IMPACT OF THE VOLATILITY OF EXCHANGE RATES ON FOREIGN DIRECT INVESTMENTS IN KENYA, CASE OF PROCTER AND GAMBLE KENYA

BY

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UNITED STATES INTERNATIONAL UNIVERSITY- AFRICA

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SUMMER 2015
STUDENT’S DECLARATION

I’m the undersigned, I declare that this is my original work and has not been submitted to any other college, institution or university other than the United States International University in Nairobi for academic credit.

Signed: __________________    Date: ________________

Id No: ______________________

This project has been presented for examination with my approval as the appointed supervisor.

Signed: __________________    Date: ________________

Dr. Amos Njuguna.

Signed: __________________    Date: ________________

Dean, Chandaria School of Business
ABSTRACT

The purpose of the study was to investigate the impact of the volatility of exchange rates on foreign direct investments in Kenya with special focus on Procter and Gamble Kenya. The research questions developed for this study were: What has been the nature and trend of foreign exchange risk risks in Kenya? Have the foreign exchange rates impacted on Procter and Gamble and lastly, what are the best techniques to manage foreign exchange risks? The research methodology used was the use of questioners to the company accountants and through the use of the firms consolidated financial statements for the past 5 years.

The study adopted descriptive research design. The population of this study was the finance staffs of Procter and Gamble Kenya who 50 in number. This study used a sampling frame of all the Finance staff in Procter and Gamble who is 50 in number. In this study simple random sampling was used. Both primary and secondary data were collected. Primary data were collected using a structured questionnaire. An informal pilot study was conducted with a group of 10-15 respondents. For easy analysis of the data, the results from the questionnaire were coded according to each element of the study to ensure the margin of error is minimized to ensure accuracy during the analysis. The findings of the study were then analyzed using Statistical Package for Social Sciences (SPSS) program and presented using graphs and charts so as to ease the understanding the results and also for interpretation purposes.

The study established that financial risks highly affect Procter and Gamble. Thus, the study concludes financial risks have high negative impact performance of companies that have invested in Kenya as Foreign Direct Investments. The study revealed that Procter and Gamble is exposed to transaction risk, economic risk and translation risk. The study recommends that corrective measures should be taken to minimize financial risks since such risks have high negative impact performance of companies that have invested in Kenya as Foreign Direct Investments.
The study further revealed that in Procter and Gamble, translation risk was recognized and managed at all the times. The study concludes that foreign sales and/ purchases and license fees and management fees are the major primary sources of the transaction and economic risk. The study further recommends that companies need to address issues on foreign sales and/ purchases and license fees and management fees, since they are the major primary sources of transaction and economic risk in companies that have invested in Kenya as Foreign Direct Investments. This is because transactions ultimately determine the rate at which currencies are exchanged and will in turn determine the cost of purchasing foreign goods and financial assets.

The study draws a further conclusion that mostly used technique to manage risk is multi-currency billing and price adjustment technique and that the most used instrument used to hedge foreign currency risks is forward contracts, in companies that have invested in Kenya as Foreign Direct Investments. The study recommends that measures should be put forward to ensure effectiveness of multi-currency billing and price adjustment technique since it is the mostly used technique to manage risk.
ACKNOWLEDGEMENT

The will of God will never take you where His grace can’t sustain you. I thank God for His sustenance, this far He has brought me, I am eternally grateful.

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DEDICATION

To my parents for their absolute belief in me

To my fiancé, for your constant love and support

To my unborn son, Amari. This is for you.
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<table>
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<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>CADIVI</td>
<td>Commission for the Administration of Currency Exchange</td>
</tr>
<tr>
<td>CBK</td>
<td>Central Bank of Kenya</td>
</tr>
<tr>
<td>FDI</td>
<td>Foreign Direct Investment</td>
</tr>
<tr>
<td>FKE</td>
<td>Federation of Kenyan Employers</td>
</tr>
<tr>
<td>KSH</td>
<td>Kenya Shillings</td>
</tr>
<tr>
<td>MNC</td>
<td>Multinational Corporation</td>
</tr>
<tr>
<td>OTC</td>
<td>Over the Counter</td>
</tr>
<tr>
<td>SPSS</td>
<td>Statistical Package for Social Sciences</td>
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<tr>
<td>SICAD</td>
<td>Ancillary Foreign Currency Administration System</td>
</tr>
<tr>
<td>TZS</td>
<td>Tanzania shillings</td>
</tr>
<tr>
<td>UNCTAD</td>
<td>United Nations Conference on Trade and Development</td>
</tr>
<tr>
<td>USD</td>
<td>United States Dollar</td>
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CHAPTER ONE

1.0 INTRODUCTION

1.1 Background of the Study

Foreign direct investments as an area of study have received significant attention from scholars for a long time. This is particularly attributed to the increasing benefits derived from FDI both by the multinational corporation and the recipient economies (Crowley, 2010). Kenya has had a long history of economic leadership in East Africa as one of the largest and most advanced economies in the region. Studies carried out in Kenya have also shown that the level of FDI’s to Kenya portrays a fluctuating trend, both in absolute and relative terms. (Kinuthia, 2010). It has retained regional advantages in FDI location, particularly as a result of its workforce and a central logistics location. Foreign investors in Kenya have tended to make relatively small investments but they are numerous and established across a wide variety of factors. They have contributed significantly to some of the more dynamic sectors in the economy such as, Oil, Real Estate, Transport, Manufacturing, Horticulture and Export diversification (FKE, 2009).

In the advent of globalization, importation and exportation of goods and services along the boundaries of countries is no longer enough for the sustenance of trade between two countries. Technology has greatly made it easier to transact across borders regardless of the time differences. Trade between countries is affected by the currencies of the countries involved in that transaction. One country’s currency will need to be expressed in terms of the other’s currency where the demand and supply of these currencies will determine the prices of domestic and foreign goods. The trading of currencies and bank deposits denominated in particular currencies takes place in the foreign exchange market (Mishkin, 2009).

These daily transactions determine the rates at which currencies are exchanged which in turn will determine the cost of purchasing foreign goods and financial assets. The transactions however, are not the only determinants of foreign exchange but also governed and determined by the Central Banks of the host countries. Central banks of the currencies trading attempt to determine the exchange rate by buying and selling the currencies involved.
Exchange rates are important because when the Kenyan shilling becomes more valuable relative to other currencies, goods in other currencies become cheaper for Kenyans favorably impacting on the economy. This study sought to determine the impact of the volatility of exchange rates in the performance of companies that have invested in Kenya as Foreign Direct Investments. Foreign Direct Investment remittances are the largest form of foreign exchange in Kenya. These remittances totaled $611.2 in 2008 (CBK). The country relies heavily on the FDI for capital and employment, as is evidenced by the fact that a third of Kenyan banks are foreign owned, controlling 51% of total banking assets in the country. FDI’s therefore are an integral part of the Kenyan economy.

In order for currencies to trade in a common market, one currency must be expressed in terms of the other. An exchange rate is the price of one currency in terms of another (Mishkin and Eakins, 2009). They can either be direct or indirect whereby a direct quotation refers to how much of the home currency is required to buy a unit of the foreign currency while an indirect quotation refers to how much a unit of the foreign currency can be obtained for a unit of the home currency (Howells and Bain, 2007).

Exchange rates can also be spot or forward whereby a spot transaction is a two day exchange of bank deposits while a forward exchange rate is an exchange at some future specified date (Mishkin and Eakins, 2009). Exchange rates can further be classified according to government control. Madura and Fox(2011) classified exchange rates as either fixed whereby the exchange rates are held constant or only allowed to fluctuate within very narrow boundaries or managed which is the exchange rate system that is in use today whereby exchange rates are allowed to fluctuate on a daily basis without any official boundaries. An exchange rate system may also be pegged to a foreign currency or a basket of foreign currencies and lastly a freely floating exchange rate system which is determined by the market forces without any intervention by the government. In Kenya, Obondi (2013) in her study of the relationship between foreign exchange rates and the central bank rate determined that a central bank sells foreign reserves when the exchange rate is going up thereby
dampening its rise and buys when it is going down in order to reduce the variability of the exchange rate.

In international transactions, country and currency risks are encountered. Country risk occurs when financial claims and business contracts become unenforceable while currency risks occur when the values of currencies fluctuate relative to each other. Foreign Exchange Markets developed in order to enable conversion of cash to different currencies to be able to transact (Kidwell et al, 2008). There is no physical location for the foreign exchange market in Kenya as there are no physical goods being exchanged at any given time, rather it is an over the counter (OTC) market, a linkage of bank currency traders. Mishkin and Eakins (2009) define a foreign exchange market as a place of trading of currencies and bank deposits. It encompasses the conversion of purchasing power from one currency into another, bank deposits of foreign currency, the extension of credit denominated in a foreign currency, foreign trade financing, trading in foreign currency options and futures contracts, and currency swaps. (Eun and Resnick, 2009).

These transactions ultimately determine the rate at which currencies are exchanged and will in turn determine the cost of purchasing foreign goods and financial assets. Trading that occurs in the foreign exchange market will determine the rate at which an investor will trade his foreign currency in order to invest in Kenya. The Central Bank of Kenya Act Cap 491 Section 28 provides that CBK may engage in foreign exchange transactions with authorized dealers, public entities, foreign central banks as well as foreign governments or their agencies as well as international financial institutions and any other person or body of persons who may be gazetted for that purpose.

In every aspect of our everyday lives, FDI is felt that is in the goods and services that we use. FDIs are not in isolation as they have provided jobs and with them, technical knowledge as they train their Kenyan employees to maintain the standards that are there in their other investments all over the world. They are the major source of foreign exchange to the country. FDI has not been consistent over the years with some periods recording low inflows. In the 80s and 90s, FDI inflow was low due to deterioration in economic performance as well as
rising problems of poor infrastructure and the high cost of living greatly impacted negatively on FDI inflows in Kenya (KPMG, 2012). In total, Kenya has more than 200 multinational companies across the sectors with Britain, US, Germany, South Africa, Netherlands, Switzerland, China and India being the main traditional sources of FDI (Kinuthia, 2010). According to the report of the Office of the President of Kenya (2008), Kenya serves as the East African business hub for many international businesses. This translates to a dependence of FDI for capital flow that in turn reflects on provision of jobs and an economy that is helped to grow by these foreign investments.

Kenya’s FDI average growth between 2007 and 2013 was forty percent (40%) with the inflows primarily going into retail and consumer products, telecommunications, technology, media, minerals, oil and natural gas sector mainly from the UK, US and India (Ernest & Young). This growth rate earning Kenya the status of an FDI hotspot joining Ghana, Mozambique, Zambia, Tanzania, Uganda, Nigeria and Rwanda. In 2013, FDI inflows stood at $514 million (KES 45.18 billion), up from $259 million (KES 22.7 billion) a year earlier which is a ninety eight per cent (98%) increase. This capital mainly went to oil, gas and the manufacturing industries (UNCTAD 2014).

The foreign exchange rates in Kenya over the last two decades have been characterized by volatility which creates uncertainty in the investment market meaning potential international businesses are naturally exposed to exchange risks if they are to invest in Kenya (Otieno, 2012). Foreign exchange rates determine how much of each currency is available as determined by forces of demand and supply. This in turn will affect the domestic goods being sold as the transactions are not done in isolation. Once the costs of production rise in a country, FDI is not easily attracted, this makes the country lose out on foreign exchange.

