EFFECT OF FOREIGN EXCHANGE RISK EXPOSURE ON PERFORMANCE OF DONOR FUNDED NON-PROFIT ORGANIZATIONS. A CASE OF COMPASSION INTERNATIONAL KENYA

BY

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UNITED STATES INTERNATIONAL UNIVERSITY-AFRICA

FALL 2018
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A Research Project Report Submitted to the Chandaria School of Business in Partial Fulfillment of the Requirements for the Degree of Masters in Business Administration (MBA)

UNITED STATES INTERNATIONAL UNIVERSITY-AFRICA

FALL 2018
STUDENT DECLARATION

I, the undersigned, 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 for academic credit.

Signed: _______________________       Date: _______________________________

Kamau Esther Waithera (ID. NO: 652311)

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

Signed: _______________________       Date: _______________________________

Mr. Kepha Oyaro

Signed: _______________________       Date: _______________________________

Dean, Chandaria School of Business
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ABSTRACT

The general objective of this study was to determine the effect of the foreign exchange risk exposure on the performance of donor funded Non-Profit Organizations in Kenya, a case study of Compassion International Kenya. To achieve this, the study was guided by three specific objectives which were to determine the types of foreign exchange risk exposures facing Compassion International Kenya, to determine the effect of the foreign exchange risk exposure on the performance of Compassion International Kenya, and to determine the options available to manage foreign exchange risks in Compassion International Kenya.

This study adopted a descriptive cross-sectional design with a case study. The descriptive research design was suitable for this study as it allowed investigation on the quantitative data that was collected. It enabled the analysis of the specific features and on the different variables for the duration taken into consideration. Data was collected using mixed methods. The study used a census of all the employees of Compassion International Kenya because the population was small. At the time of the study, Compassion International had a staff count of 78 personnel. The study also used a structured questionnaire to collect primary data which was both qualitative and quantitative. The study covered a four-year period of 2014-2017.

The financial reports for this study were obtained from Compassion International Kenya Head Office in Kenya. For the data analysis process, the study used software known as the Statistical Package for Social Sciences (SPSS version 24). Descriptive data analysis techniques were used to analyze the data. Among the quantitative tools that were employed for this study were the measures of central tendencies: frequencies, means, standard deviation and percentages. The data was then analyzed and presented in form of tables, and figures.

The first research objective established that Compassion International Kenya faces accounting, economic and transaction exposures of foreign exchange risk. The study revealed that most of the respondents had a neutral feeling towards the questions asked under this section on the impact of the accounting, economic and transaction exposures and the impact on the of the firms’ performance. On the measurement of financial performance for NGO’s, the study focused on three main financial ratios of assessing the performance of organizations: current ratio, quick ratio and available funds ratio. The study found that the financial performance of Compassion International Kenya was stable, but the organization should focus on retaining more funds to cover their current liabilities. For the measurement
of non-financial performance, the balanced score card was used to rate the organization. The study found that Compassion International Kenya beneficiaries were happy with the level of service provision. On the options available for mitigation of foreign exchange risk exposures, it was found that there are several options available for managing foreign exchange risk in organizations. This study found that the use of payment netting was the most favored method at Compassion International Kenya.

The study concluded that Compassion International Kenya, and other NGOs in Kenya, face foreign exchange risk exposures with the major types of foreign exchange risk exposures being the accounting economic and transaction exposures. These risk exposures put NGO’s operations at threat since they affect the cash flows for operations.

Based on these findings, the study recommends that the accounting, economic and transaction exposures which have a significant influence on the performance of NGO’s be mitigated by use of options available for foreign exchange risk management. The study also recommends that managers should concentrate their efforts in allocating an optimal amount of funds towards the use of payment netting, hedging and derivatives and forward and future contracts to manage their foreign exchange risk exposures for future transactions. This will help improve the performance of the organization and reduce exchange rate losses.
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ACKNOWLEDGEMENTS

I would first like to express my gratitude to The Almighty God for giving me daily strength and good health and for seeing me through my academic journey.

Secondly, I would like to thank my supervisor Mr. Kepha Oyaro for his extremely useful advice, guidance and support as I undertook this project. I would like to extend my deepest gratitude to Edwin Mokaya of Kenya Bureau of Statistics whose guidance when writing this project was invaluable. I also wish to thank Sidney Muisyo and Joel Macharia of Compassion International for the support accorded to me when I was conducting my research at their premises.

Finally, I would like to thank my parents: Ezekiel and Polly Kamau for the continuous motivation and support throughout my studies and my sister Grace Kamau for having been a source of encouragement as I did this project.
DEDICATION

I dedicate this research project to my family: Ezekiel, Polly, Grace and Lydia. Thank you for believing in me and for teaching me that I can do all things through Christ who strengthens me.
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1.0 INTRODUCTION

1.1 Background of the Study

Foreign exchange risk exposure is the impact of unexpected foreign exchange rate changes on the worth of a firm (Hagelin & Pramborg, 2004). This is also defined as the risk of unfavorable changes in a country’s exchange rate (Walker, 1978). Foreign exchange risk exposures are a cause of uncertainty for organizations that operate in an open economy (Dhagat & Raju, 2016). This effect has been heightened by globalization which has produced foreign exchange risk exposures in both domestic and international firms (Afza & Alam, 2014).

Foreign currency exposures arise whenever a company has an income or expenditure or an asset or liability in a currency other than that of the balance sheet currency. Indeed, exposures can arise even for companies with no income, expenditure, asset or liability in a currency different from the balance sheet currency. When there is a condition prevalent where the exchange rates become extremely volatile the exchange rate movements destabilize the cash flows of a business significantly. Such destabilization of cash flows that affects the profitability of the business is the risk from foreign currency exposure (Afza & Alam, 2014).

Africa has experienced phenomenal growth of NGOs at both international and national levels. This is due to the changing attitude of donor agencies about development assistance also known as donor funds and the increased demand for NGO services in Third World countries. NGOs are non-membership support organizations involved in relief, rehabilitation, or community development work in developed and, especially, developing countries. They are considered part of the civil arena in society which includes trade unions, people's associations and membership organizations, cooperatives and religious-based charities (Makoba, 2002). Lewis (2014) defined NGOs as the collection of third sector organizations working in development and who are primarily funded by the international aid system.

In an endeavor to achieve their goals NGOs face various challenges in the operations. Batti (2014) noted that NGOs require resources to be able to provide services to the society, and that good management of these resources is important for the NGO’s
sustainability. Part of this good management of resources is the management of foreign exchange risk. There are three types of foreign exchange risk exposures; transaction exposure, economic exposure, and translation exposure (Kapila and Hendrickson, 2001).

NGOs which deal with multiple currencies face foreign exchange risk exposure. Exposure is defined as the contracted, projected or contingent cashflow whose impact and magnitude is uncertain at the moment and it depends on the worth of the exchange rates. In the operations of NGOs, a falling domestic exchange rate will result in loss of revenues budgeted for project implementation. This will adversely affect the scope, cost and time of the project and consequently bring about undesirable effects like non-completion of the project or poor project quality due to budgetary limitations.

Measuring organization performance from the financial perspective is an absolute must for any business, regardless of its size. It will pay entrepreneurs to become intimately familiar with the Key Performance Indicators used to measure, monitor and provide the actionable insights needed to keep your financial performance on track (Kinyuma, 2013). Each organization must evaluate its performance which enables it to allocate its available enterprise resources towards profitable and value adding operations. It is also important to measure performance for strategic planning and positioning of the business. Performance, in line with international NGOs, enhances the image of the organization. Performance is measured using financial metrics such as profitability, liquidity, solvency, repayment capacity, short term financial management, financial efficiency and turnover capacity. These metrics are correspondingly reflected in a company’s financial statements. Profit describes how much wealth a company has created out of utilizing its available resources. The liquidity of a business determines its ability to maintain liquid cash and cash equivalents to meet its debt obligation on a timely basis using the current ratio and quick ratio (Woodruff & Fafchamps, 2014).

