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# A REVIEW OF EMPIRICAL LITERATURE ON FINANCIAL RISK MANAGEMENT AND PROFITABILITY OF LICENSED TOURISM ENTERPRISES IN KENYA

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**Abstract**

*The tourism hotel-sector remains key in most country's tourism receipts but has been heavily affected by COVID-19 pandemic and their profitability affected by financial risk related factors such as market value risk, economic risk, audit/accountings risks, occupancy risks, operational risks, credit risks, cash flow/liquidity risks, and general non-financial related risks; thus pushing industry players to craft financial risk and revenue management resilient mechanisms. Therefore, the purpose of this paper is to examine influence of financial risk management and profitability of licensed tourism enterprises in Kenya. This paper empirically reviews the perceived effect of operational and cash flow risks on profitability of licensed tourism enterprises. The paper advances the concept that effective financial risk management measures can enhance hotel profitability in dynamic business environment and recommends that tourism enterprises must adopt financial risk measures like operational and cash flow risk measures to check on their profitability during economic crisis. It is substantially of essential policy makers, practitioners, to investors and other stakeholders who are interested with firm's value in particular.*

*Keyword: Financial Risk Management, Liquidity/Cash flow Risk, Operational Risk, Profitability, Licensed Tourism Enterprises*

## INTRODUCTION

The tourism enterprises profitability in most countries is affected by risk related factors such as market value risk, economic risk, audit/accountings risks, occupancy risks, operational risks, credit risks, cash flow/liquidity risks, and general non-financial related risks. For instance, in Kenya, the Ministry of Tourism and Wildlife Research Report (2020) states that even though Kenya entered the crisis with considerable resilience, the pandemic has had a significant detrimental effect on the expansion of the tourism hotel industry. This is the case despite the fact that Kenya entered the crisis with considerable resilience. In addition, empirical statistics demonstrate that the hotel industry benefited from 13.5 percent of the total 2,048,834 international arrivals in 2019 in Kenya. At least 276,592 visitors participated in meetings and business, which had a positive impact on room occupancy rates, which ultimately translated into revenue for hotels. The hotel-sector also continues to play an important role in Kenya's tourism receipts, which increased by 3.9 percent to KSh163.56 billion in 2019, but is now threatened by the COVID-19 pandemic unless industry players craft financially risk- and revenue-management mechanisms that are resilient to pandemics (Cytonn, 2020).

To improve profitability of tourism enterprises in with specific reference to hotels various financial risk management measures have been suggested with little empirical evidence of their success. For instance, Oluoch (2016) and Muthama (2016) studies on cash flow management practices; and Njagi (2016) study on financial risk management in hotels were empirically inadequate in linking financial risks and profitability of hotels. These are clear indications that, there are inconsistencies in the exiting empirical studies on the influence of cash flow risk and operational risk on financial performance or profitability of tourism enterprises, since while some studies show positive or negative significant relationships, others shows insignificant relationship about the studied variables. More so, most studies have focused more on cash flow risks than operational related risks which do also have a bearing on hotels' profitability.

By definition, financial risk management comprises controlling of operational and cash flow related risks that can jeopardize profitability of hotel enterprises (Habib, Masood, Hassan, Mubin & Baig, 2017). Operational risk entails evaluation of cost to income ratio, analysis of operational risk data and risk control self-assessment that can affect hotel profitability (Peter, Gordon & Yueran 2018). In this article, operational risk is operationalized as the Cost to Income ratio (CIR), which indicates the ratio of operating expenses (excluding bad and doubtful debt) to the net interest revenue-including non-interest income from the tourism company. Cash flow risk entails evaluation of liquidity ratio, Net cash flow from operations to total assets and Cash conversion cycle assessments (Teruel & Solan, 2018). This is because as a prudent financial management approach, hotels need to maintain sufficient cash flows just enough to run operations while at the same time being able to service long term needs of the company. Hotel profitability is the performance of tourism hotel enterprises measured in terms of ROA and Net profit margin which evaluates hotels' income/revenue strength (Fawy, Dawood & Mohammad, 2018).