Anything that affects the demand for a country’s exports or imports has the potential to cause shifts in the supply and demand curves for foreign currency and hence alter the price of its currency in the foreign exchange market (Kidwell et al, 2008). When the exchange rate between the Kenyan shilling and other foreign currencies changes in favor of the foreign
currency, goods in Kenya become more expensive. The value of the shilling depreciates meaning; less can be bought for the same amount than was previously bought.

1.2 Statement of the Problem

Grambovas and McLeay (2006), in their research confirmed that there exists a relationship between value of the firm and foreign exchange rates movements. Changes in exchange rate could create a shift in stock prices for multinational firms, exporters and importers companies, companies that import part of their inputs and also those that import for other companies. Exchange rate movements affect prices of both imported finished goods and the costs of imported inputs, hence impacting by implication those organizations that compete with such firms.

The domestic currency Kenya Shilling has been struggling due to a strong US dollar, which is performing well against a wide basket of emerging market currencies over the years but it has been worst hit in the years 2014 and 2015. Business Monitor International predicts that the dollar will continue to strengthen due to a combination of tighter monetary policy and faster economic growth. The two main factors in the shilling’s depreciation are export weakness, low tourism and dollar strength and are set to continue in to 2015, keeping pressure on the currency (Global Strategy - FX’, October 27, 2014).

Procter and Gamble (East Africa) Ltd. operates in three East African countries namely: Kenya, Uganda and Tanzania. Over the years exchange rate fluctuations have led to an unfavourable exchange rate regime that has caused profits to subside. As the company expands and consolidates its business operations, it needs to adapt a strategic measure that will enable it to cope with the volatility of the exchange rates. With regards to Procter and Gamble Kenya; the problem of exchange rates in this company arises from three specific areas. Firstly the company’s invoices and receives payments from its regional markets in the regional currencies namely, Kenyan shilling (KSH), Ugandan shilling (UGX) and Tanzanian Shilling (TZS). Secondly the company buys its inputs in hard currencies. Thirdly as a
subsidiary, the company must project its forecasts and report its operating revenue results in the parent company’s currency which is the US Dollar.

Empirical studies include Ngari (2011), carried out a study on the effect of foreign exchange exposure on a firm’s financial performance for listed companies in Kenya and he found that the net income of the companies is affected by all the transactions that are denominated in foreign currency. Chiira (2009), found out that all the oil companies, find foreign exchange risk to be significant to them and most of them rank it as second to fluctuation in global crude oil prices. Avutswa (2010) found out that the horticultural firms use various techniques to manage the risk which they face. To the research knowledge there is limited empirical evidence on the impact of the exchange rates in the performance of companies that have invested in Kenya as Foreign Direct Investments. This study sought to fill the existing research gap by conducting study to determine the impact of the exchange rates in the performance of companies that have invested in Kenya as Foreign Direct Investments with special focus on Procter and Gamble (East Africa) Ltd.

1.3 Purpose of the Study

The purpose of this study is to determine the impact of the exchange rates in the performance of companies that have invested in Kenya as Foreign Direct Investments.

1.4 Research Questions

1.4.1 What are the types of foreign exchange risks experienced by Procter and Gamble?

1.4.2 How have the foreign exchange rates impacted on Procter and Gamble.

1.4.3 What are the best techniques to manage foreign exchange risks for Procter and Gamble?
1.5 Significance of the Study

1.5.1 Multinational Corporations
This study helps multinational corporations in Kenya understand how fluctuations in exchange rates affect their subsidiaries and how to manage these exchange rate fluctuations.

1.5.2 Potential Investors
Provides potential investors within the MNC industry with knowledge on foreign exchange fluctuations in Kenya and how to manage the fluctuations

1.6 Scope of the Study
The study is limited to Procter and Gamble Kenya. The focus is to determine how the exchange rate volatility affects operation profits of the firm.

1.7 Definition of Terms

1.7.1 Exchange Rate
An exchange rate is defined as the price of one currency in terms of another (Mishkin and Eakins, 2009).

1.7.2 Foreign Direct Investment
A Foreign direct investment is defined as an investment in a business by an investor from another country for which the foreign investor has control over the company purchased (Kidwell et al.2008).

1.8 Chapter Summary
The section presents the background information on how foreign exchange rate fluctuations impact on foreign direct investments. It further goes on to describe what exchange rates and foreign direct investments are. The second section describes the problem in the context of the organization in question. The third and fourth section goes on to describe major objectives of the research and the importance of the research study.
CHAPTER TWO
2.0 LITERATURE REVIEW

2.1 Introduction

The main objective of this study was to identify and assess the extent of how much foreign exchange volatility affects multinational corporations in Kenya. This chapter discusses the various types of foreign exchange risks and examines the current foreign exchange management practices by organizations affected by the exchange rate movements using both research based recommendations as well as those based on actual corporate measures.

2.2 Types of Risks faced by Foreign Direct Investments

Firms in increasingly integrated global economies face exchange rate risk in the course of the exchange of goods and services. Risk can be defined as the chance of loss or an unfavorable outcome associated with an action. Uncertainty does not know what will happen in the future. The greater the uncertainty, the greater the risk (Hicks, 1982).

A company faces risk if there is a currency mismatch in some aspect of the business such that a shift in foreign exchange rates, nominal or real affects the performance either adversely or beneficially (Shoup, 1998). There are three types of foreign exchange risk incurred by Multinational Corporations; these are translation, transaction and economic risk.

2.2.1 Transaction Risk

Transaction risk is the potential for a gain or loss in contracted for near term cash flows caused by a foreign exchange rate-induced change in the value of amounts due to the multinational companies or amounts that the multinational companies owes to other parties. As such, it is a change in the home currency value of cash flows that are already contracted for (Glaum, 1990). Transaction risk measures changes in the value of outstanding financial
obligations incurred prior to a change in exchange rates but not due to be settled until after the exchange rates change.

Thus, this type of risk deals with variations in cash flows the result from existing lawful obligations. It is the simplest source of foreign exchange risk and the most relevant to most companies. Transaction risk has the greatest impact on profitability at least in the short and arguably in the medium term, and it is the primary object of foreign exchange risk management for any company involved in foreign trade (Lessard, 2006).

For example it may take place in a given situation where a company borrows, trades, provide lending in a foreign currency or sells fixed assets of its sub-divisions in a foreign country. This then involves a time lag between the undertaking of the transaction and the receipt of the payment. During this period of time it is certain that exchange rates will vary and therefore expose the company to risk. This risk can either be positive or negative (Adler and Dumas, 2006).

Operating risk is the type of risk which is arises due to the multi period of cash flows arising due to an expected change in exchange rates. The present value of the future cash flows is affected as a result of an unexpected change in the exchange rate. Therefore the purchasing power or strength of a currency of home or foreign currency in a given country on a certain date in the future will be different from its foreseen value (Adler and Dumas, 2006).

Appreciation of a firm’s local currency causes a reduction in both cash inflows and outflows. The impact on a firm’s net cash flows will depend on whether the inflow transactions are affected more or less than the outflow transactions. For example the firm is in the exporting business, but obtains its supplies and borrows funds locally, its inflow transactions will be reduced by a greater degree than its outflow transactions. In this case, net cash flows will be reduced. Conversely, cash inflows of a firm concentrating its sales locally with little foreign competition will not be severely reduced by appreciation of a local currency (Madura, 2006).
2.2.2 Economic Risk

Glaum, defines economic risk as the future operating cash flows of the company that are exposed to potential currency exchange rate changes. Pramborg however, defines economic risk to be combination of transaction risk and competitive risk. For him competitive risk consists of unidentifiable anticipated transactions. Yet other authors coin the term economic risk with operational risk. The two terms operational and competitive shed light on the dual nature of economic risk in contemporary literature. On the one hand it has to do with future (operational) cash flows originating from e.g. the company’s foreign subsidiaries, foreign direct investments or day-to-day international trade which as Pramborg puts it, are as of yet unidentifiable anticipated transactions. But on the other hand in a more sophisticated manner economic risk has to do with the international competitive environment of each company.

Currency mismatches that create operating risk are less visible and sometimes harder to identify. Two mismatches, individually or together, constitute operating risk. The first mismatch between the currency of sale (in which revenues are denominated) and the currency of production (in which cost of goods, selling, or administrative expenses are denominated) affects the profit margin. The second mismatch between an enterprise’s currency of production and the currency of production of a second enterprise competing in the same market, affects the firms sales performance and market share (Shoup, 1998).

To illustrate the significance of foreign exchange rate changes on the competitive environment consider a company with a foreign subsidiary. In the case that the exchange rate of the local currency of the subsidiary changes it will affect the costs of its production factors and thus the margins on its outputs. Should the subsidiary have a foreign competitor whose production factors and thus margins were not affected by the parity shift then the competitive position between the two competitors has changed. The effects, however, continue as the net profits of the subsidiary are transferred to its parent company. To put it simply parity changes in currency pairs can affect the competitive position of subsidiaries, their net profits and net profits converted to home currencies of parent companies (Glaum, 1990).
Operating risk is determined by the structure of the markets in which the company and its competitors source inputs and products. The measurement of operating risk must accordingly take into account the nature of the company and its competition. Industries producing products for which demand is fairly inelastic are less susceptible to operating risk. Companies that sell price driven commodities such as automobiles are susceptible to extensive operating risk (Shoup, 1998). However different factors can affect the firm’s future cash flows and also affect the operating risk: such factors can include the investment policy of the firm, or external factors such as political instability in a country that would affect the levels of sales (Lessard, 2006).

### 2.2.3 Translation Risk

Translation risk is a financial accounting technicality and arises when financial accounting statements of foreign affiliates are translated into the home currency of the parent company for consolidation purposes. The translation of the subsidiary’s balance sheet and income statements from the currency of the operating units off shore to that of the parent potentially changes stock holders equity. The change in exchange rate for the currency of the subsidiary from the last translation produces accounting gains or losses that are posted to the stock holders’ equity and produce accounting risk. This risk however does not reflect realized profits or losses and it is subject to the translation methods used i.e. domestic accounting standards. The general view of authors on foreign exchange risk management is that translation risk should not be hedged because it does not add value to the company (Fatemi, 2000).

However, survey results have indicated that it is often being hedged. Hakkarainen et al. explain translation risk hedging by the existence of management compensation schemes which are often tied to financial statements and are thus affected by translation gains and losses. Thus the major question arises, what given exchange rate of the company’s accounts should be translated? Should it be the exchange rate at the statement of financial position date, the rate of exchange at the time when the firm’s assets was acquired, or at the rate of exchange half-way through the year of trading (Lessard, 2006).
2.3 Impact of Exchange Rate Volatility on Foreign Direct Investments

2.3.1 Exchange Rate and Foreign Direct Investments

Exchange rate movements have a predefined implication on FDI. Depreciation or the decline in the relative value of a domestic currency relative to another foreign currency will have an advantage of lowering labor and production cost in the destination market thereby creating a location advantage for foreign investors as Vernon (2006) calls it. This attracts investors to take the advantage of relatively cheap production cost and the minimal production cost leads to an increase in the return to foreign investors.

However this assertion is based on the assumption that this exchange rate depreciation is not anticipated beforehand. If the exchange rate movement is anticipated a priori, it may diminish the importance of the relative wage advantage as the anticipated exchange rate depreciation may be reflected in the higher investment financing cost due to the equalization of risk adjusted expected rate of return across countries as per the interest parity condition. On the other hand, this exchange rate movement should also not be coupled with a change in relative production cost for a depreciation of a domestic currency to have the stipulated effect (Ruiz, 2005).

