial performance of Real estate projects within Nairobi County and also establish the challenges faced by the organization in managing risk. The study adopted a case study research design whereby the data collection tool was mainly through interview guide. Content analysis was used to analyze the qualitative primary data, which then collected through conducting of interviews and secondary information from the organizational documents. The study focused on the financial performance of Knight Frank limited. The enterprise risk management process of an organization was focused on a number of factors including mandate from the top, determination and assessment of operational risk mitigation process, operation of the control framework, the periodic reporting and analysis process of the firm. The departmental head management of Knight Frank ltd played an important role in the operational risk management process of the firm since they were expected to incorporate the risk assessment process in the overall strategy of the firm as well as making it part and parcel of any decision being made in the organization towards improvement of financial performance. The study recommend board of directors and management to have a reasonable assurance that they understand to what extent the entity's risk management objectives affected, ensure that operations objectives are met, that the entity's reporting is reliable and that all applicable laws and regulations were being complied with in the process of risk management for the aim of improving financial performance of the real estate projects.***

Keywords: Risk Management, Operational Risk Mitigation, Strategy, Financial performance, Knight Frank Limited.

1. Introduction

Risk management has been a major issue in global business today. When you think of World Trade Center bombing, the Gulf of Mexico oil leak, the Bernie Madoff fraud scandal, the loud crash of AIG, or the Japanese Tsunami. What do these events have in common? Only weeks before the historic events, few could have predicted the events, or their severity. Yet an organization's growth and indeed survival depends on its ability to face risks both expected and those that lie at the low ends of the probability curve (Germond, 2009).

Kaplan and Norton, (2009), argue that projects are to survive, and even thrive, in a post-recession world; they need to adopt risk-based approaches to executing their strategies. Thus in the present turbulent business environments all organizations need to prepare themselves to cope with crises from whatever source unlike in an ideal world where managers would identify everything bad that could happen to them and thus develop a contingency plan for each of these sources of crisis (Browning *et al.*, 2009). It is a good idea to be prepared, however crises by definition are almost always the result of nature, malicious humans, or systems catching us unprepared (otherwise there may not have been a crisis). We cannot expect to cope with every contingency and therefore need to be able to respond to new challenges (Rondan-Cataluña *et al.*, 2010). The primary benefit of a risk-based approach to strategic execution is that it allows managers to focus on the opportunities outlined in their projects' strategic plans, while at the same time minimize the potential impact of any threats. A risk-based management control system allows managers to quickly and confidently react to opportunities (or threats) (Berinato, 2004).

Risk management in Kenya has been a subject of discussion over the years though Kenya has remained one of the most desirable African countries to choose to live in, with properties in Kenya continuing to attract international buyers. With its distinctive Indian Ocean coastline, savannah grasslands, arid bush and mountainous forests, houses for sale in Kenya attract buyers who love nature at its finest, (Wanjala, 2011).

Opportunities for developing business in the eco-tourism industry are in abundance, while Kenya's economic and cultural hubs – Nairobi and Mombasa – offer ample opportunity for real estate development and investment. With access to unrivalled property for sale in Kenya, Soft Kenya is expertly positioned to help you in your Kenyan property search. Investing right in the property business is a skill that takes time to learn but which, if mastered, can guarantee you a comfortable life because you will be able to successfully manipulate your assets to get maximum profits (Gillett et al., 2010).

External factors that can impact on organization operations will include economic change and dangers arising in political, legal, technological and demographic environments. Internal risks include human error, fraud, systems failure, disrupted production and other risks (Blackhurst et al., 2008). Internal risk management is more directly the responsibility of the organization management and its participants. Any business organization is responsible to manage financial, production, and structural capacities. They are responsible for programs to provide adequate workplace safety, which has proven to be cost-beneficial to organizations as well as fulfilling social responsibilities.

Knight Frank Limited Kenya was established in March 1998, it works closely with Knight Frank Tanzania and Knight Frank Uganda to complete a regional network that cements the Knight Frank group's expanding Central and South African interests. Advising national and international commercial and residential developers, investors, owners and occupiers we fulfill a wide range of real estate needs, including: property management, agency, valuation, project management, feasibility and research-led consultancy since the start up to date the company has been expanding and experiencing a lot of risk that gave the researcher motives of conducting the research on the best way of mitigation these risky problems.

