

**Risk Management and Financial Performance of Secondhand Car Trading Companies in Kampala District,
Uganda**

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Abstract

The study examined the relationship between risk management and financial performance of secondhand car trading companies in Kampala. The study applied a cross-sectional research design and a quantitative research approach. The study selected a sample of 242 secondhand car trading companies from 628 by simple random sampling. A structured questionnaire was used to obtain data from either an accountant or business owner. Validity of the instrument was by expert judgment while reliability, Cronbach alpha coefficient. Data analysis was carried out using SPSS (v20) to extract frequency tables, descriptive and inferential statistics for presentation and interpretation. The study found a positive relationship between risk management and financial performance; and positive relationship between working capital management and risk management. Regressed results obtained that jointly working capital management and risk management are significant predictors of financial performance. Risk management was found as the better predictor. The study further obtained a significant partial mediation of risk management in the relationship between working capital management and financial performance. The study concluded that risk management and working capital management are among the key factors that affect financial performance among secondhand car trading companies. The study also observed secondhand car trading companies would financially perform much better if concentration is directed towards risk management. Accordingly, the study recommends; risk assessment, risk mitigation, risk monitoring and control.

Keywords: Risk Management, Financial Performance, Risk Assessment, Secondhand Car, Risk Mitigation.

Introduction

Globally, secondhand car trading greatly contributes to the economic development of economies (Marc & Barbara, 2021). Their contribution is gauged in terms of poverty reduction, income generation and job creation (Financial Times, 2020). Whilst the sector's contribution, financial performance of most companies has raised much concern. KPMG (2021) survey indicates a decline in sales returns among secondhand car trading companies by 4 percent. Companies do not have enough working capital management to match the market demand (KPMG, 2021). Profitability has also consistently declined since 2012 from 14.8 percent to 10.1 percent by 2021. In Uganda, URA Annual Report (2022) indicates that the profitability of secondhand car trading companies has declined, manifesting in the revenue collected from UGX 21.4 billion in 2019 to UGX 14.2 billion in 2021. For instance, Ramzan Motor Ltd Annual Report (2021) indicates a decline in Return on Equity (ROE) from 11.7% in 2020 to 9.2% in 2021. In addition, the company's liquidity has declined considering the increase in accrued expenses by 70.5% from UGX. 17 million to UGX. 29 million. Similarly, Jambo Auto Mart Annual Report (2021) indicate a reduction in profit from UGX. 3.5 billion in 2016 to UGX. 2.09 billion. This trend is a threat to viability and sustainability of secondhand car companies in Uganda.

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Risk is defined as effect of uncertainty on objectives and it aids decision making by taking account of uncertainty and its effect on achieving objectives and assessing the need for any action (ISO, 2018). Risk management is a process, affected by an entity's board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives (Committee of Sponsoring Organizations of the Tread Way Commission (COSO, 2012). This is consistent with Marceline- Sádaba *et al.*, (2014) who postulates that for risk management to be minimized, there is need for a company to continuously carry out risk management. Tufano (2011) posits that risk management is a process, ongoing and flowing through an entity, effected by people at every level of an organization, applied in strategy setting, applied across the enterprise, at every level and unit. Risk management includes taking an entity-level portfolio view of risk, designed to identify potential events that, if they occur, will affect the entity.

According to Kutsch, Browning and Hall (2014), the coordination of activities, which are related to monitor and control risks, are covered with the term risk management, whereby main intentions and thoughts are manifest in companies' risk management policy. A risk management framework consists of organizational components to implement and execute risk management. The risk management process itself ensures the handling of risks, as identifying, evaluation, monitoring and reporting (COSO, 2012). On the other hand, Wang, Lin and Huang (2010) assert that the risk management practices of risk management framework that should be considered include risk governance, risk policy, risk context, risk identification, risk analysis, risk evaluation, risk treatment, communication and consultation, and monitoring and review of risk management process, tools and technology, and continuous improvement. From various empirical studies, risk management is largely explained by risk assessment, risk mitigation and risk monitoring and control (Banaitiene & Banaitis, 2012; Cagliano, Grimaldi & Rafele, 2015; Zou & Li, 2014).

