Risk Appetite on Corporate Investment In Selected Financial Institutions In Rwanda: A Survey Conducted on Selected Banks In Rwanda

Jacob Ochieng Onyango[1] Dr. Athanas Osiemo Kengere, (PhD)[2]

[1]. Postgraduate Student (Finance & Accounting) Mount Kenya University
[2]. Senior Lecturer - Mount Kenya University

DOI: 10.29322/IJSRP.14.06.2024.p15045

Paper Received Date: 24th May 2024
Paper Acceptance Date: 28th June 2024
Paper Publication Date: 02nd July 2024

Abstract- Currently, the concept of risk appetite is a contemporary topic among large organizations, sparking in-depth discussions and investigations. However, there is considerable confusion surrounding this subject, particularly when it comes to crafting a comprehensive statement on risk management. The big question is whether each primary risk type should have its own statement or if there should be a universal statement covering all risk appetite within the organization. The ultimate objective of risk appetite is to attain corporate goals, and this applies to both banks and microfinance institutions. These institutions have a dual set of goals to consider, including social and economic perspectives. To thoroughly examine the influence of risk appetite on collaboration, further analysis is necessary. The study adopted a descriptive research design. A population of 95 respondents with a sample figure of 77 were scientifically sampled. Data collection involved both primary and secondary sources, with structured questionnaires used to gather primary data from the respondents. Interviews were also conducted to gather narrative data, and qualitative methods were employed to analyze the responses to open-ended questions in the questionnaires. The study showed that all the variables with a mix of other influences significantly impacted corporate investment by one unit in a 0.664-fold increase in corporate investment. This highlights the critical nature of skillfully managing operations and minimizing risk tolerance. In order to accomplish this, the leadership team must be proactive in identifying potential hazards and implementing effective measures to mitigate unforeseen risks. By adopting risk management strategies, organizations can effectively minimize unanticipated obstacles, bolster their planning capabilities, elevate performance and efficiency, and cultivate strong relationships with stakeholders. Developing and maintaining trust and foresight is key to achieving success. Establishing and upholding trust with clients, communities, and regulatory bodies is a daunting undertaking that can easily be compromised or lost if not carefully nurtured. To achieve lasting prosperity, it is essential for companies to not only focus on their present circumstances, but also anticipate upcoming shifts. This entails proactively addressing advancements in technology, meeting the evolving demands of customers, and tackling social, environmental, and governance concerns. By effectively navigating these factors, companies can not only survive but also prosper in today's fast-paced and constantly evolving business world.

I. Introduction

Risks are born from the uncertainties that exist in all facets of an organization, regardless of its size, complexity, or industry. Mcnaull and Loy (2018) assert that risk encompasses not only potential threats, but also opportunities that, if seized upon, could lead to a more effective means of reaching desired objectives. However, failing to take advantage of these opportunities could also result in adverse consequences. This highlights the importance of understanding and managing both the risks associated with seizing opportunities and the risks of not taking action.

In the business world, tackling risk is crucial, and this involves many complexities. From establishing a clear risk appetite to effectively measuring and managing it, organizations face numerous challenges. Notably, one specific issue garnering attention is the concept of a risk appetite statement. This concept has posed practical obstacles for various companies that have implemented a risk appetite management framework. As it stands, the definition of risk management practices lacks consensus, with different viewpoints on its scope.

Statement of the Problem

Risk appetite creates a significant obstacle for selected micro finance institutions in effectively implementing management policies. While risk appetite is essential for sound management, it is frequently misconstrued and varies in interpretation among individuals. This is particularly problematic in selected micro finance institutions where control is largely in the hands of founders, as there is a failure to acknowledge the link between the organization's value risk.

These practices encompass a thorough collection of declarations that enhance understanding of the risks actively embraced by the company as well as those consciously evaded. The research sought to investigate strategies institutions can adopt to align risk appetite with investment objectives, mitigate investment risks, and enhance shareholder value. The focus of this research was to evaluate how risk appetite and corporate investment affect chosen financial institutions. Also, the goal was to establish the optimal level of risk required to attain corporate goals and investigate methods for proficiently controlling risk appetite in financial establishments.