In, Kenya the tourism sector has been one of the key economic drivers generating approximately 10% of the country's GDP and 9 % of total formal employment. In all for instance, the sector contributes to the country's GDP rose by 32.8 per cent from Ksh 73 billion 1n 2010 to Ksh 97.6 billion (Sindiga, 2018). Further according to world bank, tourism industry contributes to Kenya's economy as a percentage of the total exports has always stood above 15%, climaxing at 22% in the year 2007. The relative importance of tourism in Kenya's economy has risen steadily over the last 40 years (Kibara, Odhiambo & Njuguna, 2020). In terms of revenue, it ranks third after tea and horticulture as the major foreign exchange earner. It has also been identified as one of the pillars in Kenya vision 2030. Tourism is one of the leading foreign exchange earners in Kenya; indeed the sector contributes 27% of foreign exchange of the country national domestic product (GDP) (Dieke, 2020) national tourism strategy 2013-2018, department of tourism Nairobi, Kenya. Kenya is among the popular tourism destinations in Africa attracting millions of tourists over the past years (Mc Clanahan et al., 2015). The country's blueprint vision 2030, aims at making the country among the top 10 overall tourists destinations in the world. The key tourist attractions along the Kenya coast include beaches, cultural heritage and marine based habitat (Mohamed et al., 2019).

### Purpose of the study

The purpose of this paper is to examine influence of financial risk management and profitability of licensed tourism enterprises in Kenya

## LITERATURE REVIEW

The tourism enterprises profitability in most countries is affected by risk related factors such as market value risk, economic risk, audit/accountings risks, occupancy risks, operational risks, credit risks, cash flow/liquidity risks, and general non-financial related risks. For instance, in Kenya, the Ministry of Tourism and Wildlife Research Report (2020) states that even though Kenya entered the crisis with considerable resilience, the pandemic has had a significant detrimental effect on the expansion of the tourism hotel industry (Lau, Mbaru, Muly, Muthiga & Cinner, 2021). This is the case despite the fact that Kenya entered the crisis with considerable resilience. In addition, empirical statistics demonstrate that the hotel industry benefited from 13.5 percent of the total 2,048,834 international arrivals in 2019 in Kenya. At least 276,592 visitors participated in meetings and business, which had a positive impact on room occupancy rates, which ultimately translated into revenue for hotels. The hotel-sector also continues to play an important role in Kenya's tourism receipts, which increased by 3.9 percent to KSh163.56 billion in 2019, but is now threatened by the COVID-19 pandemic unless industry players craft financially risk- and revenue-management mechanisms that are resilient to pandemics (Cytonn, 2020).

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**Critique of Reviewed Literature**

Bekele (2017) carried a study on the effects of Ethiopian commercial banks' economic performance on risk management techniques. Data from eight (8) commercial banks' annual reports was the major source of information utilized in this study. The findings of the regression indicated that there was a substantial and unfavorable impact caused by liquidity risk on performance. According to a study by Waswa, Mukras and Oima (2018) on sugar firms, liquidity had a negative effect on corporate performance. Dong and Tay Su's (2018) research on the profitability and cash conversion cycle components of Vietnam Stock Exchange-listed businesses also revealed a substantial negative association between profitability and the cash conversion cycle. However, the studies were not done on tourism enterprises, thus the need for another study so as to compare empirical results.

Regarding hotels, Lima, Lus, Cátia, and Ana's (2021) research on impact variables on Portuguese Hotels' Liquidity indicated that liquidity declines in bigger hotels, creating the reverse effect. Tan, Ali, Abdollah, and Wanke (2021) study on Hotel Performance in the UK, found that unsteady financial performance was attributed to lack of financial risk controls. The univariate analysis used in the study did not show relationship with hotel profitability. It was shown that indebtedness and sales growth had more of an impact on current liquidity than fast liquidity, however they were not correlated with hotels' profitability indicators by Nada, Jelena, and Slobodan (2019) in their study.

In addition, Marisa (2018) conducted research in the tourist industry in Europe and found a negative correlation between Cash Conversion Cycle and profitability. According to the findings, businesses have the potential to increase their levels of profitability if they reduce the number of days it takes to process their accounts receivable, inventory, and payables respectively. However, the study only used Cash Conversion Cycle and did not incorporate other measures of cash flow risks.