The United States Agency for International Development (USAID) acknowledges foreign exchange risk in the implementation of projects it has funded. This arises because budgets submitted for awards, amount obligated and financial reports are in US dollars while payments for expenses are in the local currency. And further, because the exchange rate used during budgeting is likely to change by the time the funding is received. The agency recommends that the funded organizations should either have a multi-currency accounting
system or use a suitable accounting method to report foreign exchange rates. USAID notes that if the exchange rate has a measurable impact on programming and targets, such information should be shared in a timely manner, and if the rate results in additional money, such money should be used towards the program (FHI 360, MSI & USAID, 2012). Further, according to Featherston, Littlefield and Mwangi (2006), organizations, including NGOs, can mitigate against foreign exchange risk by either doing nothing, hedging (forward contracts and futures, swaps or options) among other methods.

A report by Charity Finance Directors’ Group and Stamp Out Poverty (2011) on United Kingdom charities pointed out that millions were lost due to ineffective foreign exchange management because donors did not require recipients to seek for the best foreign exchange rates. The report suggested that NGOs use competitive tendering techniques such as currency options and currency swaps when purchasing local currencies, utilize services of foreign exchange experts and shared lessons learnt with other NGOs.

Makoba (2002) noted that Kenya is one of the continent’s most active hubs for foreign aid money. The number of aid organizations based in the country grew by more than 400% between 1997 and 2006. Kenya is now home to more than 12,000 NGOs that work in healthcare, education, human rights and civic engagement with a significant number of these NGO’s located within Nairobi (Brass, 2012) The NGOs in Kenya therefore face foreign exchange risk as they request and receive donor funds in other foreign currency, while the expenditure is transacted in Kenyan Shillings. If the effect of foreign exchange risk if high, it will adversely affect the ability of the NGO to achieve its objectives. This study looked at the effect of foreign exchange risk exposure on performance of donor funded NGOs and it was a case study of Compassion International Kenya.

Compassion International Kenya is a child-advocacy NGO that connects sponsors with those who are suffering from poverty. It is a Christian NGO that partners with communities, churches, sponsors, and international donors to realize their global strategy. The organization goal is to release children from spiritual, economic, social, and physical poverty and to this end they work with sponsors to provide child sponsorship and child development programs. Through the child sponsorship programs, they are able to offer to children a long term and holistic support system, this means supporting a child from prenatal care all the way through leadership development for qualified young adults. The
organization began its operations in Kenya in 1980 and has more than 95,400 children enrolled in their programs that are in more than 355 child development centers (Compassion International, 2018).

1.2 Statement of the Problem
NGOs face foreign exchange risk exposures when they receive donor funds in foreign currency and implement their activities in local currency. Featherston, Littlefield and Mwangi (2006) looked at foreign exchange risk in microfinance institutions which take on loans in a foreign currency and then loan it out in a domestic currency. They analyzed different strategies available to the microfinance institutions to mitigate the impacts of the foreign exchange risk and noted that rating agencies need to include foreign exchange risk in the analysis of the creditworthiness of these institutions.

Direct Impact Group (2016) also noted the increasing importance of managing currency fluctuations in order to maximize the impact of donations to NGOs. The research was a self-assessment on the level of current skill by the NGO to manage foreign exchange risk. The results of the study showed an average score of 3.3 out of 10. The major challenges that the respondents said they face was high the cost of managing foreign exchange risk, slow processing time, slow response time, a high number of required documentation and low availability of mitigation measures. Further, while many of the NGOs knew about foreign exchange mitigation measures such as the spot rate, adoption rate was low and a majority of them had not implemented any strategy to manage foreign exchange risk.

According to Nzioka and Maseki (2017), foreign exchange risk has an effect on the financial performance on the non-banking companies listed in the Nairobi Securities Exchange. Their study used a regression model and found out that hedging, in terms of internal hedging, external hedging and interest rate, all had an effect on a firm’s performance. This is a very significant finding because analysis in the study showed that the study’s variables accounted for 75.5% of variance in performance compared to 24.5% contributed by variables not included in the research. This study shows that foreign exchange risk also affects firms outside the banking sector in Kenya.

The importance of prudent management of foreign exchange risk in Kenyan firms was further argued by Kiio and Ambrose (2017). The study adopted the use of return on
invested capital (ROIC) and return on assets (ROA) to assess the performance on firms listed in the Nairobi Securities Exchange and how they are affected by financial risk hedging practices. The study found a positive relationship between these two sets of variables. The researchers further pointed out that in 2015, two Kenyan companies, Kenya Airways and Uchumi Supermarkets, reported 25.7 billion shillings and 262.3 million shillings’ losses respectively because of not using proper hedging practices.

Okumu (2014) carried out research on the effect of exchange rate volatility on budget variance of international refugee NGOs in Kenya. He noted that many NGOs receive a substantial portion of the funds in foreign currency and carry out their activities in local currency, and that the problem is high in Kenya because of the regular fluctuation on the exchange rate. The model used in the study was variance analysis and multiple regression. This showed that there was a positive correlation of exchange rate to budget variance, meaning that exchange rate variations led to budget variations. He noted that there was need to share information on exchange rate fluctuation so as to assist in better financial planning.

While the above studies have shown the impact of foreign exchange risk on both international and local organizations in the financial and non-financial sectors, not many studies have been carried out on the NGO sector. Informed with this knowledge gap, this study sought to investigate the effects of foreign exchange risk exposures on the performance on NGOs with a focus on Compassion International Kenya.

1.3 General Objective
The general objective of this study was to determine the effect of the foreign exchange risk exposures on the performance of Compassion International Kenya.

1.4 Specific Objectives
1.4.1 To determine the types of foreign exchange risk exposures facing Compassion International Kenya.
1.4.2 To determine the effect of the foreign exchange risk exposures on the performance of Compassion International Kenya.
1.4.3 To determine the options available to manage foreign exchange risks in Compassion International Kenya.
1.5 Importance of the Study
This study has various benefits. This study brings new insights to the government and other stakeholders, financial investors, researchers and academicians.

1.5.1 Government and Stakeholders
This study documents the problem of limited understanding on the extent and impact of foreign exchange risk exposures in non-profit organizations in Kenya. The study findings would contribute to policy formulation to govern the management of foreign exchange rate fluctuations in projects funded by foreign currency through foreign aid, non-governmental institutions and/or private organizations.

1.5.2 Financials Investors
This study will benefit entrepreneurs and researchers considering funding from the international donor community. It will enable them run their projects well in terms of the management of the foreign exchange risk exposures. It will equip them with information on to employ available methods of averting the effects of the foreign exchange risk exposures.

1.5.3 Researchers and Academicians
The findings from this study aim to add value to the existing academic literature and empirical research on the field of foreign exchange management in Kenya where little is known about foreign exchange risk exposures as pertains to NGO’s. It will add to existing literature, research findings on the types of foreign exchange risk exposures that affect NGO’s, the measurement of performance of NGO’s and the Options available for the mitigation of foreign exchange risks.

The study findings will provide direction for further research in topics relating to foreign exchange risk exposure in not for profit organizations and governmental organizations, an area that has not been extensively researched in the recent past.
1.6 Scope of the Study
The scope of this study was limited to the effect of the foreign exchange risk on the performance of Compassion International Kenya. The study focused on the effect of transaction exposure, economic exposure and translation exposure. In total there are 78 employees in Compassion International Nairobi Kenya. The study respondents were sampled out from these from various departments in the organization. The study was carried out in month of November in the year 2018.

1.7 Definition of Terms

1.7.1 Foreign Exchange Risk
Foreign exchange risk is the response of a firm’s financial position, or the balance sheet assets and liabilities that are denominated in local currency, or the firms’ incomes and expenses to unexpected changes in foreign exchange market (Hagelin & Pramborg, 2004).