Risk assessment involves examining and scrutinizing risks according to their potential. It involves evaluating the characteristics of the risk, classification and prioritizing risks (Banaitiene & Banaitis, 2012). According to Frank *et al.*, (2014) risk analysis is fundamental because as a practice, it is useful to classify the different risks according to the amount of damage they possibly cause. This is in support of Zou and Li, (2014) who indicate that risk assessment enables the management to divide risks that are threatening the existence of the corporation from those which can cause slight damages. Risk assessment is intended to ensure that management is aware of the different risks, severity and consequence for proper management (Cagliano *et al.*, 2015). It is critical in influencing risk management decisions which involve either accepting, avoiding, reducing and transfer.

Risk mitigation is purely about providing solutions to the assessed risks (Banaitiene & Banaitis, 2012). There is consensus that a company cannot do away without risk, but should be in position to make decisions regarding the different risk encounters (Cagliano *et al.*, 2015; Kutsch *et al.*, 2014; Wang *et al.*, 2010). Cagliano *et al.*, (2015) indicate that the decisions regarding risks rotates around four aspects. First, risk acceptance where the firm may take no action regarding the identified risk, which is regarded favorable for the organization. Secondly, the avoid the risk

by reducing its engagement in activities which are regarded risky for the business. Thirdly, companies may reduce risks to an acceptable level or tolerable status. Lastly, companies may transfer risk by contracting insurance companies and factoring of debtors among others to safeguard the company from risk (Kutsch et al., 2014).

Risk monitoring and control compares the function ability of the risk mitigation practices in relation to achievement of the objectives (Frank et al., 2014). Risk monitoring and control is inevitable for every company because companies are exposed to different risk forms and their reaction changes over time (Zou & Li, 2014). As observed by Banaitiene and Banaitis (2012) risk monitoring and control enables management to identify how the different measures applied towards risks are effective or not and provides a room for improvement. Indeed, Wang et al., (2010) postulates that risk monitoring and control is critical in determining management efficiency. Moreover, it appreciates the fact that there is no ultimate solution to a particular risk. Therefore, conducting a risk management process on a continuous process would safeguard the company from surprise risk which would affect their viability in the long run (Cagliano *et al*, 2015).

Within the financial management literature, risk management continues to be highlighted one of the critical factors for enhancing financial performance. Notably, Nair, Purohit and Choudhary (2014) indicate that for companies to become competitive, they should be able control and manage the different risk exposures they encounter. This is consistent with Adeusi, Akeke, Adebisi and Oladunjoye (2014) who emphasized that risk management allows companies to set a proactive solution for its problems to increase the likelihood of becoming profitable in the long term. Specifically, risk management involves identifying and analyzing risks, developing and implementing risk control techniques as well as monitoring the progress of these techniques in order to avoid and/or reduce the impact of risk on the operations of the firm (Saleem & Abideen, 2017).

Empirical study by Kombo, Wesonga, Murumba and Makworo (2011) asserts that the ability of the company to conduct proper forecasts relies upon the framework for risk management. In addition, risk management helps management to guarantee that sufficient funds are available for the company for investment and dividends, specially where the company has effective financial risk management. Fadun (2013) conducted a study in a bank's setting where it was ascertained that risk management increases shareholders' return and has a long term effect on the overall financial performance of the company. This is in line with Njogo (2012) who pointed out that good risks management practices maximize firms' value. Whilst the above empirical studies to indicate the positive relationship between risk management and financial performance, it is not conclusive. Notable, Ramachandran and Janakiraman (2009) indicate that given the variability of risks, its relatively impossible to mitigate risks yet some companies still generate and report better performance than others. On the other hand, a case study study by Beigi (2015) conducted at Mehre Eghtesad bank in west Azerbaijan province found no relationship between risk management and financial performance.

Nevertheless, much as studies are available to explain the association between risk management and financial performance, most of such studies have been conducted mainly in developing countries. For instance, a Nair et al., (2014) was conducted from India across Islamic banks while Chopra and Sodhi (2004) was focused among

businesses in a more developed environment setting. As a consequence, little attention has been focused on the developing economies such as Uganda. This literature deficiency provides a research gap which will be bridged by this study.