1.1 Statement of the Problem

Despite of the undeniable fact that most researchers have dwelt on the Risk mitigation strategies, a lot are still remain untouched on how this strategies being helpful and contributed towards the financial performance of the organization. For instant, a study by Serafeim (2010) on the impact of risk management on financial performance recommendations found that some risk management initiatives are costly and may affect the profit margins of the organization hence lowers the financial performance of the organization. Another study by Bhattacharya and Sen (2001) cited that costly risk management activities may actually be beneficial to organization's as they can have a positive effect on the decisions of economically-minded individuals investing on real estate properties, investing in it or working for it. The relationship between risk management and a firm's profitability has been studied in Kenya but results of these studies do not appear conclusive. Nkaiwatei (2011) for example, studied the relationship between risk involved in accounting practice and profitability in the oil industry in Kenya and found that profitability was one of the factors that determine level of investments on real estate business.

Whereas many studies have been done on risk management, few of the studies have focused on the sole impact of application of risk mitigation strategies on financial performance of the organization. This has created a knowledge gap on whether risk mitigation strategies in place really drives the business to maximization of profit or has a negative impact on the business. Hence, this study endeavored to assess the effects of operational risk mitigation strategies on financial performance of real estate projects in Nairobi county Kenya. Rather than just being used as safety tool in the organization, to woo more intended investors in the market, it's important to establish also if these programs affect their financial performance especially on profitability Kaplan and Norton, (2004).

It has been observed by all mention above scholars that risk management is indeed a real problem that deters many investors from injecting money in Real estate project with the fear of Authorities such as NCA demolishing their buildings, Title Deeds being revoked among others. Hence the problem is worth researched on.

The General objective of the study

The general objective of this study was to assess the effect of operational risk mitigation strategies on financial performance of Real estate projects in Nairobi County, Kenya.

The Specific objectives of the study

1. To establish the effect of fraud avoidance on financial performance of Real estate projects in Nairobi County, Kenya.
2. To determine the effect of insecurity awareness on financial performance of Real estate projects in Nairobi County, Kenya.

2. Literature Review

2.1 Situated Rationality Theory

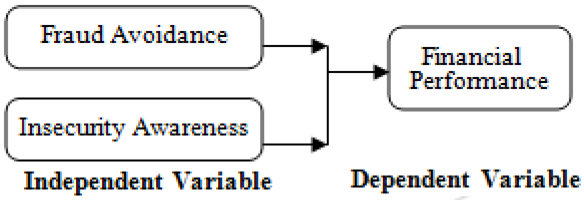
Situated rationality theory makes the argument that it is erroneous to presume that safe behaviors are inherently rational and high-risk behaviors are inherently irrational. In other words, there is likely a rational justification for why people choose to take risks that is more explanatory than assuming that a risk-taker is simply "crazy" or thrill-seeking.

If the reward of risk taking is too great, it's often considered "rational" to take risks. A teen may drive unsafely to maintain status among peers, or a person could decide that being on time to an appointment outweighs the risk of unsafe driving (Keating & Halpern-Felsher, 2008). In occupational safety, workers may not wear personal protective equipment because it is more comfortable or convenient (Hambach et al., 2011; Vernero & Montanari, 2007) and may not adhere to safe work procedures in order to complete work more efficiently (Slappendal et al., 1993).

As Finucane et al, (2000) note, the greater the perceived benefit of an activity, the lower the perceived risk. Certain aspects of situated rationality theory are connected to the concept of peer and community pressure. Taking risks in the workplace is often justified by workers who are trying to "save face" in front of coworkers or who want to impress supervisors. Also, business structures and embedded production systems tend to reward unsafe behavior because of the potential gains in compensation, output, and recognition. Choudry and Fang (2008) found that Chinese workers often took more risks in hopes that their gains in efficiency would get noticed by supervisors. These workers also noted that being paid bonuses for productivity encouraged them to work less safely, and that taking risks made them appear "tough." Mullen (2004) also found that workers routinely operated without protective gloves in order to be seen as "macho." Some female workers lifted more weight than the job required to be viewed as competent or strong in the eyes of male coworkers. Overall, workers of both genders were concerned that appearing less tough, strong, or competent jeopardized their good position in the company Situated rationality theory is related in several ways to the theory of planned behavior (Ajzen, 1985; Ajzen & Fishbein, 1980). This theory looks at the various social, environmental and psychological factors that influence a person's intent to engage in high-risk behavior. A person takes into account not only his/her own attitudes towards an action, but also the collective attitudes and subjective norms of peers regarding the action. These attitudes may serve as justification and rationale for taking a risk, especially if risk perception is low and the potential rewards (e.g. recognition from peers or superiors) are great.