Research Hypotheses

$H_0$1: Strategic risk appetite has no statistically significant effect on corporate investment in selected MFI in Rwanda.
$H_0$2: Financial risk appetite has no statistically significant influence on corporate investment in selected MFI in Rwanda.
$H_0$3: Governance risk appetite has no statistically significant influence on corporate investment in selected MFI in Rwanda.

Theoretical Framework

This research explored the Modern Portfolio Theory and Stewardship Theory that established the basis for risk appetite management.

Modern Portfolio Theory

This theory, by Harry Markowitz in 1952 posits that investors are risk-averse and will always prefer the less risky portfolio that maximizes expected return for a given level of risk. It capitalizes on optimization of investment portfolios by bearing in mind the trade-off between risk and return.

Stewardship Theory

In contrast to agency theory, which focuses on self-interest, stewardship theory proposes a different management model that portrays managers as responsible stewards acting in the owners' best interests (Donaldson & Davis, 1991). Stewardship theory has roots in social psychology, which examines executive behavior. Stewards display pro-organizational, collective behavior, prioritizing organizational goals over self-serving actions. Their behavior stays aligned with the organization's interests as they work to achieve its objectives (Davis, Schoorman & Donaldson, 1997).

Conceptual Framework

A conceptual framework serves as a powerful tool for understanding complex problems, as it visually represents the key elements involved (Peters, Elmendorf, Kandola, & Chellaraj, 2020). By compiling broad concepts, it sheds light on the connection between independent factors and dependent outcomes (Coulthard, 2017)