Statement of the Problem

Effective management of working capital management and risk is increasingly becoming a central component for financial performance the world over (Altaf & Shah, 2021). Indeed, in Uganda, auto companies are attaching utmost significance to working capital management and risk management. Such companies are offering cash discounts and reduced repayment period as well as contracting insurance companies to manage working capital management and risks (Automobile Association of Uganda (AAU, 2022). In spite of all the above, the financial performance for secondhand car trading companies continue to decline. This is manifested in the decline in the revenue collected by URA between 2019 and 2021 by 30% (URA Annual Report, 2022). Furthermore, Jambo Auto Mart Annual Report (2021) indicates a decline in profit from UGX. 3.5 billion to UGX. 2.09 billion between 2020 and 2021. Ramzan Motor Ltd Annual Report (2021) also highlight ROE decline by 2.5% in 2021. The declining financial performance of the companies is affecting the overall operations of the companies (Automobile Association of Uganda, 2022). It is likely that inadequate financial performance may be attributed to decline in working capital management and inadequate risk management. However, limited empirical information is available to explain this trend hence the motivation to address this gap.

Objective of the Study

The study examined the relationship between risk management and financial performance in secondhand car trading companies in Kampala.

Research Question

What is the relationship between risk management and financial performance in secondhand car trading companies?

Methodology

The study applied a cross-sectional research design. This research design enhances large sample coverage (Field, 2009). In addition, the study also adopted a quantitative research approach to simplify the analysis and interpretation of data. The approach was appropriate considering the relational nature of the set objectives. The study population comprised of 628 secondhand car trading companies operating within Kampala District (Automobile Association of Uganda, 2021). The study used a sample of 242 secondhand car trading companies. This number was determined based on the Krejcie and Morgan (1970) table for determining samples. These companies constituted the unit of analysis. The study targeted either the owner or accountant who served as the unit of inquiry. These people were selected because they are the major decision makers in a typical secondhand car trading company.

Results

Results in Table 1 indicate that the most appropriate measure for risk management is risk assessment explaining 20.242 percent of the overall variance of 55.129 percent. These statistics signify that responses were in agreement that the higher the intensity of risk assessment, the higher the risk management.

Table 1: Factor loading for Risk Management

Items	Risk Assessment	Risk Mitigation	Risk Monitoring and Control
Within this company, all risks are classified	.808		
Risks are ranked according to their potential loss.	.732		
Risk is evaluated in terms of both quantitative and qualitative value	.553		
Risks are subdivided into individual levels for further analysis	.548		
We do not insure catastrophic risks		.759	
Our company has a mechanism for transferring certain risks to third parties		.721	
We insure different types of risks but not all risks		.691	
We conduct regular risk reviews in this company			.834
We continuously crosscheck the effectiveness of earlier risk policies and practices			.821
Total	1.803	1.656	1.502
% of Variance	20.038	18.397	16.694
Cumulative %	20.038	38.435	55.129

Source: Primary Data (2022)

Inferential Statistics

Correlation results presented in Table 2 reveal that there exists a significant and positive relationship between risk management and financial performance ($r=.421$, $p<.01$). According to this statistic, improving risk management is likely to improve financial performance. Further analysis, this study established how each of the risk management construct relates with financial performance. A significant and positive relationship was obtained between risk assessment and financial performance ($r=.306$, $p<.01$). Risk mitigation and financial performance also indicate a significant and positive relationship ($r=.300$, $p<.01$). Based on these results, it is implied that both risk assessment and risk mitigation determine financial performance. Nevertheless, the results indicate that much as a positive relationship prevails between risk monitoring and control and financial performance ($r=.110$), such it is not significant. The implication of this result is that risk monitoring and control may not result in visible improvement in financial performance among second car trading companies. Hence forth, the results provide answers to research question two.

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Table 2 indicate a significant and positive relationship between working capital management and risk management ($r=.305$, $p<0.01$). The results implied that risk management would be enhanced if working capital management is in place. The results further indicate a significant and positive relationship between receivables management and risk management ($r=.283$, $p<0.01$) as well as a significant and positive relationship between cash management and risk management ($r=.300$, $p<0.01$). Furthermore, a significant and positive relationship was obtained between inventory management and risk management ($r=.366$, $p<0.01$). In essence, results portray that receivables management, cash management and inventory management working capital management constructs determine risk management. On the other hand, the results indicate that a positive relationship between payables management and risk management exists ($r=.114$), but such relationship is not significant. Thus, the result portrays payables management would result in unnoticeable improvement in risk management. The results address research question three.