However, the interest parity argument is often refuted empirically and there seems to be a consensus towards the positive implications of exchange rate depreciation. In addition, the depreciation of a currency raises the relative wealth of an investing multinational firm in a domestic market by lowering the investment cost of capital which is launched in domestic currency and increasing wealth which is held in terms of the appreciated foreign currency (Pagan and Ullah, 2008). Although the empirical findings leading to the positive impact of exchange rate depreciation on FDI appear to have settled, there emerges a wide ranging dispute over the possible impact of Exchange rate volatility on FDI. To show this we will rely on different theoretical models developed through time (Ruiz, 2005).
2.3.2 Exchange Rate Volatility and Foreign Direct Investment

Issues related to investment under uncertainty are not new lines of economics. Mwega and Rose (2005) noted that uncertainty reduces investment in the presence of adjustment costs. Lucas’ assertion of Mwega and Rose (2005) is not the only theoretical framework explaining the negative relationship between exchange rate volatility and foreign direct investment. Investment will also have this same negative impact due to the irreversible nature of investment (Ruiz, 2005). The recent development of models is based on the Dixit and Pindyck options to wait (Pagan and Ullah, 2008) approach and we will revise theoretical models related to it in order to show the pertinent relationship between the variables of interest to be considered in this research.

Foreign direct investment (FDI) is an increasingly important channel for resource flows between the industrial and developing sub-Saharan African (SSA) countries, on the one hand, and among the developing SSA countries themselves, on the other. Several real and potential benefits discernible from these flows include technological spillovers, job creation, improved managerial skills and productivity (Blomström and Kokko, 2007). Given the capital-deficient nature of SSA countries and the benefits accruable from these activities, FDI is essential for growth and development in the region. In fact, it has been argued that low and volatile FDI is part of the challenges to the persistent poverty, high inequality and underdevelopment of the region (Shoup, 1998).

There is an expansive literature indicating that real exchange rate volatility has a direct, deleterious effect on FDI inflows (Kiyota et.al 2005). Exchange rate volatility generates air of uncertainty as the variance of expected profits rises and its net present value falls. This could cause investors to hesitate about committing significant resources to FDI, thus serving as a serious disincentive for FDI in SSA and compounding the existing political and economic risks.
Despite the fact that literature on FDI is well established and the issue of exchange rate volatility and FDI is extensive, such literature on SSA countries are very sparse. This study evaluates the relationship between exchange rate volatility and FDI in Nigeria and South Africa. These countries are singled out for analysis in the SSA due to the observed similarity on the relationship between exchange rate volatility and FDI (Kiyota et.al 2005). In an analysis done elsewhere, it is found that it is only in these two countries that endogeneity is established between exchange rate volatility and FDI among several countries analysed (Ruiz, 2005).

Studies on the relationship between exchange rate and exchange rate volatility, on the one hand, and FDI, on the other, for SSA countries are very scanty. Chiira (2009) in a study of the South African investment in the Southern and Eastern African region, identified exchange rate as one of the major barriers to FDI in Zimbabwe, Botswana and Mozambique. Similarly, in a survey of the southern African countries, Jenkins and Thomas (2002) found that about 25 per cent of the total firms surveyed identified exchange rate risk as an important determinant of FDI in the sub-region. However, these studies did not analyse the relationship and the extent to which exchange rate volatility constrains FDI in these countries.

An attempt was made by Chirra (2009) to examine the impact of the level and volatility of real effective exchange rate on investment and growth for fourteen SSA countries. The study found that exchange rate volatility has a strong negative effect on investment. However, the focus of the study was on total investment, not FDI. Alaba (2003) is one of the very few studies that have attempted to bridge the gap on the exchange rate volatility-FDI nexus for SSA countries.

The study aimed at determining the magnitude and direction of the effects of exchange rate movement and its volatility on FDI flows to agriculture and manufacturing sectors in Nigeria. Employing the GARCH measure of volatility, the error correction methodology was used for the empirical investigation in testing the effects of both the official and parallel market exchange rates on FDI flows to agriculture and manufacturing. While the results show that
the official market exchange rate movement significantly reduces FDI inflows to agriculture, the same is, however, insignificant for the manufacturing FDI. For the volatility coefficients, official market exchange rate volatility was not found to be significant for FDI inflows (Ajayi, 2004).

2.3.3 Impact of Exchange Rate Volatility on Procter and Gamble.

Manufacturing and selling its products in various major global markets, Procter and Gamble is exposed to significant foreign currency exchange rate fluctuations. Procter and Gamble showed a decreased comprehensive income than their net income by roughly -11% in 2009 an equivalent of $1,047,000. Total comprehensive income is usually comprised primarily of net earnings, net currency translation gains and losses and net unrealized gains and losses on securities and cash flow hedges. Other comprehensive income includes financial statement translation and hedges and investment securities (P & G 2009 Annual Report, Consolidated Statements of Shareholder’s Equity). This loss was attributed to the weakening of the US dollar which is the main currency they use in their daily transactions.

In 2013 the company experienced a negative impact on sales of -4% due to foreign exchange transactions. This then had a negative impact on full-year EPS of -4% as a result of foreign exchange rates. Over the last 12 months, the US dollar appreciated by about 9% against a basket of currencies and about 11% versus the euro. The dollar was about 2% weaker versus the Japanese yen and about 11% stronger versus the Swiss franc. Against the Chinese Yuan, the dollar was about 2% weaker than it was a year ago, but that’s substantially stronger than the 4% difference in January 2013.

Procter and Gamble had a rough second quarter in the year 2015. P&G reported $20.2 billion in second quarter fiscal 2015 revenue, a 4% slide compared to the prior-year period. Net income plummeted 31% to $2.37 billion, resulting in earnings of 82 cents per share, also down 31% compared to the per-share profit reported this time last year. The down fall was mostly brought about by the fact that recent policy announcements by the Venezuelan government in 2014 that impact foreign exchange rates applied to various transactions as well as significant exchange rate movements in Argentina and other developing countries.
These policy announcements have had a lagged effect on the 2015 performance of the company.

According to Procter and Gamble’s consolidated 2013 annual report, Procter and Gamble acknowledges that it is exposed to market risks that it classifies as, interest rates, currency exchange rates and commodity prices. The report further states that, “to manage the volatility relating to this exposure, the company nets the exposures on a consolidated basis to take advantage of natural offsets. For the residual portion, the company enters into various derivative transactions pursuant to the company’s hedging policies. The financial impacts of these hedging instruments are offset in part or in whole by corresponding changes in the underlying exposures being hedged (Procter and Gamble, 2014).

The company further outlines the primary purpose of its foreign exchange hedging activities as “to manage the volatility associated with foreign currency purchases of materials and other assets and liabilities created in the normal course of business.: it has thus documented a corporate policy prescribing the range of allowable hedging activity. “ The company primarily utilizes forward exchange contracts and purchased options with maturities of less than 18 months.” In addition, according to the report, “the company enters into certain foreign currency swaps with maturities of up to five years to hedge intercompany financing transactions. The company also utilizes purchased foreign currency option with maturities of generally less than eighteen months and forward exchange contracts to hedge against the effect of exchange rate fluctuations on royalties and income from international operations (Procter and Gamble, 2014).

2.4 Strategic techniques to Manage Foreign Risk

Risk management is the process of identifying and managing any type of risk that may affect a company’s operating balance sheet. Since daily business activities are quantified to be uncertain, they possess some element of financial or non-financial risk. Such risks may include strategic failures, operational failures, financial failures, market disruptions, environmental disasters, and regulatory violations. Risk is the probability of an adverse
outcome that is best measured by statistical values such as variances and standard deviations. Most everyday investments are exposed to risk (Hicks, 1982).

In risk management companies try to identify the type of risk they face. After the identification of the risk they propose measures to insure or hedge some of the risks while monitoring their impact of the risks on the future earnings of the company (Baum, 1991).

Since it is virtually impossible for companies remove all risk from the organization, it is important that they properly understand and manage the risks that they are willing to accept in the context of the overall corporate strategy. The management of the company is primarily responsible for risk management, but the board of directors, internal auditor, external auditor, and general counsel also play critical roles (Edens, 2010). Risk can be managed in a number of ways: by the buying of insurance, by using derivative instruments as hedges, by sharing risks with others, or by avoiding risky positions altogether.

### 2.4.1 Risk Management Concepts

Risk management concepts subsequently received additional recognition and increased management interest through the American Management Association and with articles published in the Havard Business Review. Multinational US Corporation played a pivotal role in the development of the traditional insurance based risk management practices by applying the concept to their subsidiaries and joint ventures located throughout the world (Eiteman et al, 1997).

The breakthrough in terms of risk measurement was made by the Markowitz (1952) when he suggested that risk can be measured by standard deviation and assuming asset return are normally distributed. This then opened up a whole series of techniques of risk measurement using standard statistical and mathematical methods. In the development of the portfolio theory, Markowitz argued that individuals could reduce the standard deviation of the returns of their assets by holding a portfolio whose security’s returns do not move towards the same direction (Lessard, 2006).
2.4.2 Hedging

Hedging is a strategy of using derivatives to offset or reduce the risk resulting from risk to an underlying asset. In seeking to manage economic currency risk, firms can adopt either operational or financial hedging approaches or a combination of both (Shapiro, 2007). However for financial hedging it requires a strategic reorientation of operating policies regarding pricing, sourcing, locating of production and financing.

A manufacturing firm with production and sales operations in foreign countries is exposed to demand and exchange rate risks. The firm can use financial tools (e.g. forwards) to manage its risk to exchange rate risks, but these tools are not effective in altering the demand risk. However, postponing the production decision until after more accurate information about demand is an acquired buffer against demand uncertainty by better matching supply and demand. This operational decision (postponement), used as a risk hedging device, is an operational hedge of the multinational firm (Glaum, 1990)

2.4.3 Derivative Instruments

A derivative instrument is one for which the ultimate pay off to the investor depends directly on the value of another security or commodity. Examples of such instruments include forward contracts, futures contracts, swaps and options. Each of these techniques are applied differently depending on each company’s situation (Black, 1989). Options and futures allow an investors to hedge (or increase) the risk of a collection of stocks. They also allow for the duplication of cash flow patterns that already exist in other forms, creating the possibility of arbitrage if the two identical series of cash flows do not carry the same current price.

There are two simple building blocks of derivatives. They include

- **Forwards**: forwards and swaps, as well as exchange-traded futures.

- **Options**: Privately negotiated OTC (Over the Counter) options and exchange traded options.
Other forms of derivatives are created by using these building blocks in different ways and by applying them to a wide assortment of underlying assets, rates or indices.

2.4.3.1 Forward based derivatives

Forward based derivatives are divided into three sections. They include forward contracts, swaps and future contracts. The first derivative is known as the Forward Contract. It is the simplest financial derivative. It gives the holder both the right and full obligation to conduct a transaction involving a security or commodity – the underlying asset – at a predetermined future date and at a predetermined price (Black, 1989).

Any change in value of a forward contact is generally equal to the change in value of the underlying asset. Forward contracts differ from options in that options carry a different payoff system. These contracts are particularly different to every trade. They are tailor made to an end user and this makes them very difficult to resell. Forwards are therefore not uniform. The particulars in relation to credit period, location, delivery date, delivery grade and contract size are always worked out (Black, 1989).