2.2 Conceptual Framework

The study adopted the following conceptual framework:



Source: Author 2016
Conceptual framework

2.3 Operational Risk Mitigation

Operational Risk Mitigation is defined broadly and as a causal risk - the risk of loss due to failures in people, processes, systems or external events, (Sauser et al., 2009). It underlies many other risks, in particular regulatory and reputation risks, which are fundamental to the business model for financial institutions. It has also become a very costly risk for projects which have not managed it well. It is also a discipline which continues to develop rapidly in sophistication and relevance to business decision making. It is therefore important to have a deep, practical understanding of Operational Risk Mitigation management frameworks and measurement methodologies in financial institutions. Researcher will be better prepared to implement meaningful risk assessment initiatives, produce useful risk management information and understand basic modeling techniques for Operational Risk Mitigation measurement Gain an appreciation for the role of risk management in the post crisis financial services Real estate industry by Gaining an appreciation for the role of corporate governance in an organization and of the participants, elements and relationships within risk management governance (Auger et al., 2003).

Verification of the Framework is done on a periodic basis and is typically conducted by real estate organization's internal and/or external audit, but may involve other suitably qualified independent parties from external sources (Carvalho and Rabechini Jr., 2011).Verification activities test the effectiveness of the overall Framework, consistent with policies approved by the board of directors, and also test validation processes to ensure they are independent and implemented in a manner consistent with established real estate policies. Validation ensures that the quantification systems used by the real estate projects is sufficiently robust and provides assurance of the integrity of inputs, assumptions, processes and outputs. Specifically, the independent validation process should provide enhanced assurance that the risk measurement methodology results in an Operational Risk Mitigation capital charge that credibly reflects the Operational Risk Mitigation profile of the . In addition to the quantitative aspects of internal validation, the validation of data inputs, methodology and outputs of Operational Risk Mitigation models is important to the overall process (Shenhar and Dvir, 2010).

Operational Risk Mitigations is inherent in all real estate projects, activities, processes and systems, and the effective management of Operational Risk Mitigation has always been a fundamental element of a real estate's risk management program. As a result, sound Operational Risk Mitigation management is a reflection of the effectiveness of the board and senior management in administering its portfolio of products, activities, processes, and systems. The Committee, through the publication of this paper, desires to promote and enhance the effectiveness of Operational Risk Mitigation management throughout the real estate projects, (Germond, 2009).

Risk management generally encompasses the process of identifying risks to the real estate, measuring exposures to those risks (where possible), ensuring that an effective capital planning and monitoring program is in place, monitoring risk exposures and corresponding capital needs on an ongoing basis, taking steps to control or mitigate risk exposures and reporting to senior management and the board on the real estate's risk exposures and capital positions. Internal controls are typically embedded in a real estate's day-to-day business and are designed to ensure, to the extent possible, that real estate activities are efficient and effective, information is reliable, timely and complete and the real estate is compliant with applicable laws and regulation. In practice, the two notions are in fact closely related and the distinction between both is less important than achieving the objectives of each. Sound internal governance forms the foundation of an effective Operational Risk Mitigation management Framework (Auger et al., 2003). Although internal governance issues related to the management of Operational Risk Mitigation are not unlike those encountered in the management of credit or market risk Operational Risk Mitigation management challenges may differ from those in other risk areas.

The Committee is seeing sound Operational Risk Mitigation governance practices adopted in an increasing number of real estates. Common industry practice for sound Operational Risk Mitigation governance often relies on three lines of defense these includes business line management, an independent corporate Operational Risk Mitigation management function and an independent review, (Shenhar and Dvir, 2010). Depending on the 's nature, size and complexity, and the risk profile of a real estate's activities, the degree of formality of how these three lines of defense are implemented which will vary. In all cases, however, a real estate's Operational Risk Mitigation Sound Practices for the Management and Supervision of Operational Risk In the industry practice, the first line of defense is business line management. This means that sound Operational Risk Mitigation, governance will recognize that business line management is responsible for identifying and managing the risks inherent in the products, activities, processes and systems for which it is accountable.

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2.4 Research Methodology

A case study research design was selected because this brought a researcher to an understanding of a complex issue and extended experience or add strength to what is already known through previous research. Case studies emphasize detailed analysis of a limited number of events or conditions and their relationships, (Yin, 1997). Time and availability of data are also important considerations in the determination of the case study.

In this study, the target population was Real Estate firms purposively selected registered by Estate Agents and Valuers Registration Board under Ministry of Land, Housing and Urban Development with a case of Knight Frank. According to the figures extracted from the company website (www.knightfrank.co.ke), the study targeted the 40 senior management staff of Knight Frank Ltd Nairobi and targets were the operational departments who were responsible for designing effective way of implying risk mitigation strategies on financial performance of the organization in their respective department within the organization.