1.7.2 Foreign Exchange Risk Exposure
Foreign Exchange risk exposure is defined as the contracted, projected or contingent cashflow whose impact and magnitude is uncertain at the moment and it depends on the worth of the exchange rates (Dumas, 1984).

1.7.3 Non-Profit Organization
A non-profit organization is a privately-owned establishment or a formation of volunteers or an association, that is registered either nationally or internationally for the benefit of the general public and for social development (Republic of Kenya, 2013).

1.7.4 Transaction Exposure
Transaction exposure is the risk faced by companies involved in international trading that currency exchange rates will change after the companies have already entered financial obligations (Black & Tarassova, 2010).

1.7.5 Economic Exposure
It is the effect of unexpected currency rate fluctuations on a company’s future cash flow, investments and earnings. The exposure is normally long term in nature and causes a
substantial impact the firm’s value. Economic exposure is also known as operating exposure (Black & Tarassova, 2010).

1.7.6 Translation exposure

It is the risk that a company's equities, assets, liabilities or income will suffer as a result of fluctuating foreign currency exchange rates. It occurs when a firm denominates part of the equities, assets and income in a foreign currency (Black & Tarassova, 2010).

1.7.7 Domestic Currency

It is legal tender issued by the monetary authority of a country. The domestic currency is the accepted form of money in the economy, but not necessarily the exclusive currency (CPA Australia Ltd, 2009).

1.7.8 Hedging

Hedging is the amount of the foreign currency financial transactions, which are forward contracting or the equivalent, required to render the future, real or domestic-currency market value of an exposed position statistically independent of unanticipated or unexpected, random variations in the future domestic purchasing powers of these foreign currencies (Dumas, 1984).

1.8 Chapter Summary

This chapter covered the background of the study, the scope of the study, the definitions of terms in relation to foreign exchange risks exposures facing NGOs. The general objective of this study was to determine the effect of the foreign exchange risk exposures on the performance of Compassion International Kenya. The next chapter is the literature review that examined the research objectives further, followed by Chapter three that detailed the research design and methodology employed in this study. Chapter four documented the results and findings. The conclusion and recommendations are found in Chapter five of this study.
CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

This chapter presents revie

of the effects of foreign exchange risks exposures on the performance of donor funded nonprofit organizations. The chapter is focused on the specific research objectives which includes; to determine the types of foreign exchange risk exposures, to determine the effect of the foreign exchange risk exposures on the performance, and to determine the options available to manage foreign exchange risks in Compassion International Kenya. Lastly the chapter provides the summary of the literature review.

2.2 Types of Foreign Exchange Risk Exposures

Foreign exchange risk exposure is one of the major issues in international financial literature; Foreign exchange movements affect both the cash flow of an organization’s operations as well as the discount rate used to value these cash flows, this is what results to foreign exchange risk exposures. Foreign exchange rates are an important source of macroeconomic uncertainty that influence the performance and the value of the firm in an international context. There have been huge currency fluctuations that have been experienced in the past recent years causing foreign exchange risks across the economy. These currency fluctuations have raised concern on the possible effects on the performance of funds held by international organizations. This is what is known as foreign exchange risk exposures (Muller & Verschoor, 2006).

According to Chang, Hsin and Shiah-Hou (2013), found that organizations are exposed to various foreign exchange risks in their day to day operations. Unexpected or even anticipated fluctuations in foreign exchange rates will affect a firm’s financial performance and present different foreign exchange risk exposures to a firm. This argument was applied theoretically on different organizations including multinationals, exporters and importers, as well as purely domestic companies. However, their empirical studies only found limited success in discovering consistent and significant types of foreign exchange risk exposures on the value of the firms.

A study done by (Nyda

hl, 1999) clearly divided foreign exchange exposure into economic and accounting exposure. He defined Accounting exposure as being concerned
with the effect of exchange rate surprises on the accounting value of assets and liabilities. He defines Economic exposure for a firm measure as the extent to which a firm’s value, defined as the expected value of future cash flows, changes with the exchange rate.

### 2.2.1 Accounting Exposure

Foreign exchange accounting exposure can generally be divided into two major elements. The first element is the effect of exchange-rate randomness on the value of net monetary assets with fixed nominal payoffs. The second element is on the value of real assets held by the firm. In addition to inflation uncertainty, short-term foreign monetary assets are, in general, fully exposed to exchange risk, whereas domestic monetary assets are not. This is usually known as the translation exposure. Real assets, however, will be affected in value by exchange-rate movements, whatever their location. Therefore, this applies to purely domestic firms, like utilities. They may be affected by exchange-rate movements through effects on aggregate demand or on the cost of traded inputs; domestic firms that sell goods competing with imports will also be exposed to exchange-rate movements (Aggarwal & Harper, 2010).

Hagelin and Pramborg (2004) carried out a research on the accounting exposures on organizations on Japanese organizations in different sectors. They documented that 25 percent of the firms experienced significant accounting exposure. According to this research, the extent to which a firm was exposed to foreign exchange risk was linked to the firm’s export ratio. This research also examined the relationship between foreign exchange exposure and variables that were assumed to reflect derivatives usage. The results showed that firms that were predicted to hedge had lower foreign exchange exposure, on average, than comparable sample firms (Hagelin & Pramborg, 2004).

### 2.2.2 Economic Exposure

Black and Tarassova (2010), described economic exposure as a type of foreign exchange risk caused by the effect of unexpected currency fluctuations on a company’s future cash flows and net assets. It is the exposure faced by a firm that holds its assets in a different currency from the domestic currency. Adler and Dumas (1984), defined economic exposure on foreign exchange rate movement as a regression coefficient of the real value of the firm on the exchange rate across states of nature. They proposed to measure economic exposure by the slope coefficient of a linear regression of the value of the firm
on the exchange rate. This is a much more general and relevant measure of exchange rate exposure than accounting measures, but also more complex. It is complex because it is difficult to identify all, or even a small part of, the individual components of economic exposure.

Bartram, Brown, and Minton, (2010) proposed a similar but simpler approach in their research to define economic exposure. In their approach, the economic exposure for a firm is equal to the slope coefficient from a regression of the change in the firm’s value as the dependent variable and changes in exchange rates as the repressor. This approach has been used in several empirical studies on economic exposures of foreign exchange on firms.

Adler and Dumas (2010) in their later research pointed out that the concept of economic exposure is arbitrary in the sense that the financial performance of a firm and exchange rates are determined jointly. Breaking down the value of the firm into a component perfectly correlated with the exchange rate and an independent component does not imply a causal relationship between exchange rates and financial performance. This is simply a statistical breakdown to make it comparable to other studies done on the relationship between the value of an asset and inflation rates, interest rates, and, for that matter, market movements.

### 2.2.3 Transaction Exposure

Pramborg, (2004) defined transaction exposure as the effect of unexpected changes in the exchange rate used to convert a firms’ non-monetary assets and liabilities. The transaction exposure was found to occur over longer periods of time and is best managed by use of operational hedges. He further defined transaction exposure to currency risk as the potential change in the value of future cash flows as a cause of unexpected currency fluctuations, this is in relation to the liquidity of the firm. If competently executed, transaction exposure hedges should reduce the variability of cash flows and consequently the variability of a firms’ value (Pramborg, 2004).

Brown, (2001) in his research notes that transaction exposure is typically hedged in a very mechanical fashion. Economic exposures become transaction exposures this is usually within the period the transactions are done, forward contracts or spot transactions are used.
to hedge the full, anticipated amount of foreign currency. Consequently, the subsequent analysis, as well as the impact of the foreign exchange group, derives mainly from the management of economic exposures.