In a forward contract, the owner of the contract draws its value at maturation from its delivery terms of cash settlement. On maturation, if the price of the underlying is more than the contract price the buyer then makes a gain. It the price of the underlying is lower, he/she then buyers suffers a loss. Usually, the potential gain to the buyer is a loss to the seller (Baum, 1995). Forward rates are very much different from spot rates. Given upon whether the forward rate is more than the spot rate, currency being used is stipulated, the forward may be expressed as a “discount” or a “premium”. These forward premiums and discounts are expressed as yearly percentage of the change between the spot and forward rates (Baum, 1995).

The second derivatives are known as Swaps. A swap is an agreement between two parties who contact to exchange payments. They are boundlessly inflexible. Firms make their profits through operations and not from speculating on anticipated price changes. To reduce the risk
of loss from price changes, management may enter into a swap agreement. Since accounting disclosure requires swaps to be discussed in annual reports, the investor needs to understand swaps and how corporations use these derivatives to manage the firms risk (Mishkin, 2009).

Swaps are classified into the following four groups. They include, Interest rate swaps, currency swaps, commodity swaps and equity swaps. Interest rate swaps are agreements between two counter parties to exchange periodic interest- rate payments over some future period, based on an agreed- upon amount of notional principal. The term notional is used because the swap is not borrowed, lent or exchanged; it just serves as the basis for calculating of the periodic cash flows between the counter parties to the swap (Goldberg, 2006). This basically means that one party agrees to make payments based on a fixed interest rate and the counter party to make payments based on a floating interest rate (Cecchetti, 2008).

Currency swaps involves an exchange of accountabilities between currencies. It may consist of three stages. Firstly, a spot exchange of the principal. This then forms part of the swap agreement as a same effect may be obtained by using the spot foreign exchange market. Secondly, continuing exchange of interest payments during the term of the swap. This acts as a series of forward exchange contracts during the period of the swap contract. The contract is usually fixed at the same exchange rate as the spot rate used at the beginning of the swap (Black, 1989).

Thirdly, re-exchange of the principal at maturation. At this stage the swap can be considered over. Commodity Swaps are swaps that one party pays a fixed price for the goods and the counterparty pays a market rate (variable rate) over the swap period. These swaps are common in the energy industry.

Lastly equity swaps deal with the exchange of dividends earned and capital gains on a portfolio, which is based on a stock index against periodic interest payments. A equity portfolio manager may swap the variable gains on his equity portfolio to the fixed returns promised by the equity swap dealer.
The third and final derivative is known as a future contract. It is a contract between two parties to exchange assets or services at a specified time in the future at a price agreed upon at the time of the contract. In most conventionally traded futures contracts, one party agrees to deliver a commodity or security at some time in the future, in return for an agreement from the other party to pay an agreed upon price on delivery. The former is the seller of the futures contract, while the latter is the buyer (Mishkin, 2009).

There are two parties to every futures contract - the seller of the contract, who agrees to deliver the asset at the specified time in the future, and the buyer of the contract, who agrees to pay a fixed price and take delivery of the asset. While a futures contract may be used by a buyer or seller to hedge other positions in the same asset, price changes in the asset after the futures contract agreement is made provide gains to one party at the expense of the other. If the price of the underlying asset increases after the agreement is made, the buyer gains at the expense of the seller. If the price of the asset drops, the seller gains at the expense of the buyer (Howells, 2007).

2.4.3.2 Options

An option contract gives its holder the right – but not the obligation- to conduct a transaction involving an underlying security or commodity at a predetermined future date and at a predetermined price. Unlike the forward contract the option gives the long position the right to decide whether the trade will eventually take place. On the other hand, the seller of the option must perform on his side of the agreement if the buyer chooses to exercise the option. Thus, the obligation in the option market is inherently one- sided; buyers can do as they please but sellers are obligated to the buyers under the terms of the agreement. (Kidwell, 2008).

Like forwards and futures, options trade both in over the counter markets and on exchanges. When exchange-traded, just the seller of the contract is required to post a margin account because he is the only one obligated to perform on the contract at a later date. Also options
can be used on a wide variety of underlying securities, including future contracts or other options (Black, 1989).

Call Option. It is a contract that gives the holder the right (or call away), but not the obligation to buy a stated number of units of a given commodity or a foreign currency at a specified price any time prior to a specified expiration date (Black, 1989).

Put option. It is a contract that gives the buyer the right to sell (or put away) but not the obligation to sell a stated number of units of a given commodity or a foreign currency at a specified price any time prior to a specified expiration date (Black, 1989).

2.5 Chapter Summary

This section represents the nature and trend of foreign exchange rates over the last five years. How the exchange rates have affected Multi-National Corporations and what type of risks they incur. This chapter further goes ahead to explain how Procter and Gamble has been impacted by the volatility of the exchange rates and what strategic measures they can undertake to reduce these exchange rate risks.
CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents the research methodology used to find appropriate answers to the research questions raised in chapter one. The particular research design used has been discussed in detail. The population under the study has been presented with the sample design, frame, technique and size to be used. Data collection methods and analysis employed has also been presented in this chapter.

3.2 Research Design

According to Mugenda and Mugenda (1999), research design in the outline plan or scheme that is used to generate solutions to the research problems. De Vos (2002) describes two broad approaches that can be followed when conducting research, namely, qualitative and quantitative research methods. Neuman (2005) indicates that a qualitative research method focuses on constructing social reality and events, uses few subjects and thematic analysis. Nevertheless, quantitative research method focuses on subjective facts, uses many subjects and statistical analysis. The research design is therefore descriptive in nature. The advantage of selecting a descriptive study upon other research design is because the researcher needed to collect information from a fairly small sample population thereby many respondents can be questioned fairly quickly.

3.3 Population and Sampling Design

3.3.1 Population

According to Cooper and Schindler (2003), a population is a total collection of number of elements where one wishes to make some inferences. Mugenda and Mugenda (1999), describe the target population as the focus the researcher wants to generalize the result of the
study. The population of this study will be the finance staffs of Procter and Gamble Kenya who 50 in number.

3.3.2 Sampling Design

The McGraw-Hill Dictionary of Scientific & Technical Terms, (2003), describes a sample design as a procedure or plan drawn up before any data are collected to obtain a sample from a given population. It is also known as sampling plan or a survey design.

3.3.2.1 Sampling Frame

According to Cooper and Schindler (2003), a sampling frame is a list of elements in the population from which the sample is actually drawn. This study used a sampling frame of all the Finance staff in Procter and Gamble who are 50 in number.

3.2.2.2 Sampling Technique

Probability sampling is used where each population element is given a known none zero chance of being used. Probability sampling can be defined as a sampling technique where in the samples are gathered in a process that gives all the individuals in the population equal chances of being selected (Castillo, 2009).

Simple random is an prototype of probability sampling. This is when a list containing all of the population is created and used to obtain participants by random selection. This random selection guarantees that each individual has an independent and equal chance of being selected.

In this study, the simple random sample of 50 respondents from the tour operations was used. The chosen sampling method ensured that the respondents give precise information to respond to the specific research objectives thereby enhancing the credibility and reliability of the findings of this study (Cooper and Schindler, 2003).
3.3.3 Sampling Size

A sample size of 30% (and above) of any population is conventionally representative sample that enables generalization to the larger population (Mugenda & Mugenda, 1999). For this study a standard level of 90% and a standard error of 5% are given.

3.4 Data Collection Method

Both primary and secondary data were collected. Whereas secondary data was collected from secondary sources such as company financial statements and the Central bank statements. Primary data were collected using a structured questionnaire. The questionnaire consisted of closed and open ended questions that were answered by the target sample population.

3.5 Research Procedure

An informal pilot study was conducted with a group of 10-15 respondents. Conducting a pilot study allowed the researcher to obtain actual feedback from the participants and to check the accuracy of the research instrument (questionnaire). This has helped in adjusting the instrument to capture the relevant information needed for the purpose of this study.

3.6 Data Analysis

This section sums up the methods used to scrutinize the data. The study used descriptive statistics in scrutinizing and presenting results. For easy analysis of the data, the results from the questionnaire were coded according to each element of the study to ensure the margin of error is minimized to ensure accuracy during the analysis.

The findings of the study were then analyzed using Statistical Package for Social Sciences (SPSS) program and presented using graphs and charts so as to ease the understanding the results and also for interpretation purposes.
3.7 Chapter Summary

This chapter gave an perception on how the study was conducted. It has elaborated on the research design used in the methodology and the population and sampling design showing sample size and distribution. This is then succeeded by the data collection research procedure and data analysis. The next chapter provides the research findings and interpretations.
CHAPTER FOUR

4.0 RESULTS AND DISCUSSION

4.1 Introduction

This chapter discusses the explanation and presentation of the findings obtained from the field. The chapter presents the background information of the respondents, findings of the analysis based on the objectives of the study. Descriptive and inferential statistics have been used to discuss the findings of the study. The study targeted a sample size 50 of respondents from which 44 filled in and returned the questionnaires making a response rate of 88 percent. This response rate was satisfactory to make conclusions for the study. The response rate was representative. According to Mugenda and Mugenda (1999), a response rate of 50 percent is satisfactory for analysis and reporting; a rate of 60 percent is good and a response rate of 70 percent and over is excellent. Based on the affirmation, the response rate was considered to excellent.

4.2 Background Information

4.2.1 Age of the respondent

<table>
<thead>
<tr>
<th>Age Category</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>50 years and above</td>
<td>9.1%</td>
</tr>
<tr>
<td>40-49 years</td>
<td>18.2%</td>
</tr>
<tr>
<td>30-39 years</td>
<td>65.9%</td>
</tr>
<tr>
<td>21-29 years</td>
<td>6.8%</td>
</tr>
</tbody>
</table>

**Figure 4.1: Age of the respondent**

The study requested the respondent to indicate their age. From the findings, the study found that majority of the respondents, as shown by 65.9 percent indicated that they were aged between 30 to 39 years, 18.2 percent of the respondent indicated that they were aged between 40 to 49 years, 9.1 percent of the respondent indicated that they were aged 50 years and above and 6.8 percent of the respondents indicated that they were aged between 21 to 29 years. This implies that respondents of different age categories were engaged in this study.
4.2.2 Length of service in organization

Figure 4.2: Length of service in organization

The study requested the respondent to indicate the number of years they had served in the organization. From the research findings, majority of the respondents as shown by 50 percent indicated to have served in the organization for a period of 11 to 15 years, 20.5 percent of the respondents indicated to have served for a period of 16 to 20 years, 13.6 percent indicated to have served in the organization for 21 years and above, 11.4 percent of the respondents indicated to have served for a period of 6 to 10 years, whereas 4.5 percent of the respondents indicated to have served the organization for a period of 0 to 5 years. This implies that most of the respondents worked for a considerable period of time and therefore they were in a position to give credible information relating to this study.

4.2.3 Trade Currency

The study requested the respondent to indicate the currency they trade with.

Table 4.1: Currency used

<table>
<thead>
<tr>
<th>Currency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Us Dollar</td>
<td>84.1</td>
</tr>
<tr>
<td>British Sterling Pound</td>
<td>0.80</td>
</tr>
<tr>
<td>Euro</td>
<td>14.0</td>
</tr>
<tr>
<td>Swiss Franc</td>
<td>1.10</td>
</tr>
<tr>
<td>Japanese Yen</td>
<td>0.00</td>
</tr>
</tbody>
</table>

The study findings revealed that the most commonly used currency is US Dollar as shown by 84.1 percent, followed by Euro as shown by 14.0 percent. The British Sterling Pound is the next commonly used as shown by 0.80 percent, followed by Swiss Franc as shown by 1.10
percent. The least used currency is Japanese Yen as shown by 0.0 percent. These findings depict that Procter and Gamble mainly uses US Dollar as their foreign currency in their transactions.