Table 3.1: Sample frame

Job Groups	*Sample Size*
Property management	11
Agency	08
Valuation	06
Project Management	08
Feasibility and research-led consultancy	07
Total	40

Source (www.knightfrank.co.ke)

In order to meet the objective of the study, open and closed ended questionnaires were used to collect the primary data developed by the researcher.

The questionnaires were used to obtain primary data from the sampled population, who were the departmental heads and senior managers. All the respondents were asked the same questions in the same order. The questionnaires provide both qualitative and quantitative data.

Secondary data were also used, extracted from previous research reports and company documents review. A descriptive study was analyzed based on secondary data obtained from available financial statements derived from the Website of Study Company.

Qualitative analysis was done on the information collected from the results of the questionnaires; quantitative analysis was included, both descriptive and inferential statistical techniques were used. Descriptive statistics was used to analyze the quantitative data. The findings were presented using tables, graphs and pie charts.

3. Results and Discussions of the Findings

A total of 40 respondents were targeted out of which Thirty Six (36) returned the questionnaires issued translating to a response rate of 90%. The main reason of managing risk is to improve the financial performance of the organization. The Organization exists to make profit. If anything ever exist that threatens this objective, then it is the work of the management to deal with it. There was as a result of the support of the statement by the number of respondents who agreed. All the 36 representing 100 %of the respondents were in agreement with 30 representing 83.33 % of them strongly agreeing.

From the findings, that confirms the findings of the study by Hardy (2002), who stated that a firm maximizes profit if risk is properly managed. It was noted that, on average, 80.56 % respondents were in agreement with statements related to the operational risks with “proper operational risk mitigation enables a firm to maximize profits above that which would have prevail” commanding a large strong support of 88.89 % of respondents. However, few respondents were not sure as some of them were still new in the industry.

The study sought to find out if the operational risk mitigation strategy applied in the organization improves financial performance; 69.44% of the respondents were in agreement that the kind of risk mitigation strategies applied within their organization were basically to improve performances thus increase revenues. 5.56% of the respondents were neutral about this topic as they had no idea what exactly increases financial performance. The 25% of the respondents who expressed their dissatisfaction claiming that it is not the only factor that improves financial performance but there are other major players that increases the profitability level including the amount invested.

These operational risks involved in real estate projects scares away potential investors who get demoralized from investing as also explained by the study by Hardy (2002). This was confirmed by all the investors who responded in confirmation. 88% of the respondents all agreed with only 12% unsure whether the statement was true or false.

4. Summary of the Findings

The objective of the study was to effect of operational risk mitigation strategies on financial performance of real estate projects in Nairobi County. From the research conducted by Mwangi (2012) on the effect of risk mitigation practices on the financial performance of commercial banks in Kenya, it was concluded that risk mitigation and the related practices are considered significantly important to the operations and financial performance of these commercial banking institutions, confirming the results of this studies.

The researcher used arithmetic mean and percentages when analyzing the responses. A mean of 4 and above meant that respondents strongly agreed and anything below 3 meant that respondents strongly disagreed with the statements. Most of the responses had a mean of 4 and above hence showing that operational risk mitigation strategies in place indeed influenced financial performance of real estate firms in Nairobi County, Kenya as discussed below:

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Financial performance of real estate projects: The study sought to find out if the financial health of the organization. 88.89% of the respondents responded positively bas they claimed that the organization is strong financially. This they attribute to the more projects the organization has been starting and completing within a reasonable time. Only a few respondents were unsure if the financial health is from the business or injection of more capital by the shareholders. It also noted that many investors fear high risky ventures; however, these are the ones that bring in more return. This was supported by all the respondents (36) representing 100% of respondents reported that higher sales, translates to more profits.

5. Conclusions

Operational risk mitigation helps people to work through their concerns without any fear of risk that may crop in due to fraud of the documents or Insecurity. The study concludes that lack of proper knowledge on risk mitigation strategies poses a challenge in improvement of financial performance. If all the mitigation strategies are implemented, the real estate projects in Kenya will attract more investors and the financial performance will be improve.

6. Recommendations

In order to ensure that operational risk mitigation strategies are easily accepted and effectively adopted there is need for Risk Management personnel of Real estate projects in Nairobi County, Kenya to increase ways of mitigating the operational risks, during the implementation or those mitigation strategies process; this will reduce the risks in the real estate and attract more investors to invest and hence improving the financial performance.

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Paper ID: 7091602 DOI: 10.21275/7091602

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