Comparatively, Akenga's (2017) research on the financial performance of listed companies revealed that the current ratio has a considerable impact on financial performance, and comparable findings were seen for cash reserves. Despite this, the sample sizes of these studies were rather small, which limits the capacity to generalize the results of the research to a larger population. Additionally, a comparable study has to be done in tourist companies so that empirical findings can be compared.

The Financial Analysis of the Tourism Sector in Italy carried out by Lorenzo, Federica and Elisabetta (2017) revealed that Hotels with turnovers surpassing 2.5 million in the year before to the one analyzed exhibited net revenue rise rates on average over 10 percent, peaking at 16 percent. However, the study just gave a financial analysis status report without showing predictors like cash flow risks of profitability of tourism hotels'. The Ayneshet (2020) research on profitability in the hotel business in Hawassa City found that Equity ratio, total operating Cost, Hotel Age, and liquidity ratio) share 85.1 percent of Profitability in Four star Hotels in Hawassa, although the study did not completely capture cash flow concerns.

The influence of cash flow management on the profitability and long-term viability of small and medium-sized businesses (SMEs) in Zimbabwe, such as hotels, was also studied by Wadesango, Tinarwo, Sitcha and Machingambi (2019). Because many small businesses (hotels included) were unwilling to implement efficient cash management techniques, many failed.

The operational risk was examined by Fadun and Oye (2020), who conducted a longitudinal analysis of 20 Nigerian commercial banks that had been granted licenses. The study's findings demonstrated that banks' financial performance benefited from sound techniques of managing operational risk. However, the research was only conducted in 20 different commercial banks, which limits its applicability to a broader audience than if it had been conducted in a larger number of institutions. For the purpose of comparing the results of studies conducted on tourist businesses, a comparable research with a greater number of participants might also be conducted.

A second research by Ali, Bagram, and Ali (2018) looked at the function of risk management and its influence on the performance of Pakistani firms. The eleven-year period from 2005 to 2015 was used to compile the data for this research, which was based on public annual statements from five big and five small Pakistani tourist hotels. In Pakistan, risk management has a major influence on corporate success, according to the findings of this research. Large hotel financial performance was found to be negatively affected by operational risk, but small hotel financial performance was shown to be positively influenced by it, according to the results. The sample size of the study was also insufficient (five major tourist hotels and five small tourist hotels), which prevented the researchers from successfully generalizing their results to a more extensive population. Similarly, Mira, Ivana, and Andrea's (2019) research on hotel enterprises in selected Mediterranean nations indicated that cash flow to operational revenue had a statistically significant and favorable influence on profitability in all studied countries.

**Research gaps**

First, there is a mixture of empirical findings on influence of cash flow risks on tourism hotels' profitability (shows either negative or positive relationship); sample sizes used in most reviewed studies is small-raising generalizability of research findings to a wider population, and some used cross sectional data which has less validity and reliability compared to time series data. Secondly, operational risks-profitability correlation has been least done in tourism hotel enterprises, thus future researches must focus on larger target population and sample sizes, use time series data (span of 5years and above) and incorporate both cash flow risks and operational risks in the study's conceptual model.

## MATERIAL AND METHODS

The research used a systematic approach. Literature search from published sources and profitability and financial risk management reviews comprised the study. Content analysis and structured documentary guides were used to extract data from published and unpublished sources. A variety of data bases or mixtures of information sources were used to handle different goals of the research. Data were collected from the works review for each specific purpose. It was decided to advance the content and give it face validity by using a combination of professional opinions and collected works searches. The data was gathered from a variety of sources, including Google Scholar, Scopus, Science Direct, Eric, and the Directory of Open Access Journals (DOAJ), and was supplemented by an increase in the number of document references used. Key words were combined with an array of search string commands that included parenthesis and other special characters to help narrow down the results. Licensed tourism enterprises were included in the search terms used by the researchers. Financial risk management was also included in the list of search terms. To synthesize information, we searched published peer-reviewed and grey literature from 2000 to 2020 and excluded 14 articles that had nothing to do with the topic.