### 4.2.4 Foreign Currency Denominated Transactions to Total Transactions

**Table 4.2: Foreign Currency Denominated Transactions to Total Transactions**

<table>
<thead>
<tr>
<th>Foreign currency</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>00-20%</td>
<td>2</td>
<td>4.5</td>
</tr>
<tr>
<td>20-40%</td>
<td>8</td>
<td>18.2</td>
</tr>
<tr>
<td>40-60%</td>
<td>31</td>
<td>70.5</td>
</tr>
<tr>
<td>60-80%</td>
<td>3</td>
<td>6.8</td>
</tr>
<tr>
<td>Total</td>
<td>44</td>
<td>100.0</td>
</tr>
</tbody>
</table>

The study requested the respondents to indicate the percentage of foreign currency denominated transactions to total transactions in their organization. The findings revealed that majority of the respondents as shown by 70.5 percent indicated 40-60% of foreign currency denominated transactions to total transactions, 18.2 percent of the respondents indicated between 20-40%, 6.8 percent of the respondents indicated 60-80%, whereas 4.5 percent of the respondents indicated between 0-20%. These findings reveal that Procter and Gamble use 40-60% of foreign currency denominated transactions to total transactions.

### 4.3 Foreign Exchange Rate Risk

#### 4.3.1 Categorizing Financial Risks

**Table 4.3: Categorizing financial risks**

<table>
<thead>
<tr>
<th></th>
<th>Highly Risky</th>
<th>Risky Moderate</th>
<th>Less Risky</th>
<th>Negligible</th>
<th>Mean</th>
<th>Std deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inflation Rate</td>
<td>29</td>
<td>12</td>
<td>1</td>
<td>2</td>
<td>1.455</td>
<td>0.283</td>
</tr>
<tr>
<td>Exchange Rate</td>
<td>32</td>
<td>10</td>
<td>2</td>
<td>0</td>
<td>1.318</td>
<td>0.326</td>
</tr>
<tr>
<td>Credit Risk</td>
<td>26</td>
<td>14</td>
<td>3</td>
<td>1</td>
<td>1.523</td>
<td>0.274</td>
</tr>
<tr>
<td>Stock Prices</td>
<td>22</td>
<td>16</td>
<td>6</td>
<td>2</td>
<td>1.727</td>
<td>0.191</td>
</tr>
</tbody>
</table>
4.3.1.1 Inflation Rate
The study sought to determine the level of financial risks and therefore requested the respondents to categorize inflation rate as being either highly, moderate, less or negligible risky. From the study findings, majority of the respondents indicated that inflation rate was highly risky, as shown by a S.D of 0.283. The findings depict that inflation rate was found to be the second most risky rate which performance of Procter and Gamble.

4.3.1.2 Exchange Rate
The study also sought to determine the respondents’ opinion on the level of financial risks with regard to exchange rate. From the study findings, majority of the respondents indicated that exchange rate was the most risky, as shown by a S.D of 0.326. The findings show that exchange rate primarily affects the performance of Procter and Gamble.

4.3.1.3 Credit Risk
The study further sought to determine the level of financial risks and therefore requested the respondents to categorize credit risk as being either highly, moderate, less or negligible risky. From the study findings, majority of the respondents indicated that credit risk was moderately risky, as shown by a S.D of 0.274. The findings depict that credit risk can probably be easily managed as opposed to the previous two exchange rates.

4.3.1.4 Stock Prices
The study sought to determine the respondents’ opinion on the level of financial risk with regard to stock prices. From the study findings, majority of the respondents indicated that inflation rate was highly risky, as shown by a S.D of 0.191. The findings reveal that stock prices are the least risky and merely affect the performance of Procter and Gamble.
Correlation of Foreign Exchange Rate Risk and Performance

Table 4.4: Correlations

<table>
<thead>
<tr>
<th></th>
<th>Foreign Exchange Rate</th>
<th>Performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign Exchange Rate</td>
<td>Pearson Correlation</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>-.791**</td>
</tr>
<tr>
<td></td>
<td>N</td>
<td>44</td>
</tr>
<tr>
<td>Performance</td>
<td>Pearson Correlation</td>
<td>-.791**</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>.002</td>
</tr>
<tr>
<td></td>
<td>N</td>
<td>44</td>
</tr>
</tbody>
</table>

The study conducted a Pearson product moment correlation to determine the strength of relationship between foreign exchange rate risk and performance. The study found that there is a strongly negative significant relationship between foreign exchange rate risk and performance as shown by correlation coefficient of -0.791. The p-value (p=0.002) was found to less 0.05 an indication that there is a significant negative correlation between foreign exchange rate risk and performance.

This means that increase in foreign exchange rate risk results in poor performance.

4.3.2 Company’s Risk

Table 4.5: Company’s Risk

<table>
<thead>
<tr>
<th>Statement</th>
<th>Strongly Disagree</th>
<th>Disagree</th>
<th>Uncertain</th>
<th>Agree</th>
<th>Strongly Agree</th>
<th>Mean</th>
<th>Std deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>The company is exposed to transaction risk</td>
<td>0</td>
<td>1</td>
<td>10</td>
<td>32</td>
<td>1</td>
<td>3.750</td>
<td>1.238</td>
</tr>
<tr>
<td>The company is exposed to economic risk</td>
<td>1</td>
<td>4</td>
<td>7</td>
<td>28</td>
<td>4</td>
<td>3.682</td>
<td>1.029</td>
</tr>
<tr>
<td>The company is exposed to translation risk</td>
<td>2</td>
<td>4</td>
<td>6</td>
<td>29</td>
<td>3</td>
<td>3.614</td>
<td>1.079</td>
</tr>
</tbody>
</table>
4.3.2.1 Transaction risk

The study requested the respondents to indicate their level of agreement with whether their company is exposed to transaction costs. The study findings established that majority of the respondents agreed that their company is exposed to transaction risk, as shown by a mean of 3.750 and a S.D of 1.238. These findings depict that Procter and Gamble is exposed to transaction risks.

The findings concur with those of Lessard (2006), who asserted that transaction risk has the greatest impact on profitability at least in the short and arguably in the medium term, and it is the primary object of foreign exchange risk management for any company involved in foreign trade.

4.3.2.2 Economic Risk

The study also requested the respondents to indicate their level of agreement with whether their company is exposed to economic risks. From the study findings, majority of the respondents agreed that their company is exposed to economic risk, as shown by a mean of 3.682 and a S.D of 1.029.

These findings show that Procter and Gamble is exposed to economic risks. The findings were found to concur with those of Glaum (1990) that parity changes in currency pairs can affect the competitive position of subsidiaries, their net profits and net profits converted to home currencies of parent companies.

4.3.2.3 Translation Risk

The study further requested the respondents to indicate their level of agreement with whether their company is exposed to translation risks. The study findings established that, majority of the respondents agreed that their company is exposed to translation risk, as shown by a mean of 3.614 and a S.D of 1.079.

These findings depict that Procter and Gamble is exposed to translation risks. These findings were found to be consistent with those of Fatemi (2000), who argued that companies are
faced with the translation risk, and the general view of authors on foreign exchange risk management is that translation risk should not be hedged because it does not add value to the company.

**Correlation of Foreign Exchange Risk and Performance**

**Table 4.6: Correlations**

<table>
<thead>
<tr>
<th>Source</th>
<th>Foreign Exchange Risk</th>
<th>Performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign Exchange</td>
<td>Pearson Correlation</td>
<td>1</td>
</tr>
<tr>
<td>Risk</td>
<td>Sig. (2-tailed)</td>
<td>-.701**</td>
</tr>
<tr>
<td></td>
<td>N</td>
<td>44</td>
</tr>
<tr>
<td>Performance</td>
<td>Pearson Correlation</td>
<td>-.701**</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>.012</td>
</tr>
<tr>
<td></td>
<td>N</td>
<td>44</td>
</tr>
</tbody>
</table>

The study conducted a Pearson product moment correlation to determine the strength of relationship between foreign exchange risk and performance. The study found that there is a strongly negative significant relationship between foreign exchange rate risk and performance as shown by correlation coefficient of -0.701. The p-value (p=0.012) was found to less 0.05 an indication that there is a significant negative correlation between foreign exchange risk and performance.

This means that increase in foreign exchange risk results in poor performance of companies.

**4.3.3 Primary Sources of the Firm’s Transaction Risk**

**Table 4.7: Primary Sources of the Firm’s Transaction Risk**

<table>
<thead>
<tr>
<th>Source</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign Sales And/ Purchases</td>
<td>25</td>
<td>56.8</td>
</tr>
<tr>
<td>Foreign Borrowing or Lending</td>
<td>13</td>
<td>29.5</td>
</tr>
<tr>
<td>Contracted Sales And/ or Purchases</td>
<td>6</td>
<td>13.6</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>44</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>
4.3.3.1 Foreign sales and purchases

The study requested the respondents to indicate the primary sources of their firm’s transaction risk. Majority of the respondents indicated that the primary source of their firm’s transaction risk was foreign sales and/ purchases, as shown by 56.8 percent. These findings depict that the primary sources transaction risk in Procter and Gamble is foreign sales and purchases.

The findings were found to be consistent with those of Shapiro, (2007) that state that any unforeseen changes in exchange rates affect viable cash flows and this situation can only be rebalanced by restructuring the structure of operational variables such as cost, volume, price and revenues.

4.3.3.2 Foreign borrowing or lending

The study findings revealed that 29.5 percent of the respondents indicated that the primary sources of their firm’s transaction risk was foreign borrowing or lending. These findings depict that in Procter and Gamble, foreign borrowing or lending is one of the primary sources of transaction risk.

The findings concur with Adler and Dumas (2006), who argued that transaction costs may occur in a case where a company operates with respect to any cash transfer between domestic currency and overseas currency. What follows is a time lag between the undertaking of the transaction date and the receipt of the payment. During this period of time, it is definite that exchange rates will definitely fluctuate and thus pose a financial risk to the company.

4.3.3.3 Contracted sales and/or purchases

The study findings further revealed that 13.6 percent of the respondents indicated that the primary sources of their firm’s transaction risk was contracted sales and/ or purchases. These findings depict that in Procter and Gamble, contracted sales and/ or purchases is one of the primary sources of transaction risk.
The findings agree with the findings of Adler and Dumas (2006) who cite that the strength or value of a home or foreign currency in any country on a particular date in the future will be different from its present value, by the time a purchase is undertaken.

4.3.4 Primary Sources of the Firm’s Economic Risk

Table 4.8: Primary Sources of the Firm’s Economic Risk

<table>
<thead>
<tr>
<th>Source</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intra- Firm and Inter Foreign Debt</td>
<td>2</td>
<td>4.5</td>
</tr>
<tr>
<td>Inter- Firm and Intra- Firm Payment For Goods and Services</td>
<td>11</td>
<td>25.0</td>
</tr>
<tr>
<td>Rent and Lease Payments</td>
<td>13</td>
<td>29.5</td>
</tr>
<tr>
<td>Royalties, License Fees and Management Fees</td>
<td>18</td>
<td>40.9</td>
</tr>
<tr>
<td>Total</td>
<td>44</td>
<td>100</td>
</tr>
</tbody>
</table>

4.3.4.1 Intra- Firm and Inter Foreign Debt
The study requested the respondents to indicate the primary sources of the firm’s economic risk. The findings revealed that 4.5 percent of the respondents indicated that intra- firm and inter foreign debt were the primary sources of the firm’s economic risk. These findings depict that intra- firm and inter foreign debt were not the major causes of the economic risk in Procter and Gamble.