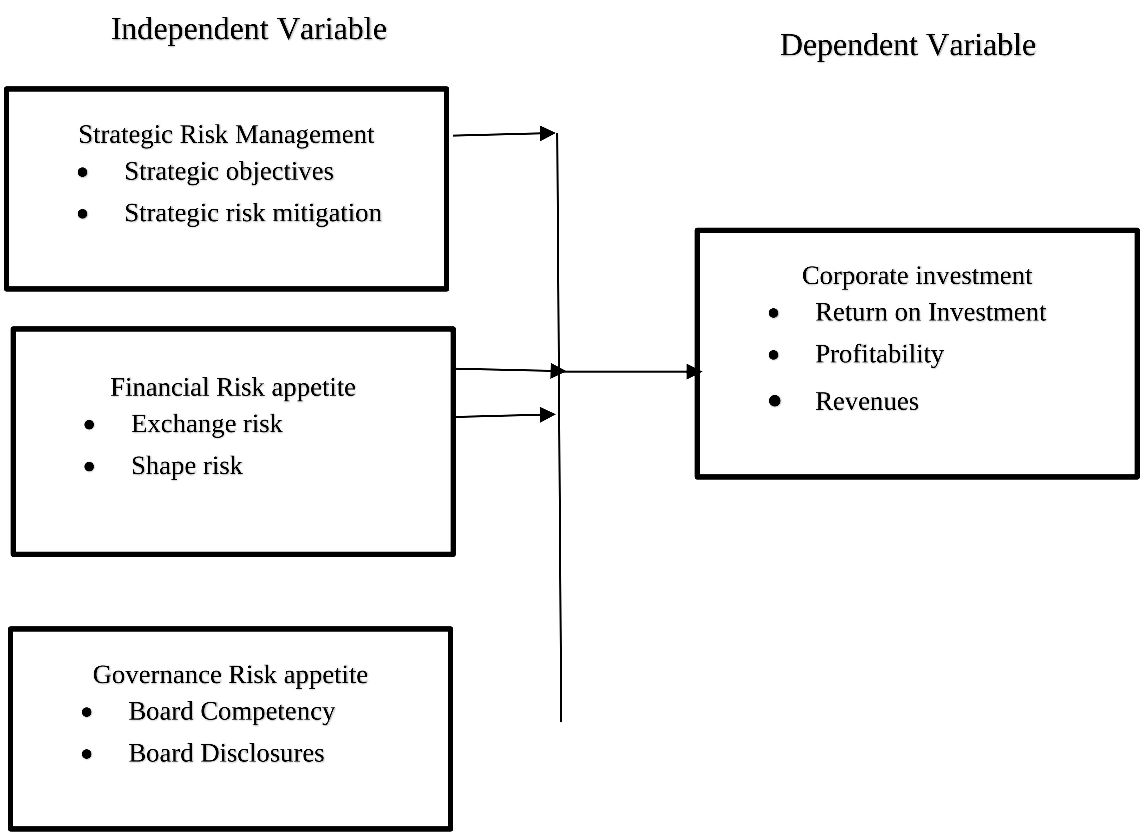

Figure 2.1: Conceptual framework

3.0 Methodology

This study adopted a descriptive survey design. It is adopted since It involves describing the facts and characteristics of a given population or group by means of such instruments as interview schedules and questionnaires as it is applied in this research. The accessible population of finance and operations departments constituted of 98 managers who the researcher had reasonable access to. Simple random sampling was used as the technique offered representativeness thereby reducing the risk of bias. 98 people were incorporated with a sample size of 77 participants chosen by use of a scientific calculation using Taro Yamane 1967 formula. The study incorporated primary data with questionnaires which the researcher used the drop and pick technique.

Reliability (test re test) and validity (content and construct) tests were used to check for consistency and accuracy with the Cronbach's alpha coefficient levels of 0.7 being the cutoff point for a reliable questionnaire. Quantitatively, the results were presented using descriptive statistics of percentages, frequencies and means while Inferential statistics adopted regression and correlation.

$Y = \alpha + \beta 1X1 + \beta 2X2 + \beta 3X3 + \mu$

Y= DV – Corporate investment

β = beta Values

α = Constant

μ= Error term

X1 = Strategic Risk appetite

X2 = Financial Risk appetite

X3 = Governance Risk appetite

4.0 Results and Findings

4.1 Regression analysis

Regression analysis also provides insights into the significance of individual predictors and the overall model fit.

Table 1: Regression

Model	R	R^2	Adjusted R^2	Std. Error
1	.900[a]	.810	.7981	.2355

The findings from our analysis reveal a strong relationship between key decision-making factors such as governance, strategy, policy, evaluation, and organizational structure and risk appetite within selected micro finance institutions. This is supported by the significant adjusted R squared value of 0.798, indicating that these factors explain approximately 79.8% of the variation in risk appetite. Additionally, the strong positive correlation (R = 0.901) further emphasizes the impact of these factors on risk appetite and losses within these institutions. In simpler terms, our data highlights that changes made to governance, strategy, policy, evaluation, and organizational structure are responsible for almost 80% of the changes in risk appetite observed in the selected micro finance institutions.

Table 2: Regression Analysis

	Unstandardized Coefficients		Standardized Coefficients		
.	Beta	Std. Error	Beta	T	Sig.
1 (Constant)	.194	.050		1.887	.061
SR	.824	.040	.850	20.790	.000
FR	.484	.034	.079	2.449	.015
GR	.664	.026	.010	.363	.020
a. DV: CI					

Corporate Investment = 0.194 + 0.769(Risk appetite) + 0.824(Strategic Risks) + 0.484(Financial Risks) + 0.664(Governance Risk) + error. This equation demonstrates that when all factors except risk appetite are held constant at zero, the predicted level of corporate investment would be 0.194. Furthermore, for every unit increase in risk appetite, there was a corresponding increase of 0.769 in corporate investment. Similarly, a unit increase in strategic risks, financial risks, or governance risk resulted in increases of 0.824, 0.484, and 0.664

4.2 Summary of the Study

It is revealed that there is significant diversity in risk appetite and corporate investment among microfinance institutions in Rwanda. Upon examining the regression equation, it is evident that there exists an inverse correlation between the variables. In particular, the study highlights the impact of governance on limiting risk appetite. Overall, the research effectively demonstrates that the selected variables effectively mitigate risk appetite in microfinance institutions in Rwanda.

5.1 Conclusions

According to the findings, an enhancement in governance exhibits a direct link to a reduction in risk appetite within manufacturing companies. This pattern is mirrored when it comes to the influence of strategy, as an increase in this area also results in decreased risk appetite for financial institutions. Furthermore, the study demonstrated that a stronger policy framework yields lower risk appetite for microfinance institutions in Rwanda. The significance of this link is further emphasized by the discovery that more frequent evaluations lead to fewer risk appetite in Rwandan microfinance institutions. Additionally, it was revealed that a well-established organizational structure plays a crucial role in reducing risk appetite within microfinance institutions in Rwanda.