## RESULTS

| Author & year | Research paper & Journal title | Methodology | Findings | Gaps |
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| Fadun and Oye (2020) | Impacts of Operational Risk Management on Financial Performance: A Case of Commercial Banks in Nigeria. International Journal of Finance & Banking Studies, Vol 9 No 1. | The research strategy for this study was a longitudinal one. The 20 commercial banks in Nigeria that have been granted licenses were included as part of the study's population. The Linear Multiple Regression Model was used in order for the data to be analyzed effectively. | According to the data, excellent operational risk management approaches have a favorable influence on the financial performance of banks. | The investigation was only conducted in 20 different commercial banks, thus it is possible that the results cannot be generalized to a larger population as a whole. This research will focus on 165 tourist businesses that have valid licenses. |
| Bekele (2017) | Effect of risk management practices on the financial performance of commercial banks in Ethiopia. SSRN Electronic Journal. | The annual reports of eight (8) chosen commercial banks that were active in Ethiopia during the years of 2006 and 2015 were combed through for secondary data in order to compile this study's findings. | The results of the regression showed that performance had been negatively influenced by liquidity risk in a significant manner, as demonstrated by the findings. | The study results cannot be generalized to a larger population due to the limited sample size, which consisted of just eight different banks. 165 licensed tourist businesses are the focus of this investigation. |
| Ali, Bagram and Ali (2018) | Critical role of risk management and its impact on business performance in Pakistan. Journal of Business and Tourism, 4(1) | The correlational research approach was employed for this study, and the data for it were obtained from the annual statements of five large tourist hotels and five small tourist hotels that were published during a period of eleven years, from 2005 to 2015. | The results of the regression indicated that both operational risk and liquidity risk had significant and detrimental effects on the financial performance of large hotels. On the other hand, the impact of operational risk on performance was shown to | The study's unit of analysis was not clear since hotels are classified using star rating and not just lamped into small and large hotels. The study's sample size was also too small (five large |

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| | | | be considerable but positive for small hotels. | tourist hotels and five small tourist hotels), thus fall short of generalizability of research findings to a wider population. |
| Dong & Tay Su (2018) | The relationship between working capital management and profitability: A Vietnam case International Research Journal of Finance and Economics 38(3). | A cross-sectional research strategy was utilized by the researcher in order to carry out the study, the purpose of which was to determine whether or not there is a connection between a company's profitability and the various aspects of a cash conversion cycle for businesses that are traded on the Vietnam Stock Exchange. | According to the findings, there is a significant and significant negative association between profitability, which was calculated in terms of gross operating profit, and the cash conversion cycle. | The study was based on cross sectional data which is less powerful than time series data. Secondly, the study did not show sample size or sampling frame thus faces generalizability issues. |
| Akenga (2017) | | A total of thirty distinct companies were selected via the process of purposive selection to make up the sample size. The research examined the years 2010 through 2015 and analyzed the degree to which financial statements were published consistently over that span. The study was carried out using a causal research design, and the multiple regression method | According to the findings of the research, the current ratio has a considerable impact on a company's financial success. Similar findings were found for cash reserves. | The study was based on listed firms- not tourism enterprises which could have liquidity problems unique to them and also focused on general financial performance of firms and not specifically on profitability |
| Waswa, Mukras and Oima (2018) | During the period of 2002 to 2016, the researchers investigated how the capacity of | The target population consisted of 11 sugar enterprises that were registered with the Kenya Sugar board in 2010, and | The findings indicate that a firm's liquidity has a negative influence on its performance, which shows that businesses involved in | First, the study focused on only 5 firms- thus a small sample falls short of generalizability of |