The impact of exchange rate changes on a firm’s competitive position is best managed by use of operational hedging. Hedging should be done by firms that wish to stand out from similar firms as this will affect other decisions such as the workshop and activity costs for nonprofit organizations, the fundraising strategies, the location for activities and their treasury management (Pantzalis, Simkins, & Laux, 2001). In their study, it was also noted that the use of derivatives does not do away with the risk entirely if the amount of foreign cash flows expected by the firm is uncertain and not perfectly correlated with the exchange rates. The solution herein is for the firms to make adjustments in their operations such as moving activities to countries or locations where revenue will be mainly received in local currency. The impact of unexpected changes in exchange rate of the domestic currency in this case will offset (Pantzalis, Simkins, & Laux, 2001).

2.2.4 Foreign Exchange Risk Exposures and Financial Performance

Firms who transact in foreign currencies in the course of carrying out their businesses inevitably get exposure to foreign exchange rate risk. Firms are increasingly operating across borders; exporting and importing raw materials and finished goods, employing foreign capital, people and processes and controlling their resources globally—thus the importance of currency fluctuations. Exchange rate risk can be broadly defined as the risk that a company’s financial performance will be affected by exchange rate movements. Measuring and managing exchange rate risk exposure is critical in reducing a firm’s vulnerability from major exchange rate movements, which could adversely affect profit margins and the value of net assets (Aggarwal & Harper 2010).

Eiteman, Stonehill and Moffert (2010), noted that important task of the financial manager is to measure foreign exchange exposure and to manage it so as to maximize the profitability, cash flows, and market value of the firm. These three components, profits, cash flows and market value – are the key financial elements of how the relative success or failure of a firm is viewed. The reported earnings of any publicly traded company are fundamental to the market’s opinion of that company (Copeland, Weston, & Shastri, 2005). Since these transactions are in the future and the price is not set, it is changes in the real exchange rates (relative competitiveness) that generate the gains or losses in
future cash flows. The effects of operating exposure are more important for the financial position of the firm than the effects of transaction exposure. However, unlike transaction exposure, which is easily identified (directly from looking at the transaction contracts), operating exposure is somewhat subjective: it depends on assessing the impact of exchange-rate changes on transactions into which the firm has not yet entered. To determine operating exposure, it is necessary to measure the change in the expected future cash flows of the firm in response to changes in the exchange rate (Irene, 2011).

A firm’s operating exposure, according to Pringle and Connolly (2013), is determined by the structure of the markets in which the firm sources its inputs such as labor and materials, and sells its products, and the firm’s ability to mitigate the effect of exchange rates by adjusting its markets, product mix, and sourcing. Since prices have not been set for future transactions, operating exposure depends not on changes in nominal exchange rates, but on changes in real exchange rates. As with transaction exposure, operating exposure should only be a function of unexpected changes in the real exchange rate as expected changes should be incorporated into current expectations about future firm’s performance. However, under relative PPP the expected change in the real exchange rate is zero. Under absolute PPP, the change in the exchange rate is determined by its movement back toward the assumed equilibrium. Unless there is large sudden devaluation, this typically happens slowly. However, to the extent that deviations from PPP are expected to cause real exchange rate changes over the medium term, the firm should incorporate these expectations into its pricing, production, and location decisions and should be prepared for such movements (Pringle & Connolly, 2013).

2.3 Foreign Exchange Risk Exposures and Performance

2.3.1 Foreign Exchange Risk Exposures

As defined by Eiteman, Stonehill, and Moffett, (2010), foreign exchange exposure is a measure of the potential for a firm’s profitability, net cash flows and market value to change because of a change in exchange rates. An important task of the financial manager is to measure foreign exchange exposure and to manage it to maximize the profitability, cash flows, and market value of the firm. These three components, profits, cash flows and market value are the key financial elements of how the relative success or failure of a firm is viewed. The reported earnings of any publicly traded company are fundamental to the market’s opinion of that company (Copeland, Weston, & Shastri, 2005). Formally,
operating exposure can be defined as „the extent to which the firm’s operating cash flows would be affected by random changes in exchange rates (Eun, & Resnick, 2010). Since these transactions are in the future and the price is not set, it is changes in the real exchange rates (relative competitiveness) that generate the gains or losses in future cash flows.

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2.3.2 Exchange Rate Volatility
The impact of exchange rate movement to the international Non-Governmental organizations affects the cash flow, cost of project implementation and reporting since they are not profit-making organizations. In order to minimize the possibility of financial loss, it is therefore essential that corporations with foreign exchange exposures identify measure and manage their risk effectively (Adler & Dumas, 2010). Managing foreign exchange risk is a fundamental component in the safe and sound management of all firms or institutions that have exposures in foreign currencies. It involves prudently managing foreign currency positions in order to control, within set parameters, the impact of exchange rate on the financial positions of the institution (Adler and Dumas, 2010). It is a unique complication of financial management that exposes the organization to risk in three different areas of operation.
Transaction or Contractual risk. It is basically cash flow risk and deals with the effect of exchange rate movement on transactional account exposure related to receivables, payables or repatriation of dividends. The risk that the local currency value of foreign currency receipts will fall or that the local value of foreign currency payments will rise between the fixing of a contract and the date of payment or receipt. An exchange rate change in the currency of denomination of any such contract will result in a direct transaction exchange rate risk to the firm. Transaction exposure exists when the future cash transactions of a firm or individual are affected by exchange rate fluctuations. It arises out of transactions exposures which entails gains and losses that arise from settlements of transactions whose terms are stated in foreign currency (Brass, 2012).

Translation or Accounting risk. The concept of accounting exposures arises from the need to translate accounts that are denominated in foreign currencies into the home currency of the reporting entity in accordance with appropriate accounting principles. The translation risk is a multinational company’s concern and its consideration may be irrelevant to many locally incorporated companies (Eun, & Resnick, 2010). It considers the sensitivity of company value to fluctuations in foreign exchange rate. It’s arises where a firm has foreign affiliates and keeping books in the respective local currency but for the purpose or reporting and consolidating the accounts it must translate its accounts to the donor contact currency or parent organization currency.

Economic risk. It represents any impact of exchange rate fluctuations on the firm’s future cash flows. It is the possibility that the parent currency denominated net present value of cash flows will adversely be affected by exchange rate movements. Unlike the transaction exposure, economic exposure is long term in approach and does not only focus on hedging their currency payables or receivables but also determines how all the cash flows of a firm will be affected by possible exchange rate movement. Economic exposure management should aim at neutralizing the impact of unexpected exchange rates changes on net cash flows between the cost and revenue side (Lewis, 2014).

2.3.3 Monthly revaluations of monetary assets
At the end of each month most Non-for-profit organization revalue all the assets denominated in currencies other than the operational currency. This generates exchange gains or losses depending on the direction of the differences between the organization's reporting rate and the rate of exchange at the end of the month closing (UNHCR 2005).
2.3.4 Currency conversions

Currencies in which contributions to international NGOs are presently received and held differ from the currencies in which a large portion of expenditures are incurred. Because of their multi-currency operational environment, they must convert one currency to another to another to fund operating expenditure which exposes them to gains and losses that arise from fluctuations in their applicable operational rate of exchange following the actual fluctuation in international monetary rates. It is not possible to eliminate all gains and losses that arise from foreign exchange rate changes between the functional currency and the currency of assets/liabilities (UNHCR 2005).

A study conducted by Helhel, (2015), investigated foreign exchange rate risk exposure of 37 manufacturing firms traded in Istanbul Stock Exchange in Turkey during the period of 2005-2014 by using regression model. Unlike previous studies, the relationship has been conducted by regressing ratio of return on capital employed instead of stock returns of firms against both contemporaneous and lagged exchange-rate changes. The findings show that analyzed firms exposed to exchange-rate fluctuations can be explained by the level of its export ratio and size of assets. The firms with high level of export ratio and large size of assets tend to have less exposure. The evidence also indicates that age of firm is not determining factor for exchange exposure.