Table 2: Multiple Regression Analysis

	Unstandardized		Standardized	t	Sig.	Collinearity	
	Coefficients		Coefficients			Statistics	
	B	Std. Error	Beta			Tolerance	VIF
(Constant)	1.418	.310		4.575	.000		
Working capital management	.263	.068	.259	3.883	.000	.907	1.102
Risk Management	.359	.070	.342	5.125	.000	.907	1.102
	R	R ²	Adj. R ²	F	Sig.	Durbin-Watson	
	.488 ^a	.238	.230	29.462	.000 ^b	2.040	

a. Predictors: (Constant), Risk Management, Working capital management

b. Dependent Variable: Financial Performance

Source: Primary Data (2022)

Table 2 reveals $F=29.462$, $Sig.=.000$ in relation to the predicting variables of working capital management and risk management, which signalizes a statistical ability of the model to predict the dependent variable. In addition, the overall model indicates that the variance inflation factor (VIF) for each of the studied variables is less than 5 while the tolerance is greater than 0.1. These results signify that the regression model was free from multi-collinearity which confirms cleanness of data used in this study. Therefore, the study implies the obtained regression statistics obtained were fit to be relied upon making conclusions and recommendations. The model further indicates $Adj\ r^2 = .230$ which implies that jointly working capital management and risk management explain 23% of the variance in financial performance among second car trading companies.

Results in relation to the standardized coefficients indicate $\beta = .259$, $t = -3.883$, $p < .05$ corresponding to working capital management and $\beta = .342$, $t = 5.125$, $p < .05$ in relation to risk management. The results signify that both working capital management and risk management significantly predict financial performance. While this is the case, a comparative analysis of the Beta values indicates that risk management is the better predictor of financial performance among second hand car trading companies.

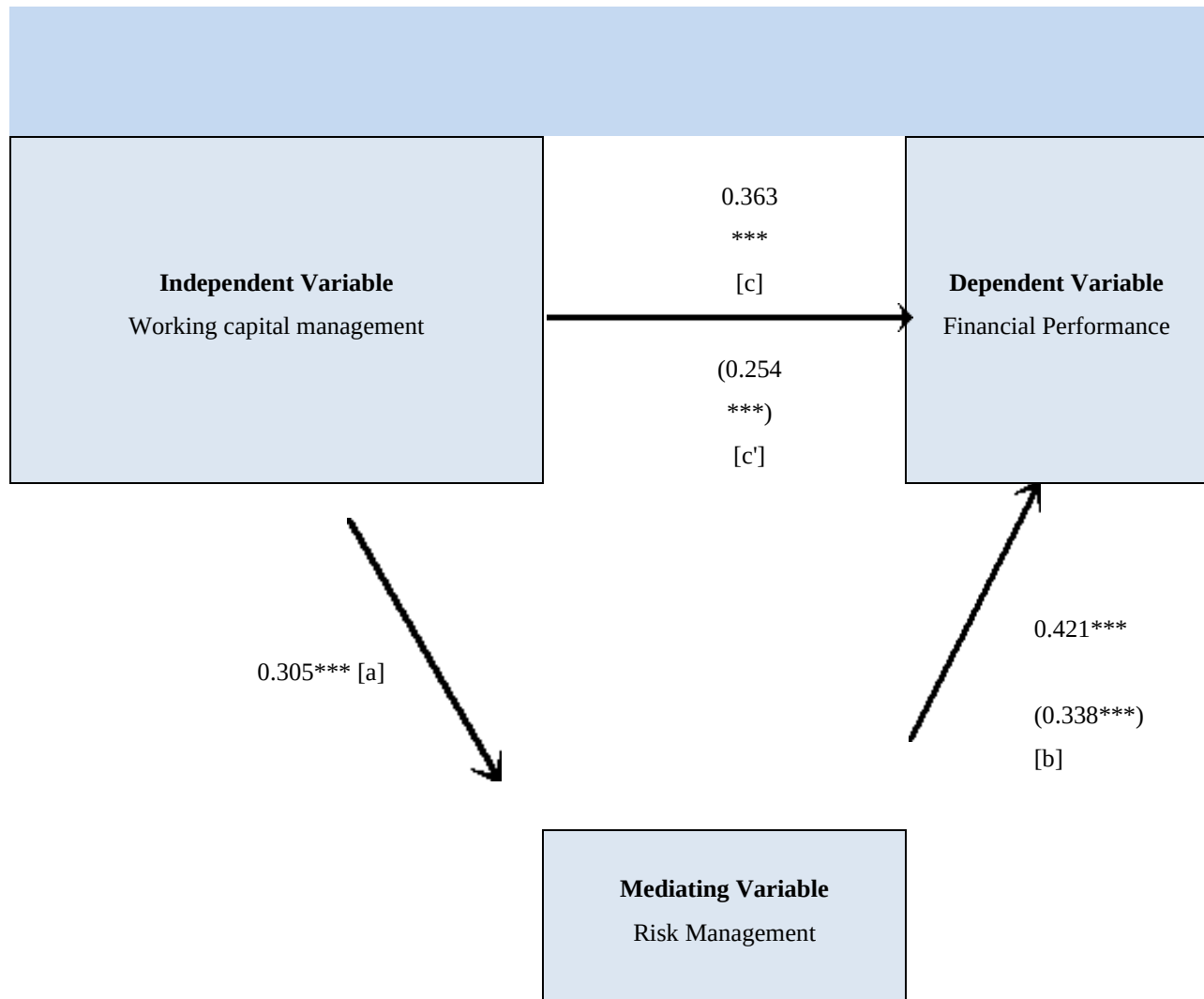
Table 3: Mediating Effect of Risk Management