4.3.4.2 Inter- Firm and Intra- Firm Payment for Goods and Services
The findings also revealed that 25 percent of the respondents indicated that inter- firm and intra- firm payment for goods and services were the primary sources of the firm’s economic risk. These findings depict that in Procter and Gamble, inter- firm and intra- firm payment for goods and services were causes of the economic risk.
4.3.4.3 Rent and Lease Payments

The findings further revealed that 29.5 percent of the respondents indicated that rent and lease payments were the primary sources of the firm’s economic risk. The findings show that in Procter and Gamble, rent and lease payments were causes of the economic risk.

4.3.4.4 Royalties, License Fees and Management Fees

The study findings further revealed that most of the respondents indicated that royalties, license fees and management fees were the major primary sources of the firm’s economic risk. These findings depict that in Procter and Gamble, that royalties, license fees and management fees are the major sources of economic risk.

4.3.5 Recognizing and management of translation risk

Table 4.9: Recognizing and management of translation risk

<table>
<thead>
<tr>
<th>Opinion</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>All of the Times</td>
<td>33</td>
<td>75.0</td>
</tr>
<tr>
<td>Sometimes</td>
<td>11</td>
<td>25.0</td>
</tr>
<tr>
<td>Total</td>
<td>44</td>
<td>100</td>
</tr>
</tbody>
</table>

The study requested the respondents to indicate whether translation risk was recognized and managed by their firm. From the study findings, majority of the respondents indicated that translation risk was recognized and managed by their firm at all the times as shown by 75 percent, whereas 25 percent of the respondents indicated that it was sometimes recognized and managed.

These finding depict that in Procter and Gamble, translation risk was recognized and managed at all the times. These findings concur with Markowitz (1952) who suggested that risk can be measured by standard deviation and assuming asset return are normally distributed. This then opened up a whole series of techniques of risk measurement using standard statistical and mathematical methods. He argued that individuals could reduce the
standard deviation of the returns of their assets by holding a portfolio whose security’s returns do not move towards the same direction.

4.3.6 Currency Translation

Table 4.10: Primary Reasons for Currency Translation

<table>
<thead>
<tr>
<th>Reason</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Preparation of Consolidation Financial Statements</td>
<td>23</td>
<td>52.3</td>
</tr>
<tr>
<td>Accounts and Tax Regulations</td>
<td>21</td>
<td>47.7</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>44</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

4.3.6.1 Preparation of Consolidated Financial Statements

The study requested that respondents to indicate the primary reasons for currency translation in their organization. From the study findings, majority of the respondents indicated that the primary reasons for currency translation in their organization was preparation of consolidation financial statements, as shown by 52.3 percent. These findings depict that preparation of consolidation financial statements was the primary reasons for currency translation in Procter and Gamble.

4.3.6.2 Accounts and Tax Regulations

The study findings further revealed that 47.7 percent of the respondents indicated that the primary reasons for currency translation in their organization was accounts and tax regulation. These findings revealed that accounts and tax regulations was also a reason for currency translation in Procter and Gamble.
### 4.4 Impact of Foreign Exchange Rate

#### Table 4.11: Impact of foreign exchange rate on Procter and Gamble

<table>
<thead>
<tr>
<th>Statement</th>
<th>Strongly Disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly Agree</th>
<th>Mean</th>
<th>Std Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>It’s important to use consolidation techniques to guard a firm against risks</td>
<td>0</td>
<td>0</td>
<td>6</td>
<td>22</td>
<td>16</td>
<td>4.227</td>
<td>0.987</td>
</tr>
<tr>
<td>Companies should use effective cost accounting evaluation procedures to guard a firm against risks.</td>
<td>0</td>
<td>0</td>
<td>17</td>
<td>20</td>
<td>7</td>
<td>3.773</td>
<td>0.780</td>
</tr>
<tr>
<td>Translation risk influence the firm competitiveness</td>
<td>0</td>
<td>0</td>
<td>10</td>
<td>21</td>
<td>13</td>
<td>4.068</td>
<td>0.863</td>
</tr>
<tr>
<td>Currency exchange rates may change after the companies have already entered into financial obligations</td>
<td>0</td>
<td>0</td>
<td>4</td>
<td>24</td>
<td>16</td>
<td>4.273</td>
<td>1.059</td>
</tr>
<tr>
<td>Fluctuation of exchange rates can lead to major losses for firms</td>
<td>0</td>
<td>0</td>
<td>2</td>
<td>22</td>
<td>20</td>
<td>4.419</td>
<td>1.151</td>
</tr>
<tr>
<td>Companies need to implement a hedging strategy</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>24</td>
<td>19</td>
<td>4.409</td>
<td>1.177</td>
</tr>
<tr>
<td>Companies should using forward rates to lock in an exchange rate</td>
<td>0</td>
<td>0</td>
<td>3</td>
<td>14</td>
<td>27</td>
<td>4.445</td>
<td>1.317</td>
</tr>
<tr>
<td>Unexpected currency fluctuations on a company’s future cash flows can subject a firm to economic risk</td>
<td>0</td>
<td>0</td>
<td>4</td>
<td>18</td>
<td>22</td>
<td>4.429</td>
<td>1.131</td>
</tr>
<tr>
<td>Economic risk can have a substantial impact on a company’s market value</td>
<td>0</td>
<td>0</td>
<td>5</td>
<td>15</td>
<td>24</td>
<td>4.432</td>
<td>1.171</td>
</tr>
<tr>
<td>Economic risk has far-reaching effects since is long-term in nature</td>
<td>0</td>
<td>0</td>
<td>2</td>
<td>22</td>
<td>20</td>
<td>4.409</td>
<td>1.151</td>
</tr>
<tr>
<td>Unexpected changes in foreign exchange rates affect the company</td>
<td>0</td>
<td>0</td>
<td>3</td>
<td>17</td>
<td>24</td>
<td>4.477</td>
<td>1.210</td>
</tr>
</tbody>
</table>
From the finding on the respondent level of agreement on the impact of foreign exchange rate on Procter and Gamble, the study found that majority of the respondent agreed that unexpected changes in foreign exchange rates affect the company as shown by mean of 4.477, companies should using forward rates to lock in an exchange rate as shown by mean 4.445, economic risk can have a substantial impact on a company’s market value as shown by mean of 4.432.

Unexpected currency fluctuations on a company’s future cash flows can subject a firm to economic risk as shown by mean of 4.429, currency exchange rates may change after the companies have already entered into financial obligations as shown by mean 4.273, it’s important to use consolidation techniques to guard a firm against risks as shown by mean of 4.227, fluctuation of exchange rates can lead to major losses for firms as shown by mean of 4.419,

Economic risk has far-reaching effects since is long-term in nature and companies need to implement a hedging strategy as shown by mean 4.409 in each case, translation risk influence the firm competitiveness as shown by mean 4.068 and companies should use effective cost accounting evaluation procedures to guard a firm against risks as shown by mean of 3.773. This was supported by low standard deviation an indication that respondent had similar opinion.

These findings were consistent with Procter and Gamble (2014) that the company also utilizes purchased foreign currency option with maturities of generally less than eighteen months and forward exchange contracts to hedge against the effect of exchange rate fluctuations on royalties and income from international operations.
4.5 Management of Foreign Exchange Risk

Table 4.12: Management of Foreign Exchange Risk

<table>
<thead>
<tr>
<th>Statement</th>
<th>Strongly Disagree</th>
<th>Disagree</th>
<th>Uncertain</th>
<th>Agree</th>
<th>Strongly Agree</th>
<th>Mean</th>
<th>Std deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exchange rate risk management is an integral part of every firm’s decisions about foreign currency risk</td>
<td>0</td>
<td>0</td>
<td>4</td>
<td>9</td>
<td>31</td>
<td>4.614</td>
<td>1.491</td>
</tr>
<tr>
<td>Currency risk hedging strategies entails eliminating or reducing risk</td>
<td>0</td>
<td>3</td>
<td>10</td>
<td>22</td>
<td>9</td>
<td>3.841</td>
<td>0.803</td>
</tr>
<tr>
<td>Currency fluctuations has no significant impact on the company's operating cash flows and competitive position</td>
<td>28</td>
<td>13</td>
<td>3</td>
<td>0</td>
<td>0</td>
<td>1.432</td>
<td>0.311</td>
</tr>
<tr>
<td>By invoicing in domestic currency, an exporter is able to shift transaction risk to his consumers abroad</td>
<td>0</td>
<td>5</td>
<td>8</td>
<td>14</td>
<td>17</td>
<td>3.977</td>
<td>0.796</td>
</tr>
<tr>
<td>Instead of shifting exchange rate risk to their counterparts, exporters can eliminate it at least partially through appropriate hedging</td>
<td>0</td>
<td>2</td>
<td>2</td>
<td>12</td>
<td>26</td>
<td>4.273</td>
<td>1.254</td>
</tr>
<tr>
<td>Operating risk cannot be quantified properly in order to be hedged by financial means</td>
<td>1</td>
<td>8</td>
<td>26</td>
<td>9</td>
<td>2.977</td>
<td>0.737</td>
<td></td>
</tr>
<tr>
<td>Operating risk is better managed by operational means (i.e. choice of sourcing, production locations and pricing strategy)</td>
<td>0</td>
<td>10</td>
<td>9</td>
<td>14</td>
<td>11</td>
<td>3.591</td>
<td>0.545</td>
</tr>
</tbody>
</table>

The study sought to determine the extent to which respondent agreed with the above statements relating to management of foreign exchange risk. From the study findings, majority of the respondents strongly agreed that exchange rate risk management is an integral part of every firm’s decisions about foreign currency risk, as shown by a mean of 4.614. The findings also revealed that majority of the respondents agreed that instead of shifting
exchange rate risk to their counterparts, exporters can eliminate it at least partially through appropriate hedging, as shown by a mean of 4.273; by invoicing in domestic currency, an exporter is able to shift transaction risk to his consumers abroad, as shown by a mean of 3.977; currency risk hedging strategies entails eliminating or reducing risk, as shown by a mean of 3.841; and operating risk is better managed by operational means, as shown by a mean of 3.591.

The findings further revealed that majority of the respondents were neutral about their opinion on whether operating risk cannot be quantified properly in order to be hedged by financial means. However, majority of the respondents were of the opinion that currency fluctuations has no significant impact on the company's operating cash flows and competitive position, as shown by a mean of 1.432.

These findings were found to be consistent with the findings of Hicks (1982) who explained translation risk hedging by the existence of management compensation schemes which are often tied to financial statements and are thus affected by translation gains and losses. Similarly, the findings were found to concur with those of Baum (1991) who asserted that risk management involves identifying the types of risk within the company, measuring those potential risks, proposing means to hedge, insure or mitigate some of the risks and estimating the impact of various risks on the future earnings of the company.