According to a study by Gacheru (2012), on the effect of budgetary process on budget variances in NGOs in Kenya sought to determine the relationship between budgeting process and budget variances in Kenyan NGOs. Based on the population of 6,075 she used a sample of 20 to collect data and descriptive data analysis and concluded that budget preparation, control and implementation significantly influence budget variance.

According to a study by Bett, (2013), on the Impact of Exchange rate on diaspora remittance in Kenya. The objective of the study was to investigate the effect of exchange rate on Kenya diaspora remittance. The population of the study was based on the average monthly exchange rates, Diaspora remittances, inflation rates and interest rates between January 2005 and December 2012 using data from CBK and KNBS. The findings were exchange rates have an impact on the amount of remittances received in Kenya at a particular point in time. It demonstrated that at a higher level of exchange rate more
money is remitted into Kenya and when the Kenya shillings strengthens against US Dollar less money ten to be remitted into Kenya.

The role of foreign exchange risk management on performance management of exporting firms in developing countries relating to attributes i.e currency risk assessment and currency risk management strategies and the indicators of performance profitability and sales growth) were constructed. The findings indicate a moderate applicability level of foreign exchange risk management, low level of financial performance and a significant positive relation between foreign exchange risk management and performance of exporting firms (Adler & Dumas, 1984).

2.3.5 Exchange Rate Exposure and Financial Performance
Determinants and level of exposure to changing exchange rates for corporations because of the implications for business activity of FX risk and the difficulty in predicting fluctuations in foreign exchange markets. Empirical research indicates that volatile exchange rates affect the revenue and profits of both multinational and local corporations (Muller & Verschoor, 2006). Because of the prevalence of outsourcing activities to foreign countries, corporations incur costs in foreign currency (e.g., wages, taxes and material) and it is important for corporate financial managers to be aware of the extent of this exposure. Furthermore, corporations not involved in foreign exchange trades or outsourcing activities are also exposed to the fluctuating exchange rates through competition with multinational organizations, foreign competitors, and macroeconomic conditions.

Local and multinational organizations find their income statements and business performance affected by fluctuating exchange rates, in spite of their having only indirect financial exposure (Pringle, & Connolly, 2013). A change in prices, the cost of final goods, the cost of raw material, labor costs or the costs of input or output and other substitute goods due to fluctuating exchange rates may have an adverse effect on the competitive position of a local or domestic firm with no international and foreign activities. Theory and empirical work in financial economics suggest that the exposure of a firm to changing exchange rates depends on the type of product and the nature of the competitive environment in which the firm operates. The general concept of exposure is
the level of impact on the net worth of a firm due to fluctuating exchange rates (El-Masry, 2006).

Dominguez and Tesar (2006) studied the connection between the exchange rate and the firm value. The exchange rate exposure of firms publicly listed was observed in 8 countries in both industrialized and emerging markets. The results indicated the link between exposure and other variables such as the size of the firm, its position in the multinational market, foreign trade and transaction, international assets, and ability to compete according to the industrial standard as indicated by an example of their regression where exposure was observed more in small firms compared to large and medium firms. Moreover, exposure was also observed in firms with international activity dependent on multinational status, international assets, and foreign sales holdings.

2.4 Options Available to Manage Foreign Exchange Risks

Foreign exchange risk can be managed in various ways. This section discusses techniques used for hedging against risk. Hedging can also be defined as all the actions taken to change the exposed positions of a company in one currency or in multiple currencies. According to Clark et al. (1993), hedging refers to the technique of making offsetting commitments in order to minimize the impact of unfavorable potential outcomes. The risk manager’s choice of the different types of hedging techniques may, however, be influenced by costs, taxes, effects on accounting conventions and regulation. The different types of hedging techniques are discussed hereafter.

2.4.1 Payments Netting

This system is used in international transactions by multinational companies and involves reducing fund transfers between affiliates to only a netted amount. It requires the firm to have a centralized organization of its cash management. There are basically two forms of payments netting. These include bilateral and multilateral netting. Bilateral netting involves the transfer of a netted amount between two affiliates. Bilateral payment is valuable only to the extent that subsidiaries sell back and forth to each other (Shapiro, 1978). Multilateral netting involves the transfer of a netted amount among three or more affiliates. The use of payments netting reduces the physical flow of funds from one subsidiary to another. As a result, measurable costs such as the cost of purchasing foreign exchange, the opportunity cost of the float (time in transit) and other transaction costs are
minimized or eliminated. Netting systems are set up to reduce the costs associated with inter-affiliate cash transfers that result from business transactions. The payoff from multilateral netting systems can be large relative to their expense (Shapiro, 2002).

2.4.2 Prepayments
This method of payment requires an importer to pay the exporter in full before shipment is made (Hill, 2001). Payment is usually made in the form of international wire transfer to the exporter’s bank account or foreign bank draft. This method affords the supplier the greatest degree of protection and it is normally requested of first-time buyers whose credit worthiness is unknown or whose countries are in financial difficulty. If currency is thought to appreciate, then prepaying enables the company to pay at a lower rate. If the future rate finally depreciates, the firm is worse off than if it had done nothing. This method poses a big risk to the importer as he/she depends totally on the integrity of the exporter but offers the greatest protection for exporters because no credit extension is required. The primary disadvantage of prepayment is that it can limit the exporter’s sales potential (Dennis, 1993).

2.4.3 Leading and Lagging
A lead strategy involves attempting to collect foreign currency receivables early when a foreign currency is expected to depreciate and paying foreign currency payables before they are due when a currency is expected to appreciate. A lag strategy involves delaying collection of foreign currency receivables if that currency is expected to appreciate and delaying payables if the currency is expected to depreciate (Hill, 2001). Leading and lagging involves accelerating payments from weak-currency countries to strong-currency countries and delaying inflows from strong-currency to weak-currency countries. However, lead and lag strategies can be difficult to implement. The firm must be in the position to exercise some control over payment terms. Leading and lagging is a zero-sum game; that is, while one party benefits, the counterpart loses. Thus, the benefit gained from taking advantage of exchange rates may be outweighed by the cost of losing business due to the zero-sum nature of this method. The practice of leading and lagging has developed as one of many methods of hedging against adverse impacts of exchange rate movements. (Bradley & Moles, 2002)

2.4.4 Hedging with Derivatives
Hedging includes all acts aimed at reducing uncertainty about future (unknown) price movements in a commodity, financial security or foreign currency. Undertaking forward or futures sales or purchases of the commodity, security or currency can be done in over the counter (OTC) forward or in the organized futures market. As an alternative to speculation, many financial managers are turning to hedging strategies and using derivatives to reduce foreign currency risk. Previous studies have shown a widespread use of derivative products among Canadian, US and European firms in managing their risks including long-run exchange rate exposures. Hedging is also studied to discern the ideal strategy for hedging. Wang and Low (2003) provide one such strategy in which the best hedging strategy is given in terms of the relationship of other factors to the hedge (e.g., future of foreign currency denominated stock index, equity interdependence, futures, markets of foreign exchange). These factors play a vital role in designing the best strategies for hedging.

Companies adopt different methods to ‘pass through’ changes in exchange rates into foreign prices; as a result of their ‘exposure’ to exchange rates their profits have to be adjusted accordingly. As prices lead to a change in profitability, a company’s pass through and exposure should be related. Bodnar, Dumas and Marston (2002) demonstrate that pass through can have an effect on the exchange rate exposure because companies with inelastic demand can pass the changes in price on to the end user. The question of exchange rates affecting the price level is again a popular. This application is called exchange rate pass through because it informs how much of the exchange rate impact is passed through changes in the price. The technique of invoicing in the consumer’s currency results in higher profits, bigger output and lower prices as compared to billing in the exporter’s currency.