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| | sugar companies to satisfy their short-term commitments influences the financial success of those companies. | the purposive sampling approach was used to collect data from 5 of those firms. The random effects regression model was used for the investigation. | the Kenya sugar industry have inadequate cash flows and are highly indebted. | research findings; secondly the study analyzed general firm performance and not profitability only. |
| Lima S, Luís, C, Cátia M, and Ana L (2021 | Impact Factors on Portuguese Hotels' Liquidity. *Journal of Risk and Financial Management 14: 144* | The research was conducted with a primary emphasis on Portuguese hotel businesses, and data collection took place on July 4th, 2019. There were a total of 1102 hotel firms that were included in the sample. However, in order to complete the RNET (National Register of Tourist Enterprises) database, it was necessary to gather additional data (STAR, ROOMNUMB) | Since only a small percentage of hotels' short-term liabilities can be covered by current assets, the location of a hotel has no bearing on its liquidity; hotels without restaurants have higher liquidity; hotels with a higher rating have lower liquidity; and hotels with higher ratings have lower liquidity. | The study only analyzed liquidity parameters in hotels without linking it to hotel profitability, a gap that will be addressed in the proposed study |
| Tan, Y, Ali J, Abdollah H, and Wanke, P (2021). | Hotel Performance in the UK: The Role of Information Entropy in a Novel Slack-Based Data Envelopment Analysis. *Entropy 23 (184)* | The study sampled 197 tourist hotels and used financial ratios to analyze hotel financial position as measured by ROA for the period 2017-2020 | The univariate analysis showed financial lags within the stated period. The unsteady financial performance was attributed to lack of financial risk controls | The study was only based on univariate analysis of financial position of each hotel in each year, but did show financial risk related factors that attributed to unstable financial performance of the sampled hotels |
| Nada, M,Jelena A and Slobodan A (2019) | Hotel specific determinants of liquidity-evidence from the hotels in AP Vojvodina. | The research used data from hotels registered in the Autonomous Province of Vojvodina as a source of sample. As of 2014-2018, | According to the data, there is a significant gap in the levels of liquidity that are kept by the hotels situated in AP Vojvodina | The study did not link liquidity ratio with hotels' profitability ratios, a gap that can be addressed by the |

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| | *The Service Industries Journal, 39(6)* | there are 45 municipalities under AP Vojvodina, and 220 hotels have been registered under the category of 551-hotels and other companies in those towns. This analysis relied on secondary data gleaned from Scoring, a database that has every bit of data available from the financial records of every Serbian company. | and for the years 2014-2018 as a whole. The outcomes of the aforementioned regression models indicate that indebtedness and sales growth both have a significant impact on liquidity ratios, which may be evaluated using the current liquidity ratio and the fast liquidity ratio, respectively. | proposed study |
| Lorenzo G, Federica L and Elisabetta V (2017) | Overcoming Borders: a Financial Analysis of Tourism Sector in Italy<br><br>*Journal of Economics and Development Studies* | In this research, modern approaches for analyzing financial statements were used for the purpose of evaluating important economic ratios and financial flows, and logistic regression modeling was utilized to analyze the data. The empirical study used data for the years 2013 to 2015 that were obtained from the Aida database maintained by Bureau Van Dijk. Over 12,000 different Italian tourist companies were included in the sample. | Hotels that had turnovers of more than 2.5 million in the year that was taken into consideration exhibited rates of rise in their net revenue that were, on average, more than 10 percent, reaching 16 percent in the turnover class that ranged from 4 million to 6 million euros. On the other hand, hotel enterprises experienced, on average, a loss in net profit, despite the fact that there had been a major improvement over the course of the three years under consideration. | The study just gave a financial analysis status report without showing predictors (like operational and cash flow risks) of profitability of tourism hotels' |
| Ayneshet, A (2020) | Determinants of Profitability in Hotel Industry: A Case Study in Hawassa City Administration, | The annual reports and audited financial statements of four-star hotels were combed through to acquire secondary information on the properties' respective | According to the findings, the profitability of four-star hotels in Hawassa can be broken down into four categories: the equity ratio, total operating cost, | The study only captured liquidity ratio and not liquidity risks among other financial risks that will be captured in the |