Model		Unstandardized Coefficients		Standardized Coefficients		F	R	R ²	Adj. R ²	ΔR^2
		B	Std. Error	Beta						
Model 1	Control Variables	3.677	.204			.189 ^a	0.036	0.010	0.010	0.036
	Years	.141	.075	.189						
	Employees	.022	.095	.022						
	Turnover	.126	.103	.164						
	Capital	-.135	.087	-.223						
	Structure	-.038	.102	-.028						
Model 2	Independent Variable	2.475	.313							
	Years	.076	.072	.102						
	Employees	.005	.090	.005						
	Turnover	.085	.098	.110						
	Capital	-.128	.082	-.211						
	Structure	-.029	.097	-.021						
	Working capital management	.360	.074	.355**		.381 ^b	.145	.118	.168	.110
Model 3	Mediating Effect	1.504	.354							
	Years	.048	.068	.064						
	Employees	.055	.086	.056						
	Turnover	.045	.092	.058						
	Capital	-.099	.078	-.163						
	Structure	-.031	.091	-.023						
	Working capital	.258	.073	.254**						

management								
Risk	.356	.072	.338**	.496 ^c	.246	.218	.218	.101
Management								

Source: Primary Data

Type of mediation	Significant		
			0.00403
Sobel z-value	2.875247	p =	7
95% Symmetrical Confidence interval			
	Lower	0.02924	
	Higher	0.15446	
Unstandardized indirect effect			
	a*b	0.09185	
	Se	0.03194	
Effective Size measures		R² measures	
Standardised			
Coefficients			
Total:	0.363		
Direct:	0.254		
Indirect:	0.103		
Indirect to Total ratio	0.283		



Note: Type of Mediation: Partial; Durbin-Watson=2.040, n=192.

Figure 1: Mediation Effect of Risk Management in the relationship between working capital management and financial performance

According to Baron and Kenny (1986), four conditions must be fulfilled to conclusively state a significant mediation. First, the effect or relationship to be mediated should be existent, and this is reflected in Model 2 ($r^2 = .118$, $F = 381$, $p < 0.01$). Secondly, there should be a relationship between when the mediator is included into the model as reflected in Model 3 ($r^2 = .218$, $F = .496$, $p < 0.01$). Thirdly, the beta coefficient of the mediator should remain significant when the both the independent and the mediator are included in the same model, as reflected by $\beta = .338$, $p < 0.01$ considering both working capital management and risk management as independent variables. Lastly, the beta-coefficient of the independent variable should reduce with the inclusion of the mediating variable (Beta = .355 to .254).

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From Figure 1, a Sobel z-value of 2.875247 with p-value of 0.004037 and the beta weight for the basic relationship between risk management and financial performance ($r=0.254$, $p<0.05$) were registered. In addition, it is evident that the Sobel z-value is large with a p-value less than 0.05 confirming the mediation effect of risk management. It is further indicated that the total ratio index or proportional index of working capital management is 0.300 suggesting that 30% of the effect of working capital management towards financial performance is direct while 70% is indirect, revealing a partial type of mediation.