2.4.5 Forward and Futures Contracts
A forward contract involves a commitment to trade a specified item at a specified price at a future date. It is a contract made today for delivery of an asset at a pre-specified time in the future at a price agreed upon today. Forward contract involves an arrangement between two parties to exchange currencies or any other commodities at a future date and at a price determined today (Eun, & Resnick, 2010). The contract is based on a future price that is agreed in advance No money changes hands until the expiry time. Futures contract is a special type of contract with standardized delivery dates and sizes that would
allow trading on an exchange. A system of margin requirements is designed to protect both parties against default. Forward and futures contracts are relatively similar foreign exchange instruments. Both forwards and futures are agreements that bind two parties to exchange currencies at a fixed exchange rate at a future date. Essentially, both contracts offer the benefit of securing cash flows on imminent transactions (Ricci and Morrison, 1996).

There are, however, a number of significant differences that distinguish forwards from futures. Forward contracts are customized in terms of the amounts and maturities of currencies exchanged and are negotiated with commercial banks or other financial institutions. Conversely, futures contracts have standard lot sizes (which vary by currency), mature on a standard (quarterly) basis, and are executed by securities brokerage houses on an organized exchange. Moreover, futures contracts are traded for only seven major currencies versus the dollar (the Japanese yen, the German mark, the Canadian dollar, the Mexican peso, the British pound, the Swiss franc, and the Australian dollar) while forward contracts can be established for any currency (Ricci and Morrison, 1996). The difference in the usage level between forward and futures contracts may be explained by the flexibility of forward contracts, which can be tailored to meet customer needs, as opposed to futures contracts, which cannot. In addition, the costs associated with futures contracts tend to be significantly higher than those associated with forward contracts, both in terms of transaction costs and prepayments required (Pasmanter, 1993), resulting in negative benefit-cost analyzes.

2.4.6 Currency Options

A currency option gives the right, but not the obligation to buy or sell a specific currency at a specific price within a specific period of time. Giving the option the buyer or holder, the right but not the obligation, either to buy or sell a quantity of an item at fixed price, on or before a specified date in the future (El-Masry, 2006). While American options can be exercised in whole or in part at any time up to expiration, European options can be exercised only at expiration. Options provide a number of advantages. It is used to hedge against foreign exchange rate risk arising from import or export of goods. Secondly, it can be used to hedge against exchange rate fluctuations arising from foreign investments or funding in any currency. Finally, options offer a very high degree of gearing or leverage, which makes them attractive for speculative purposes too (Cowdell, 1993).
2.4.7 Currency Swaps

A typical currency swap is an agreement between two parties to exchange two currencies at the spot or current exchange rate, with the agreement that they will reverse the exchange rate that prevailed at the time of the initial exchange (Tygerson, 1993). Currency swaps require the party receiving the currency with a higher interest rate in that country’s currency to pay the interest to the counter party at a rate that represents the interest rate differential between the two countries. Currency swaps provide an opportunity for customers to balance currency resources in situations where there are excess funds in one currency and shortage of funds in another (Evans and Malhotra, 1994). Madura and McCarty (1989) indicate that currency swaps may be too sophisticated to most companies and require extensive documentation.

2.4.8 Diversification

According to Aggarwal and Harper, (2010), diversification is an important strategy to react against exchange rate changes, which affect the performance of many firms. Many companies such as Japanese auto producers are now seeking flexibility in production location, in part to be able to respond to large and persistent exchange rate changes that make production much cheaper in one location than another. Some of the diversification policies include; shifting of markets for output, shifting sources of supply, shifting product lines and production facilities as a defensive reaction to adverse exchange rate changes.

2.5 Chapter Summary

This chapter looked at review of literature regarding the research specific objectives. It covered the theoretical basis of the research and the literature review of the three specific objectives of the research: which are; types of foreign exchange risk exposures, the measures of performance in NGOs, and the options for management of foreign exchange risk. The next chapter looks at the research methodologies that will be used to carry out the research for the project and the research procedures that were used to carry out the study.
CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction
This chapter describes data and techniques that was used in carrying out this study. The section provides specific account on the research methodology which includes; the research design that was used in the study, the details of the target population, how the reliability and validity of the study was ascertained, piloting, the research process used and how the data analysis was carried out and lastly the chapter summary.

3.2 Research Design
According to Cooper and Schindler (2003), research design is the blueprint for collection, measurement and analysis of data. Saunders, and Lewis (2012) defined research design as the plan and structure of investigation conceived so as to obtain answers to research questions. This study adopted a descriptive cross-sectional design with a case study. Data was collected using mixed methods. According to Saunders, and Lewis (2012), descriptive studies are concerned with descriptions of phenomenon or characteristics associated with a subject population. In this regard, the study focused on describing the phenomena or characteristics associated with this subject matter which is the effect of foreign exchange risk exposure on performance of donor funded NGOs. This also entails estimates of the proportion of the population with these characteristics and discovery of associations among the relevant variables. The independent variable of this study is foreign exchange risk exposure while the dependent variable is performance of the NGOs.

Further, this study adopted a cross-sectional design. A cross-sectional design is one which analyses data as collected from a single point of time (Cooper & Schindler, 2003). This study collected data from the population of Compassion International Kenya employees to assess the relationships between variables of the study. The collection of data was at a single point in time. The study used mixed methods. In this regard, the study collected both qualitative and quantitative data and analyzed them. The qualitative data allowed for the study to collect and analyze data and to explain further the relationships of the variables beyond what was captured by the research tool (Collins & Hussey, 2009). In terms of quantitative data, the study collected data on the financials of Compassion

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International Kenya to allow for the computation of financial ratios and financial performance statistics, and also the opinions of the respondents were quantified using a 5-point Likert scale to allow for statistical analysis.

Lastly, the study adopted a case study research design. This is because data was only collected from one organization, which is Compassion International Kenya. A case study is appropriate because case studies are able to provide rich details in data and also capture complexities in real data (Mugenda & Mugenda, 2009).

3.3 Population and Sampling Design

3.3.1 Population

Cooper and Schindler (2003) defined population as the whole set of objects or events under investigation. In this study, the population was the employees of Compassion International Kenya. A list of the employees was sourced from the Human Resource department and it formed the population of the study. The NGO has 78 members of staff. The population is as shown in Table 3.1. The NGO has two departments of administration and program. The administration is made up of 8 staff members and this is 10.2% of the total staff, while the program department is made up of 70 staff members who form 89.8% of staff. The ratio of male to female is about 60/40.

Table 3.1: Population Distribution

<table>
<thead>
<tr>
<th>Department</th>
<th>Number</th>
<th>Percentage (%)</th>
<th>Gender</th>
<th>Number</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Administration staff</td>
<td>8</td>
<td>10.20%</td>
<td>Male</td>
<td>3</td>
<td>37.50%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Female</td>
<td>5</td>
<td>62.50%</td>
</tr>
<tr>
<td>Program staff</td>
<td>70</td>
<td>89.80%</td>
<td>Male</td>
<td>28</td>
<td>40.00%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Female</td>
<td>42</td>
<td>60.00%</td>
</tr>
<tr>
<td>Total</td>
<td>78</td>
<td>100%</td>
<td></td>
<td>78</td>
<td></td>
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</table>

Where the population is large, sampling is preferred to save on time and cost of data collection since a well-structured sample can adequately represent the whole population. However, for this study, a population of 78 respondents was adequately small to warrant a census, where data was then collected from all the members of the population.
3.3.2 Sampling Design

3.3.2.1 Sampling Frame
A research sampling frame is that part of the research plan that indicates how cases are to be selected for observation. The design therefore maps out the procedure to be followed to draw the study’s sample. A sampling frame is a list of elements from which the sample is actually drawn and is closely related to the population under study (Cooper & Schindler, 2003). In this study, the sampling frame constituted employees of Compassion International Kenya.

3.3.2.2 Sampling Techniques
This study adopted probability sampling technique which is census sampling technique and the use of stratified random sampling approach. Stratified random sampling is sampling involved in dividing the population into smaller sections called strata and within each stratum sample elements were selected on a random basis.