This study asserts that an organization's risk appetite culture greatly influences the effectiveness of its risk management strategy. A successful risk strategy involves incorporating risk into the organization's overall vision, strategies, and actions. Additionally, the involvement of top management is crucial in identifying and addressing risk appetite s. The study also discovered that consolidating risk appetite data from various self-assessments across the organization yields valuable insights for establishing an appropriate hierarchy. This structure serves as a fundamental blueprint for overall risk management within firms.

5.2. Recommendations

Additionally, the team should establish efficient strategies to promptly address unforeseen risks as they arise. Implementing a risk appetite approach can yield numerous advantages, such as minimizing unwanted shocks, enhancing planning and performance, and fostering positive relationships with stakeholders. Moreover, the study underscores the significance of corporate social responsibility for businesses. Developing trust and having foresight are crucial elements in building a thriving company. However, earning and maintaining trust with customers, communities, and regulatory bodies can be challenging. Nevertheless, trust is a vital factor that can immensely benefit a company.

REFERENCES

[1] Asad, H., Toqeer, I., & Mahmood, K. (2022). A qualitative phenomenological exploration of social mood and investors' risk appetitein an emerging economy. Qualitative Research in Financial Markets, 14(1), 189-211.

[2] Anh, D. L. T., Gan, C., Jin, S., & Anh, N. T. (2022). Uncertainty, risk aversion and corporate performance: evidence from the Asia-Pacific region. Journal of the Asia Pacific Economy, 1-21.

[3] Ahmed, Z., Noreen, U., Ramakrishnan, S. A., & Abdullah, D. F. B. (2021). What explains the investment decision-making behaviour? The role of financial literacy and financial risk tolerance. Afro-Asian Journal of Finance and Accounting, 11(1), 1-19.

[4] Bauer, M. D., Bernanke, B. S., & Milstein, E. (2023). Risk appetite and the risk-taking channel of monetary policy. Journal of Economic Perspectives, 37(1), 77-100.

[5] Bunyamin, M., & Wahab, N. A. (2022). The Influence of Financial Behaviour on Financial Risk appetiteIn Investment Decision: A Conceptual Paper. International Journal of Industrial Management, 14(1), 529-542.

[6] Baruah, M., & Parikh, A. K. (2018). Impact of risk appetiteand demographic factors on financial investment decision. International Journal of Financial Management, 8(1), 36-48.

[7] Burton, E. L. (2015). The impact of risk aversion on economic development in Portugal. Perspectives on Business and Economics, 33(4), 26-38.

[8] Can Ergün, Z., Cagli, E. C., & Durukan Salı, M. B. (2023). The interconnectedness across risk appetite of distinct investor types in Borsa Istanbul. Studies in Economics and Finance, 40(3), 425-444.

[9] Disatnik, D., & Steinhart, Y. (2015). Need for cognitive closure, risk aversion, uncertainty changes, and their effects on investment decisions. Journal of Marketing Research, 52(3), 349-359.

[10] Epetimehin, F. M. (2013). Impact of risk appetite on the value of a firm. European Scientific Journal, 9(22).

[11] Egly, P. V., Johnk, D. W., & Perez Liston, D. (2010). Foreign portfolio investment inflows to the United States: The impact of investor risk aversion and US stock market performance. North American Journal of Finance and Banking Research, 4(4), 25.

[12] Fang, X., & An, L. (2017). A study of effects of entrepreneurial passion and risk appetite on entrepreneurial performance. Revista de Cercetare si Interventie Sociala, 56, 102-113.

[13] Guo, J., Zhang, B., Guo, Y., & Li, F. (2022). Expectation or risk aversion when outward foreign direct investment firms invest in the belt and road: Evidence from China. Research in International Business and Finance, 62, 101728.

[14] González-Sánchez, M., Nave, J., & Rubio, G. (2020). Effects of uncertainty and risk aversion on the exposure of investment-style factor returns to real activity. Research in International Business and Finance, 53, 101236.