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| | Ethiopia. *International Journal of Research in Business Studies and Management Volume 7 (3).* | financial performances from 2013 to 2017. | hotel age, and liquidity ratio. | proposed study |
| Marisa T C (2018). | The impact of working capital on profitability in the European tourism. European Journal of Finance, 119(3). | In this study, which spanned the years 2009-2016 and employed a sample population consisting of 59,131 European tourist enterprises, the researchers evaluated whether or not there was a correlation between efficient management of working capital and profitability.. | According to the findings, there is an inverse connection between CCC and profitability. According to the findings, businesses have the potential to increase their levels of profitability if they reduce the number of days it takes to process their accounts receivable, inventory, and payables respectively. | The study only used Cash Conversion Cycle and did not incorporate other measures of cash flow risks |
| Mira D, Ivana T & Andrea A (2019 | Profitability determinants of hotel companies in selected Mediterranean countries. , *Economic Research- 32:1,* | On a massive dataset, dynamic panel data models were calculated for the years 2007 to 2015 using the period of time from those years. | There is a statistically significant and positive impact on the profitability of companies across all of the countries studied when it comes to cash flow to operational revenue. Only Spain, which also has the greatest turnover per employee, has a substantial labor productivity, whereas all other nations, with the exception of Portugal, have a considerable total asset turnover ratio. In addition, Spain has the highest average annual | Although the Generalized Method of Moments (GMM) created by Arellano and Bond (1991) was employed in the study, which is one of the most extensively used techniques in empirical research employing firm-level data, the sample size of hotels as the unit of analysis was not provided in the paper. |

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| | | | employee turnover. With the exception of Greece, the country with the greatest amount of debt, the solvency ratio correlates positively with profitability. | |
| Wadesango N, Tinarwo N,Sitcha L and Machingambi, S (2019) | The impact of cash flow management on the profitability and sustainability of small to medium sized enterprises in Zimbabwe International Journal of Entrepreneurship, 23(2). | The target demographic consisted of 55 individuals who were employed by one of the 14 small firms located in either Harare or Gweru. The number of responders in the sample was determined using the Yamane formula, which yielded a total of fifty. In the process of collecting data, we make use of things like surveys and interviews. | According to the findings that were derived through the use of the chi square test methodology, the majority of cash management strategies that are being implemented by SMEs like hotels are having a substantial impact on the profitability and viability of these enterprises. The findings also demonstrated that the majority of small and medium-sized enterprises (SMEs) are hesitant to successfully implement cash management procedures, which leads to their failure. | The sample size was small (50 respondents) thus facing short of generalizability of research finding to a wider population. Chi square method used in analysis has less statistics power compared to other powerful financial analysis tests. |

## CONCLUSION AND RECOMMENDATIONS

The paper concludes that one, existing survey data indicate that tourism enterprises in Kenya have recorded sharp decline in their profitability indices. Notably, with travel advisories and lockdowns due to covid-19 pandemic in 2020 and 2021, all tourism hotel enterprises recorded low profitability indices. Secondly, to improve profitability of tourism enterprises with specific reference to hotels, various financial risk management measures have been suggested but with little empirical evidence of their success. Thirdly, reviewed empirical studies show conflicting results on the influence of financial risk management measures on firm profitability.

The paper recommends that, one, though financial risk measures should be adopted as significant mitigation measures of firm profitability, most existing empirical studies have been done in sugar firms, listed stock firms, firm stores, banks with scanty studies in tourism enterprises. Secondly, though tourism enterprises must adopt operational and cash flow risk measures to check on their profitability during economic crisis, the conflicting study findings on the influence of operational and cash flow risks on firm profitability, necessitates a further empirical study to be done on tourism enterprises so as to compare empirical findings

## LIMITATIONS AND FURTHER STUDIES

This research was purely desktop research whose focus was critically reviewing of the existing theoretical and empirical literature to provide answers to the formulated research objectives. Additionally, the study did not focus on a specific country or various countries hence the findings and conclusions may not be generalized in a specific industrial segment or any firms that are in operation. The review is also limited to the employed indicators and constructs and the various measure of the study concepts. The majority of the empirical researches were based on tourism enterprises around the world.

Prevailing empirical and theoretical literature on financial risk management and profitability was this study's main focus. The study thus did not empirically collect and analyze data on the same hence a full study can be undertaken to determine the existing relationship among the considered variables. Further, most empirical studies have not utilized moderating, mediating or intervening variables; therefore, further study should focus on the moderating effect of firm size or intervening role of government policies and regulations. Lastly, this study did not incorporate a specific context hence future reviews may include firms in a given sector or across sectors.

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