Discussion of Findings

The findings obtained that risk management is necessary in enhancing financial performance among companies. The findings reveal how important it is to ensure effective risk management if they are to determine future financial performance. This is consistent with Adeusi et al., (2014) who emphasized that risk management allows companies to set a proactive solution for its problems to increase the likelihood of becoming profitable in the long term. Equally, Njogo (2012) acknowledges that good risks management practices maximize firms' value. The current study reemphasize that risk is indispensable from business irrespective of its nature or size. Moreover, risk management concept comprises sub-dimensions of risk assessment, risk mitigation and risk monitoring and control. On that note, this study suggests that companies should find how best they can manage risk by enhancing such practices and direct their businesses towards a possible profit, liquidity and solvency improvement. Indeed, companies engaged in risk management are able to easily identify, control and minimize uncertainty which is a major impediment for success (Tufano, 2011).

Notable, with risk assessment the findings reveal that financial performance would be enhanced. This argument is based on the fact that both risk assessment and financial performance were found to be positively related. Therefore, the study postulates that companies should endeavor to classify all the different forms of risks, rank risks according to their potential and seek further analysis of risk to minimize risk occurrence in future. As a result, the impediments within the organizational setup are likely to be addressed and therefore enable companies to generate profit and become more liquid. These findings collaborate with Nair et al., (2014) who highlighted that it is necessary for companies to assess risk and seek solution to such risks for potential success. In addition, findings also suggest that the ability of a company to evaluate risk based on both quantitative and qualitative analysis enables them to understand the different risk encounters to enable managers make informed financial decisions. This is in support of earlier findings by Kinyua, Gakure, Gekara and Orwa (2015) who affirm that effective risk assessment guides companies to minimize risk by coming with specific decisions necessary for enhancing financial performance. In summary, the ascertained results suggest that "you cannot manage what you can measure". Rather, being able to assess risk, creates a platform for boosting financial performance, and should be taken with ultimate care.

Likewise, the findings obtained that risk mitigation is positively associated with financial performance. This suggests that business tend to record improvements in financial performance by improving risk mitigation. However, studies specific to risk mitigation and financial performance are minimal. Instead, most studies such as

Gates et al., (2012) are conclusive to risk management in general where they strongly believe that risk management provides a base for the right future work of the organization concerning the developing and the implementation of new programs for the risk control to ensure that the company becomes financially significant. In addition, Mwangi (2012) eludes that the fundamental ability of risk management is that it reduces the instability of earnings or cash flow which stimulates financial performance. Based on the the aforementioned literature, it is conclusive that this specific study adds value to the existing literature regarding the two variables.

Indeed, the study highlights that through risk mitigation, companies are able to take action by implementing what they consider appropriate strategies for reducing business exposure. Furthermore, the findings communicate that when companies adopt risk mitigation practices, namely; either accept risk, transfer risk, ignore risk or avoid risk, and each of these actions would have a considerable effect on the overall financial performance. However, it is noted by Ramachandran and Janakiraman (2009) that given the variability of risks, its relatively impossible to mitigate risks, yet companies still go ahead to report better performance than others. Furthermore, Beigi (2015) obtained found no relationship between risk management, specifically risk mitigation and financial performance.

Further still, the findings obtained that risk monitoring and control practices are necessary in enhancing financial performance. These findings reveal suggest that businesses are generally risky, and face different forms of risks which must be consistently be assessed and mitigated to safeguard operations. In this vein, the findings propose regular risk reviews of risks and consistent crosschecking of of the available risk policies and practices in order to enhance overall risk monitoring and control. Once risks are controlled, companies can be expectant of improved financial performance in terms of improved return on the investment, profit margin ratio and adequate liquidity. This is in line with Boermans and Willebrands (2012) who emphasized that risk monitoring and control enables companies to continuously devise better risk strategies and policies necessary for boosting financial performance. More so, Zou and Li, (2014) consistently suggests that risk monitoring should be a continuous process due to the dynamic risk encounters.

Conclusions

The study communicates how companies perceive risk as something they cannot do without, but rather ensure the adopted practices are able to protect the and maintain business operational. In addition, the study notifies that risk management significantly plays a mediating role between working capital management and financial performance. Accordingly, this study exhibits that as companies devote efforts towards working capital management, they should bear in mind that they operate under risks. Therefore, ultimate improvement in financial performance as a result of working capital management will require exhibiting effective risk management.

Recommendations

Risk assessment should be enhanced to ensure that the various risks are examined and scrutinized according to their potential. This will enable car dealers to identify the various risks that require close attention if businesses are to prosper.

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