4.5.1 Techniques to manage risk

Table 4.13: Techniques to manage risks

<table>
<thead>
<tr>
<th>Technique</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Offsetting Debts against Claims</td>
<td>12</td>
<td>27.3</td>
</tr>
<tr>
<td>Multi-Currency Billing and Price Adjustment</td>
<td>19</td>
<td>43.2</td>
</tr>
<tr>
<td>Re- Invoicing</td>
<td>8</td>
<td>18.2</td>
</tr>
<tr>
<td>Factoring</td>
<td>5</td>
<td>11.4</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>44</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>
4.5.1.1 Offsetting debts against claims
The study sought to establish from the respondents the techniques used to manage risks in their organizations. The findings of the study revealed that 27.3 percent of the respondents indicated that their company offsets debts against claims, as a way to manage risks. These findings depict that offsetting debts against claims technique is used in Procter and Gamble to manage risks.

4.5.1.2 Multi-currency billing and price adjustment
The study findings also revealed that 43.2 percent of the respondents indicated that their company uses the multi-currency billing and price adjustment technique to manage risks. These findings show that multi-currency billing and price adjustment is the most commonly used technique in Procter and Gamble to manage risks.

4.5.1.3 Re-invoicing
The findings of the study further revealed that 18.2 percent of the respondents indicated that their company uses the re-invoicing technique to manage risks. These findings depict that re-invoicing technique is also used in Procter and Gamble to manage risks.

4.5.1.4 Factoring
The study also revealed that 11.4 percent of the respondents indicated that their company adopted the factoring technique to manage risks. These findings depict that in Procter and Gamble, factoring technique was used to manage risks, though it is not the commonly used technique.

Correlation of Techniques to Manage Risk and Performance

Table 4.14: Correlations

<table>
<thead>
<tr>
<th>Techniques</th>
<th>Techniques Pearson Correlation</th>
<th>Performance</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Techniques</td>
<td>Pearson Correlation</td>
<td>1</td>
<td>.814**</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td></td>
<td></td>
<td>.010</td>
</tr>
<tr>
<td>N</td>
<td></td>
<td>44</td>
<td>44</td>
</tr>
<tr>
<td>Performance</td>
<td>Pearson Correlation</td>
<td>.814**</td>
<td>1</td>
</tr>
</tbody>
</table>

[^14]: Correlations
The study conducted a Pearson product moment correlation to determine the strength of relationship between techniques to manage risk and performance. The study found that there is a strongly positive significant relationship between techniques to manage risk and performance as shown by correlation coefficient of 0.814. The p-value (p=0.010) was found to less 0.05 an indication that there is a significant positive correlation between techniques to manage risk and performance. This means that increase in appropriate techniques to manage risk results in improved performance of the companies.

### 4.5.2 Instruments Used To Hedge Foreign Currency Risks

**Table 4.15: Instruments used to hedge foreign currency risks**

<table>
<thead>
<tr>
<th>Technique</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Currency Options</td>
<td>12</td>
<td>27.3</td>
</tr>
<tr>
<td>Forward Contracts</td>
<td>21</td>
<td>47.7</td>
</tr>
<tr>
<td>Future Contracts</td>
<td>8</td>
<td>18.2</td>
</tr>
<tr>
<td>Foreign Currency Swaps</td>
<td>3</td>
<td>6.8</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>44</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

#### 4.5.2.1 Currency Options

The study requested the respondents to indicate instruments that are used in their firm to hedge foreign currency risk. From the study findings, 27.3 percent of the respondents indicated that they use currency options instrument to hedge foreign currency risk. These findings depict that in Procter and Gamble the currency option instrument is used in hedging foreign currency risk. These findings concur with those of Kidwell (2008) that options give the buyer the desired insurance while allowing him to benefit from a favorable shift in the underlying price.
4.5.2.2 Forward Contracts

The study further revealed that most of the respondents indicated that their company uses forward contracts technique to hedge foreign currency risk, as shown by 47.7 percent. These findings show that Procter and Gamble mainly uses the forward contracts technique to hedge foreign currency risk. The findings were found to be in agreement with those of Black (1989) who argued that forward contracts are the straight forward form of derivatives, since it obliges one party to buy, and the other to sell, a specified sum of a nominated underlying financial instrument (currency) at a specific price, on a specific date in the future.

4.5.2.3 Future Contracts

The study findings further revealed that 18.2 percent of the respondents indicated that their company uses future contracts instruments to hedge foreign currency risk. These findings show that Procter and Gamble also uses the future contracts instrument to hedge foreign currency risk. These findings concur with those of Howells (2007) that futures contract may be used by a buyer or seller to hedge other positions in the same asset, price changes in the asset after the futures contract agreement is made provide gains to one party at the expense of the other. This could be the reason that it is not the commonly used instrument in Procter and Gamble to hedge foreign currency risk, so as to avoid the loss incase price of the asset drops.

4.5.2.4 Foreign Currency Swaps

The study further revealed that 6.8 percent of the respondents indicated that their company uses foreign currency swaps technique to hedge foreign currency risk. The findings reveal that foreign currency swaps technique is the least used technique to hedge foreign currency risk. These findings concur with Goldberg (2006) who argued that the foreign currency swaps technique benefits both parties since it exploits one competitive advantage.
4.6 Chapter Summary

The chapter presented the results of the survey. The data obtained from the survey was analyzed using descriptive statistics. The study found that financial risks highly affect foreign direct investments in Kenya. The study also revealed that foreign direct investments in Kenya are exposed to transaction risk, economic risk as well as translation risk.

The study further revealed that the major primary source of its transaction risk was foreign sales and/ or purchases and that the major primary sources of the firm’s economic risk is license fees and management fees. The study found that translation risk was recognized and managed at all the times by foreign direct investments in Kenya, and that the mostly used technique is multi-currency billing and price adjustment. The primary reason for currency translation is preparation of consolidation financial statements. The next chapter discusses the major findings of the study, major conclusions drawn and areas for further research.
CHAPTER FIVE

5.0 SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presented the discussion of key data findings, conclusion drawn from the findings highlighted and recommendation made there-to, the conclusions and recommendations drawn were focused on addressing the objective of the study. The researcher had intended to examine are the types of foreign exchange risks experienced in Kenya, to determine how the foreign exchange rates have impacted on Procter and Gamble, and to examine the best techniques to manage foreign exchange risks.

5.2 Summary of the Study

The general objective of this study is to determine the impact of the exchange rates in the performance of companies that have invested in Kenya as Foreign Direct Investments.

The study will be guided by the following research questions

i. What are the types of foreign exchange risks experienced in Kenya?

ii. How has the foreign exchange rates impacted on Procter and Gamble?

iii. What are the best techniques to manage foreign exchange risks?

The study sought to determine the level of financial risks. From the research findings, the study revealed that financial risks highly affect performance of companies that have invested in Kenya as Foreign Direct Investments. The study sought to establish whether Procter and Gamble is exposed to transaction, economic and translation risks. From the research findings, the study revealed that Procter and Gamble is exposed to transaction risk, economic risk as well as translation risk.

The study also revealed that the major primary source of the firm’s transaction risk was foreign sales and/ purchases this is evident by a response rate of 56.8%. The major primary source of the firm’s economic risk is license fees and management fees as per 40.9%
response rate. The findings further revealed that translation risk was recognized and managed at all the times as shown by 75%. The study sought to establish the primary reasons for currency translation Procter and Gamble. From the research findings, the study revealed that primary reason for currency translation is preparation of consolidation financial statements as shown by 52.3%.

On the impact of foreign exchange rate on Procter and Gamble, the study found that unexpected changes in foreign exchange rates affect the company as shown in table 4.11 by a mean of 4.477, companies should using forward rates to lock in an exchange rate as shown by a mean of 4.445, economic risk can have a substantial impact on a company’s market value as shown by a mean of 4.432, unexpected currency fluctuations on a company’s future cash flows can subject a firm to economic risk as shown by a mean of 4.429, currency exchange rates may change after the companies have already entered into financial obligations by a mean of 4.273, it’s important to use consolidation techniques to guard a firm against risks by a mean of 4.227 and finally fluctuation of exchange rates can lead to major losses for firms by a mean of 4.419. Economic risk has far-reaching effects since is long-term in nature and companies need to implement a hedging strategy, translation risk influence the firm competitiveness and companies should use effective cost accounting evaluation procedures to guard a firm against risks.

The study sought to establish the techniques to manage risk in Procter. From the research findings, the study revealed that Procter and Gamble uses all the stated techniques, but the mostly used technique is multi-currency billing and price adjustment. The study also revealed that Procter and Gamble uses forward contracts instrument to hedge foreign currency risks.

5.3 Discussion

5.3.1 Foreign Exchange Rate Risk

The study established that that exchange rate and inflation rate were highly risky, whereas credit risk and stock prices were moderately risky. The established that Procter and Gamble Company is exposed to transaction risk, as, economic risk, and to translation risk. The study also established that the major primary source of its transaction risk was foreign sales and/
purchases, and that the major primary sources of the firm’s economic risk is license fees and management fees. The study further established that translation risk was recognized and managed at all the times. The study revealed that in Procter and Gamble, the primary reason for currency translation is preparation of consolidation financial statements. The findings concur with those of Lessard (2006), who asserted that transaction risk has the greatest impact on profitability at least in the short and arguably in the medium term, and it is the primary object of foreign exchange risk management for any company involved in foreign trade.

According to Hicks (1982), greater risks are associated with greater uncertainties. Any company is exposed to risk in case there is a currency mismatch in some aspect of the business such that a shift in foreign exchange rates, nominal or real affects the performance either adversely or beneficially (Shoup, 1998). For instance, Glaum (1990) asserted that transaction risk, which is the potential for a gain or loss in contracted for near term cash flows, is caused by a foreign exchange rate-induced change in the value of amounts due to the multinational companies or amounts that the multinational companies owes to other parties. As such, it is a change in the home currency value of cash flows that are already contracted for. According to him, transaction risk measures changes in the value of outstanding financial obligations incurred prior to a change in exchange rates but not due to be settled until after the exchange rates change.

Similarly, Lessard (2006) argue that economic risk has to do with the international competitive environment of each company. He further asserts that economic risk is determined by the structure of the markets in which the company and its competitors source inputs and products. The measurement of this risk must accordingly take into account the nature of the company and its competition. Industries producing products for which demand is fairly inelastic are less susceptible to operating risk. Shoup (1998) argues that companies that sell price driven commodities such as automobiles are susceptible to extensive operating risk. However, he asserts that different factors can affect the firm’s future cash flows and also affect the economic risk: such factors can include the investment policy of the firm, or external factors such as political instability in a country that would affect the levels of sales.
The findings were also found to concur with those of Fatemi (2000) who asserted that translation risk is a financial accounting technicality and arises when financial accounting statements of foreign affiliates are translated into the home currency of the parent company for consolidation purposes. He added that that translation risk should not be hedged because it does not add value to the company. However, survey results have indicated that it is often being hedged by the existence of management compensation schemes which are often tied to financial statements and are thus affected by translation gains and losses.

5.3.2 Impact of Foreign Exchange Rate

On the impact of foreign exchange rate on Procter and Gamble, the study found that unexpected changes in foreign exchange rates affect the company, companies should using forward rates to lock in an exchange rate, economic risk can have a substantial impact on a company’s market value, unexpected currency fluctuations on a company’s future cash flows can subject a firm to economic risk, currency exchange rates may change after the companies have already entered into financial obligations, it’s important to use consolidation techniques to guard a firm against risks, fluctuation of exchange rates can lead to major losses for firms, economic risk has far-reaching effects since is long-term in nature and companies need to implement a hedging strategy, translation risk influence the firm competitiveness and companies should use effective cost accounting evaluation procedures to guard a firm against risks. These findings were consistent with Procter and Gamble (2014) that the company also utilizes purchased foreign currency option with maturities of generally less than eighteen months and forward exchange contracts to hedge against the effect of exchange rate fluctuations on royalties and income from international operations.