3.3.2.3 Sampling Size
The sample size is a smaller set of the larger population (Cooper & Schindler, 2003). Mugenda and Mugenda (2003) argues that the sample must be carefully selected to be representative of the population and that there need for the researcher to ensure that the subdivisions entailed in the analysis are accurately catered for. For this study a census was adopted in which all the employees were sampled out to participate in the study. The sample size for this study was 78 employees from Compassion International Kenya as indicated in the Table 3.2 below.

Table 3.2: Sample Size Distribution

<table>
<thead>
<tr>
<th>Department</th>
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<th>Percentage (%)</th>
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<tr>
<td>Total</td>
<td>78</td>
<td>100%</td>
<td></td>
<td>78</td>
<td></td>
</tr>
</tbody>
</table>
3.4 Data Collection Methods
Primary data was collected using a structured questionnaire. The questionnaire had close-ended questions. The questions were divided into four parts and were administered by way of talking to the various respondents and requesting them to fill it out. Part I comprised general questions relating to the profile of the organization and the demographics of the respondent. Part II comprised questions relating to types of foreign risk exposures. Part III had questions relating to performance of Compassion International Kenya. Part IV had questions relating to foreign exchange risk management.

A Likert scale of 1 to 5 was used to measure the extent to which the various respondents agrees or disagrees with the issues raised. The choice for Likert scale is advised by the fact that it is a psychometric scale commonly used in questionnaires and is the most widely used scale in survey research. Secondly, it allows respondents specify their level of agreement or disagreement to a statement. Hence, the advantage this tool adds is that it measures respondents’ perceptions on two fronts, that is positive and negative and again it is by design drawn from psychological dimensions, thus affirming to be the best tool to measure respondent’s perception about issues raised in the research instrument.

3.5 Research Procedures
The research process started with the development of the research proposal. After the approved by the supervisor, data collection started by obtaining an introduction letter from USIU and a letter from the senior management of Compassion International Kenya to permit data to be collected from their staff members. After this, research assistants were recruited and trained on ethical considerations, the research process, the procedure of administering the questionnaire and how to record data. After this, a pilot of the study was carried out.

After formulation of clear questionnaires and training of research assistants, it is always advisable to do a pilot test to see if it is obtaining the results you require, by asking people to read it through to see if there are any ambiguities, which one would not have noticed (Kumar, 2010). A pilot study of this research was done with 5 respondents. The research assistants collected data from the respondents and the researcher then asked the respondents to rate the research instrument and the process. This information was used to refine the research instrument by removing and amending ambiguous questions and also including relevant questions which were not captured.
According to Mugenda and Mugenda (2009), validity of a research instrument is the ability of it to produce accurate and meaningful research results. Another definition is the ability of the research analysis of the data to fully represent the research variables. Content validity was achieved through literature review of related studies while face validity was achieved through incorporating the comments of key informants and subject experts.

The reliability of a research instrument is the ability of that instrument to give consistent results each time the instrument is administered (Mugenda and Mugenda, 2009). A good research instrument should be able to give results which are stable and repeatable each time the instrument is administered. To measure this, a Cronbach alpha is used to test internal consistency. A standard minimum value of alpha of 0.7 is recommended. The researcher used the Statistical Package for the Social Science (SPSS version 21) software to check if the responses to the questions as measured using the 5-point Likert scale were reliable. This study had an alpha of 0.79 which is within acceptable limits of reliability.

3.6 Data Analysis Methods

The research data was coded and analyzed using Statistical Package for the Social Science (SPSS Version 24.0) and Microsoft excel software. Descriptive summaries was used to analyze the results and answer the research questions. Owing to the perceived research quality intended in this study, both qualitative and quantitative methods of data analysis were used. The reason for the utilization of the two methodologies is that the qualitative methods was used to explore the perceptions that the various results give, based on the questionnaires used, while the quantitative methods were used to determine the extent and frequency of the perceptions as well as the relationship between variables. Key among the quantitative tools that were employed are descriptive statistics, which included measures of central tendencies such as frequencies, means, standard deviation and percentages. These tools of analysis were used for instance to determine views of commonality and deviations from commonality. The following regression model was used to test the relationship between the variables.

\[ Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + e \]

Where
\[ Y = \text{is the performance of the NGO} \]
\[ \beta_0 = \text{is the constant/y intercept} \]
\[ X_1 = \text{is the type of foreign exchange risk exposure} \]
\[ X_2 = \text{is the options of foreign exchange risk exposure management} \]
\[ e = \text{is the error term} \]

### 3.7 Chapter Summary

This chapter described the research methodology and procedures that was used to carry out the study. It covered the research design, the population and census design used in the study, the data collection instrument, the research procedure, the pilot study and the data analysis methods. The next chapter presents the results and findings of this study according to the study objectives.
CHAPTER FOUR

4.0 RESULTS AND FINDINGS

4.1 Introduction
This chapter presents the results and the findings of this project from the data which was collected and analyzed. The chapters seek to achieve the specific objectives of this study through empirical research, which are: to determine the types of foreign exchange risk exposures facing Compassion International Kenya, to determine the effect of the foreign exchange risk exposures on the performance of Compassion International Kenya, and, to determine the options available to manage foreign exchange risks in Compassion International Kenya.

4.1.1 Response Rate
This was a census research and therefore the researcher issued 78 questionnaires to all the employees of Compassion International Kenya. Only 56 were filled and returned giving a response rate of 66.67% as shown in Table 4.1. The response rate was adequate for the study.

Table 4.1: Response Rate

<table>
<thead>
<tr>
<th>Questionnaires</th>
<th>Number</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Filled and submitted back to researcher</td>
<td>52</td>
<td>66.67</td>
</tr>
<tr>
<td>Not filled</td>
<td>26</td>
<td>33.33</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>78</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

4.2 Demographic Information

4.2.1 Gender of Respondents
The study required the respondents to indicate their gender. This is shown in Figure 1. The study had 52 respondents, 35 of them were female which represents 67% while 17 were male which represented 33% of the total respondents. This corresponds which the gender distribution of the population where the ratio of male to female staff members of Compassion International Kenya was 40/60.
4.2.2 Age of Respondents
The respondents were required to indicate their age as shown in Table 3. Majority of the respondents at 48.1% were between 31-40 years, 26.9% were between 41-50 years, 17.3% were above 50 years while 7.7% were between 20-30 years.

<table>
<thead>
<tr>
<th>Age</th>
<th>Frequency</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>20-30 years</td>
<td>9</td>
<td>17.3</td>
</tr>
<tr>
<td>31-40 years</td>
<td>14</td>
<td>26.9</td>
</tr>
<tr>
<td>41-50 years</td>
<td>25</td>
<td>48.1</td>
</tr>
<tr>
<td>&gt;50 years</td>
<td>4</td>
<td>7.7</td>
</tr>
<tr>
<td>Total</td>
<td>52</td>
<td>100</td>
</tr>
</tbody>
</table>

4.2.3 Education Level
The respondents were asked to indicate their level of highest education qualification at shown in Table 4. 42.3% had certificate as their highest qualification, 21.2% had masters, 19.2% had university undergraduate, 9.6% had diploma while 7.7% had secondary certificate.
### Table 4.3: Education Level

<table>
<thead>
<tr>
<th>Education</th>
<th>Frequency</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Secondary</td>
<td>4</td>
<td>7.7</td>
</tr>
<tr>
<td>Certificate</td>
<td>22</td>
<td>42.3</td>
</tr>
<tr>
<td>Diploma</td>
<td>5</td>
<td>9.6</td>
</tr>
<tr>
<td>University undergraduate</td>
<td>10</td>
<td>19.2</td>
</tr>
<tr>
<td>Masters</td>
<td>11</td>
<td>21.2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>52</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

#### 4.2.4 Departments in the Organization

The study also found out about the departments there respondents worked in. The organization has two main departments, administration and program. Majority of the respondents were in programs department at 90.4% while only 9.4% of the respondents were in administration. This information is shown in Figure 4.3.