[15] Gontarek, W., & Bender, R. (2019). Examining risk governance practices in global financial institutions: the adoption of risk appetite statements. Journal of Banking Regulation, 20, 74-85.

[16] Gontarek, W. (2016). Risk governance of financial institutions: The growing importance of risk appetite and culture. Journal of Risk Management in Financial Institutions, 9(2), 120-129.

[17] Geetha, S. N., & Selvakumar, M. M. (2016). An analysis on the factors influencing risk appetite level of individual investors. International Journal of Business Excellence, 9(2), 253-264.

[18] Hussain, S., & Rasheed, A. (2023). Risk appetite as mediating factor in individual financial investment decisions: a developing-country study. Studies in Economics and Econometrics, 1-14.

[19] Heo, W., Rabbani, A. G., & Lee, J. M. (2021). Mediation between financial risk appetite and equity ownership: Assessing the role of financial knowledge underconfidence. Journal of Financial Services Marketing, 26, 169-180.

[20] Hirawati, H., Sijabat, Y. P., & Giovanni, A. (2021). Financial literacy, risk tolerance, and financial management of micro-enterprise actors. Society, 9(1), 174-186.

[21] Hatch, C. D., Carlson, K., & Droms, W. G. (2018). Effects of market returns and market volatility on investor risk tolerance. Journal of Financial Services Marketing, 23, 77-90.

[22] Hunjra, A. I., & Rehman, Z. U. (2016). Factors affecting investment decision mediated by risk aversion: a case of Pakistani investors. International Journal of Economics and Empirical Research, 4(4), 169-181.

[23] Kyaw, K., Olugbode, M., & Petracci, B. (2022). Stakeholder engagement: Investors' environmental risk aversion and corporate earnings. Business Strategy and the Environment, 31(3), 1220-1231.

[24] Kasoga, P. S. (2021). Heuristic biases and investment decisions: multiple mediation mechanisms of risk appetiteand financial literacy—a survey at the Tanzania stock market. Journal of Money and Business, 1(2), 102-116.

[25] Lee, P. L., Lye, C. T., & Lee, C. (2022). Is bank risk appetite relevant to bank default in times of Covid-19?. Central Bank Review, 22(3), 109-117.

[26] Larkin, C., Lucey, B. M., & Mulholland, M. (2013). Risk appetiteand demographic characteristics: Preliminary Irish evidence. Financial Services Review, 22(1).

[27] Nazari, S., Basati, M., & Jamshidinavid, B. (2017). The Effect of Institutional Ownership on the Relationship between Risk Appetite and Financial Performance. Specialty Journal of Accounting and Economics, 2(2), 66-73.

[28] Perveen, N., Ahmad, A., Usman, M., & Liaqat, F. (2020). Study of investment decisions and personal characteristics through risk tolerance: Moderating role of investment experience. Amazonia Investiga, 9(34), 57-68.

[29] Thanki, H., & Baser, N. (2021). Determinants of financial risk appetite(FRT): An empirical investigation. The Journal of Wealth Management, 24(2), 48-64.

[30] Xiao, J., Wang, Y., & Wen, D. (2023). The predictive effect of risk aversion on oil returns under different market conditions. Energy Economics, 126, 106969.

[31] Zhu, M., & Tao, Y. (2022). Economic policy uncertainty, entrepreneurial risk appetite, and corporation innovation in innovative cities–empirical evidence from the Shenzhen Special Economic Zone. Management Decision.

[32] Zhu, M., & Tao, Y. (2022). Economic policy uncertainty, entrepreneurial risk appetite, and corporation innovation in innovative cities–empirical evidence from the Shenzhen Special Economic Zone. Management Decision.

[33] Zeb, M., Qazi, L. T., & Javaid, M. N. (2021). Risk Aversion or Institutional Myopism; the mediating role of Financial Performance in the relationship of Corporate Social Responsibility and Institutional Ownership. Business & Economic Review, 13(3), 35-58.

AUTHORS

First Author – Jacob Ochieng Onyango, Postgraduate Student (Finance & Accounting) Mount Kenya University

Second Author – Dr. Athanas Osiemo Kengere, (PhD), Senior Lecturer - Mount Kenya University