Similarly, the findings were found to concur with those of Eun and Resnick (2009), who stated that foreign currency risk management means taking actions that will minimize the negative effects of currency fluctuations on the financial statements, on firm's receivables and payables arising from existing obligations and on long term future cash flows of a firm. He added that Innovativeness of the managers and rapid growth of financial instruments have
made accessible to firms mitigating tools that can be used in dealing with the impact of foreign currency rate fluctuations.

Ngari (2011) asserts that since transaction exposure hedges can affect the variability of firm value, they can also affect the risk of poorly diversified managers’ shareholdings. He further argues that translation gains or losses tend to be unrealized and have little direct impact on firms’ cash flows, which suggests that translation exposure hedges create little shareholder value through reducing expected costs of financial distress, taxes or the underinvestment problem.

Changes in exchange rates may, according to Eun and Resnick (2009), affect the settlement of contracts, cash flows, and the firm valuation as measured by share prices and thus important for financial managers to know the firm’s foreign currency exposure and properly manage the exposure. By doing so, managers can stabilize the firm’s cash flows and enhance the firm’s value (Brigham and Ehrhardt, 2008). They further add that while many managers understand the effects of random exchange rate changes on the dollar value of their firm’s assets and liabilities denominated in foreign currencies, they often do not fully understand the effects of volatile exchange rates on operating cash flows.

Similarly, the findings concur with those of Choi (2012) that firms may use risk shifting techniques by invoicing all overseas purchases and sales transactions in the home currency of the firm and thereby avoiding transaction exposure related primarily to exports and imports. He added that the organization can reduces the volume and amount of transactions it needs to cover an exposure by use of netting strategies.

5.3.3 Foreign Exchange Risk Management Techniques
The study revealed that exchange rate risk management is an integral part of every firm’s decisions about foreign currency risk, exporters can eliminate it at least partially through appropriate hedging other than shifting exchange rate risk to their counterparts, an exporter is able to shift transaction risk to his consumers abroad by invoicing in domestic currency,
currency risk hedging strategies entails eliminating or reducing risk, and operating risk is better managed by operational means. The study further revealed that currency fluctuations have no significant impact on the company's operating cash flows and competitive position. The study further revealed that the mostly used technique to manage risk is multi-currency billing and price adjustment technique and that the most used instrument used to hedge foreign currency risks is forward contracts.

These findings were found to be consistent with the findings of Hicks (1982) who explained translation risk hedging by the existence of management compensation schemes which are often tied to financial statements and are thus affected by translation gains and losses. Similarly, the findings were found to concur with those of Baum (1991) who asserted that risk management involves identifying the types of risk within the company, measuring those potential risks, proposing means to hedge, insure or mitigate some of the risks and estimating the impact of various risks on the future earnings of the company.

The findings further concur with those of Shapiro (2007) who suggested that firms can adopt either operational or financial hedging approaches or a combination of both. He however noted that for financial hedging, it requires a strategic reorientation of operating policies regarding pricing, sourcing, locating of production and financing.

Glaum (1990) suggested that for manufacturing firm with production and sales operations in foreign countries that is exposed to demand and exchange rate risks, can use financial tools (e.g. forwards) to manage its risk to exchange rate risks. However, he found that these tools are not effective in altering the demand risk. He proposed that a better option would be that involving postponing the production decision until after more accurate information about demand is an acquired buffer against demand uncertainty by better matching supply and demand. According to him, this operational decision (postponement), used as a risk hedging device, is an operational hedge of the multinational firm.
Similarly, the findings were found to be consistent with those of Black (1989) who emphasized that each techniques is applied differently depending on each company’s situation. For instance, he asserted that forward contract is the simplest financial derivative and it is used to give the holder both the right and full obligation to conduct a transaction involving a security or commodity –the underlying asset- at a predetermined future date and at a predetermined price. He further argued that forward contracts differ from options in that options carry a different payoff system and that these contracts are particularly different to every trade. They are tailor made to an end user and this makes them very difficult to resell. According to him, forwards are not uniform and that particulars are in relation to credit period, location, delivery date, delivery grade and contract size are always worked out.

5.4 Conclusion

5.4.1 Foreign Exchange Rate Risk
The study established that financial risks highly affect Procter and Gamble. Thus, the study concludes financial risks have high negative impact performance of companies that have invested in Kenya as Foreign Direct Investments. The study revealed that Procter and Gamble is exposed to transaction risk, economic risk and translation risk. The study also revealed that, the major primary source of its transaction risk was foreign sales and/ purchases and that the major primary sources of the firm’s economic risk is license fees and management fees.

5.4.2 Impact of Foreign Exchange Risk
The study further revealed that in Procter and Gamble, translation risk was recognized and managed at all the times. The study concludes that foreign sales and/ purchases and license fees and management fees are the major primary sources or the transaction and economic risk.

5.4.3 Foreign Exchange Risk Management Techniques
The study draws a further conclusion that mostly used technique to manage risk is multi-currency billing and price adjustment technique and that the most used instrument used to hedge foreign currency risks is forward contracts, in companies that have invested in Kenya as Foreign Direct Investments.
5.5 Recommendations

5.5.1 Recommendations for Improvement

Based on the study findings, the study suggest

5.5.1.1 Foreign Exchange Rate Risk

The study recommends that corrective measures should be taken to minimize financial risks since such risks have high negative impact performance of companies that have invested in Kenya as Foreign Direct Investments

5.5.1.2 Foreign Exchange Risk

The study further recommends that companies need to address issues on foreign sales and/ purchases and license fees and management fees, since they are the major primary sources of transaction and economic risk in companies that have invested in Kenya as Foreign Direct Investments. This is because transactions ultimately determine the rate at which currencies are exchanged and will in turn determine the cost of purchasing foreign goods and financial assets

5.5.1.3 Foreign Exchange Risk Management Techniques

The study recommends that measures should be put forward to ensure effectiveness of multi-currency billing and price adjustment technique since it is the mostly used technique to manage risk.

5.5.2 Recommendations for Further Research

The study sought to establish determine the impact of the exchange rates in the performance of companies that have invested in Kenya as Foreign Direct Investments. The study recommends that a study should be done on impact of foreign direct investment on financial performance of the companies.
REFERENCES


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Lessard, M.C. (1993), "Exporters can choose different terms of sale", *Business Credit*, 95 (6), 40-51.


Appendix I: Questionnaire

Section A: Demographic information.

1. Age of the respondent
   - Below 20 years [ ]
   - 21-29 years [ ]
   - 30-39 years [ ]
   - 40-49 years [ ]
   - 50 years and above [ ]

2. Length of service in the organization
   - 0-5 years [ ]
   - 6-10 years [ ]
   - 11-15 years [ ]
   - 16-20 years [ ]
   - 21 years and above [ ]

3. Designation of the respondent _________________________

4. What currencies do you mostly trade with?
   - US Dollar [ ]
   - British Sterling Pound [ ]
   - Euro [ ]
   - Swiss Franc [ ]
   - Japanese Yen [ ]
   - Others (specify)……

5. What is the percentage of foreign currency denominated transactions to total transactions?
   - 00-20% [ ]
   - 20-40% [ ]
Part B: Foreign Exchange Rate Risk

Note:

Translation Risk. This is the risk that is inherent when a foreign subsidiary translates its financial statements into the home currency of the parent company.

Transaction Risk. This is foreign risk that arises from the normal course of business.

Economic Risk. This is when the exchange rate movement may cause changes in future operating cash flow, decline sales volume, increase input costs or decrease competition position.

1. Kindly categorize the following financial risks from highly risky to negligible risky as shown in table below:

<table>
<thead>
<tr>
<th>Risk</th>
<th>Highly Risky</th>
<th>Risky Moderate</th>
<th>Less Risky</th>
<th>Negligible</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inflation Rate</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exchange Rate</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Credit Risk</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stock Prices</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

2. Please state any other risk or factor……………

3. Using a scale of 1-5 tick the appropriate answer from the alternatives, 1- Strongly Disagree 2- Disagree 3- Uncertain 4- Agree 5- Strongly Agree.

<table>
<thead>
<tr>
<th>Risk</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>The company is exposed to transaction risk risk</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The company is exposed to economic risk risk</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The company is exposed to translation risk risk</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

4. What are the primary sources of this firm’s transaction risk.

   Foreign sales and/ purchases [ ]
   Foreign borrowing or lending [ ]
5. What are the primary sources of the firm’s economic risk?

- Intra- firm and inter foreign debt
- Inter- firm and intra- firm payment for goods and services
- Rent and lease payments
- Royalties, license fees and management fees
- Other (please specify) …………….. 

6. Is translation risk recognized and managed by your firm?

- All of the times
- Sometimes
- Never
- Not applicable

7. What are the primary reasons for currency translation?

- Preparation of consolidation financial statements
- Accounts and tax regulations
- Other, please specify ……………..

Part C: Impact of Foreign Exchange on Procter and Gamble

To what extent do you agree with the following statement relating to the impact of foreign exchange rate on Procter and Gamble (5-Strongly Agree, 4-Agree, 3-Neutral, 2-Disagree- strongly disagree)

<table>
<thead>
<tr>
<th>Statement</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. It’s important to use consolidation techniques to guard a firm against risks</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Companies should use effective cost accounting evaluation procedures to guard a firm against risks</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
3. Translation risk influence the firm competitiveness

4. Currency exchange rates may change after the companies have already entered into financial obligations

5. Fluctuation of exchange rates can lead to major losses for firms

6. Companies need to implement a hedging strategy

7. Companies should using forward rates to lock in an exchange rate

8. Unexpected currency fluctuations on a company’s future cash flows can subject a firm to economic risk

9. Economic risk can have a substantial impact on a company’s market value

10. Economic risk has far-reaching effects since is long-term in nature

11. Unexpected changes in foreign exchange rates affect the company

### Part D Management of Foreign Exchange Risk

Using a scale of 1-5 tick the appropriate answer from the alternatives, 1- Strongly Disagree 2- Disagree 3- Uncertain 4- Agree 5- Strongly Agree.

<table>
<thead>
<tr>
<th></th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Exchange rate risk management is an integral part of every firms decisions about foreign currency risk</td>
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<tr>
<td>2. Currency risk hedging strategies entails eliminating or reducing risk</td>
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<tr>
<td>3. Currency fluctuations has no significant impact on the company's operating cash flows and competitive position</td>
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</tr>
</tbody>
</table>
4. By invoicing in domestic currency, an exporter is able to shift transaction risk to his consumers abroad

5. Instead of shifting exchange rate risk to their counterparts, exporters can eliminate it at least partially through appropriate hedging

6. Currency fluctuations has no significant impact on the company’s operating cash flow and competitive position

7. Operating risk cannot be quantified properly in order to be hedged by financial means

8. Operating risk is better managed by operational means (i.e. choice of sourcing, production locations and pricing strategy)

9. Do you use any of the following techniques to manage risks?
   - Offsetting debts against claims [ ]
   - Multi-currency billing and price adjustment [ ]
   - Re-invoicing [ ]
   - Factoring [ ]
   - Other (please specify)………………

10. If your firm hedges foreign currency risks, which of the following instruments do you use?
   - Currency options [ ]
   - Forward contracts [ ]
Future contracts [ ]

Foreign currency swaps [ ]

Other (please specify)……………

Thank you