![Figure 4.2: Department in the Organization](image)

#### 4.2.5 Working Experience

The respondents of the study had worked for Compassion International Kenya for varying number of years as shown in Table 5. A majority of them, 44.2% had worked for 6-10 years, 19.2% had worked for less than 2 years, 13.5% had worked for 2-5 years, 11.5% had worked for 11-15 years and another 11.5% had also worked for more than 15 years.
Table 4.4: Working Experience in the Organization

<table>
<thead>
<tr>
<th>Years worked</th>
<th>Frequency</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 2 years</td>
<td>10</td>
<td>19.2</td>
</tr>
<tr>
<td>2-5 years</td>
<td>7</td>
<td>13.5</td>
</tr>
<tr>
<td>6-10 years</td>
<td>23</td>
<td>44.2</td>
</tr>
<tr>
<td>11-15 years</td>
<td>6</td>
<td>11.5</td>
</tr>
<tr>
<td>&gt;15 years</td>
<td>6</td>
<td>11.5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>52</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

4.3 Types of Foreign Exchange Risk Exposures

The first objective of the study was to determine the types of foreign exchange risk exposures facing Compassion International Kenya. From literature review, there are two types of foreign exchange risks, economic exposure and accounting exposure. The respondents were asked to rate their level of agreement that the organization was facing either of the foreign exchange risks. The responses were then analyzed for their mean and the standard deviation as shown in Table 4.5. The Table 4.5 shows that the response that Compassion International Kenya faces accounting exposure had a mean of 1.75 and standard deviation of 1.065, while Compassion International Kenya faces economic exposure had a mean of 1.5 and standard deviation of 0.632. This shows that more respondents agreed that the organization faced more risk in economic exposure compared to accounting exposure.

Table 4.5: Foreign Exchange Risk

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Compassion International Kenya faces economic exposure</td>
<td>1.500</td>
<td>0.632</td>
</tr>
<tr>
<td>Compassion International Kenya faces accounting exposure</td>
<td>1.750</td>
<td>1.065</td>
</tr>
</tbody>
</table>

4.3.1 Compassion International Kenya Faces Accounting Exposure

The respondents were asked to rate their level of agreement or disagreement to whether Compassion International Kenya faces accounting exposure. This was recorded using a 5-point Likert scale. This was analysed for the frequency and percentage of each response as shown in Table 4.6.
The Table 4.6 shows that 56.3% of the respondents strongly agreed that Compassion International Kenya faces accounting exposure, followed by 25% who agreed, 12.5% who disagreed and 6.3% who neither agreed nor disagreed. Therefore, it can be deduced that Compassion International Kenya faces accounting exposure. This means that the changes in foreign exchange rate have an effect on the accounting values of assets and liabilities held by Compassion International Kenya.

**Table 4.6: Accounting Exposure**

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strongly agree</td>
<td>29</td>
</tr>
<tr>
<td>Agree</td>
<td>13</td>
</tr>
<tr>
<td>Neither agree nor disagree</td>
<td>3</td>
</tr>
<tr>
<td>Disagree</td>
<td>7</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>52</strong></td>
</tr>
</tbody>
</table>

**4.3.2 Economic Exposure**

The respondents were asked to rate their level of agreement or disagreement to whether Compassion International Kenya faces economic exposure. This was analysed for the frequency and percentage of each response as shown in Table 4.7. The analysis in Table 7 shows that majority of the respondents at 55.8% Compassion International Kenya faces economic exposure risk. 26.9% agree while 17.3% strongly agree. This means that economic exposure risk is not a major form on foreign exchange risk exposure which the NGO faces. This type of exposure is faced with a firm which holds assets in a different value compared to its domestic currency and as such, this means that Compassion International Kenya holds mainly holds its assets in Kenya shillings.

**Table 4.7: Economic Exposure**

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strongly agree</td>
<td>9</td>
</tr>
<tr>
<td>Agree</td>
<td>14</td>
</tr>
<tr>
<td>Disagree</td>
<td>29</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>52</strong></td>
</tr>
</tbody>
</table>
4.4 Foreign Exchange Risk Exposures and Performance

4.4.1 Financial Ratio Analysis

The following Table 4.8 and Figure 4.3 shows the financial ratios of Compassion International Kenya. Current ratio, quick ratio and available funds ratios were calculated for 2017, 2016, 2015 and 2014. The current ratio for 2017 was 0.9613, for 2016 was 0.9587, for 2015 was 0.9760 and for 2014 was 0.9574. This shows a stable trend of keeping slightly more current liabilities than current assets indicating that the organization spends most of the cash and cash equivalents it received. The quick ratio also is generally stable between a high of 0.9613 and a low of 0.8954 between years 2017 and 2014. The available ratio is a more conservative analysis of liquidity. Literature indicates that it can be as low as 0.75. For this organization, the ratio is between a high of 0.6890 and a low of 0.4351. This ratio shows the most improvement from 2014 to 2017 indicating the organization’s made deliberate efforts to improve their cash position. The exchange rate rose from 2013 with a low of 86.67 to 2017 with a high of 104.76. With an increase in the foreign exchange there was a decrease in the available funds’ ratio showing an inverse relationship between the available funds and the foreign exchange.

<table>
<thead>
<tr>
<th>Ratios</th>
<th>2017</th>
<th>2016</th>
<th>2015</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Ratio</td>
<td>0.9613</td>
<td>0.9587</td>
<td>0.976</td>
<td>0.9574</td>
</tr>
<tr>
<td>Quick Ratio</td>
<td>0.9613</td>
<td>0.9643</td>
<td>0.922</td>
<td>0.8954</td>
</tr>
<tr>
<td>Available Funds Ratio</td>
<td>0.689</td>
<td>0.5388</td>
<td>0.4955</td>
<td>0.4351</td>
</tr>
</tbody>
</table>
Figure 4.3: Yearly Changes of Financial Ratios

Figure 4.4: Yearly Changes of the average exchange rate

4.4.2 Balanced Score Card

The balanced score card is a non-financial measure of an organization’s performance in relation to financial measures, customer satisfaction, internal process, and innovation and improvement. This study used a Likert scale to assess the level of agreement of the
respondents to the organization’s efforts to address the indicators in the balanced scorecard matrix. This analysis is shown in Table 4.9.

Table 4.9: Balanced Score Card

<table>
<thead>
<tr>
<th>Description</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Compassion International Kenya customers are happy with the level of service provision</td>
<td>1.56</td>
<td>0.512</td>
</tr>
<tr>
<td>Compassion International Kenya uses innovation and learning objectives to drive improvement in financial performance of the organization, customer relations, and internal process performance of the organization</td>
<td>1.69</td>
<td>0.704</td>
</tr>
<tr>
<td>Compassion International Kenya financial performance is good</td>
<td>1.75</td>
<td>0.683</td>
</tr>
<tr>
<td>All the organizational elements of Compassion International Kenya are effectively and efficiently interlinked and to work towards achieving the organizational goals</td>
<td>1.81</td>
<td>0.655</td>
</tr>
</tbody>
</table>

The variables for the study in Table 4.9 have been arranged starting from the most agreeable to the least agreeable in terms of the value of the means. Compassion International Kenya customers are happy with the level of service provision is the most agreeable with a mean of 1.56 and standard deviation of 0.512, followed by Compassion International Kenya uses innovation and learning objectives to drive improvement in financial performance of the organization, customer relations, and internal process performance of the organization with a mean of 1.69 and standard deviation of 0.704, followed by Compassion International Kenya financial performance is good with a mean of 1.75 and standard deviation of 0.683, and lastly is All the organizational elements of Compassion International Kenya are effectively and efficiently interlinked and to work towards achieving the organizational goals with a mean of 1.81 and standard deviation of 0.655.

4.5 Options Available to Manage Foreign Exchange Risks

The Table 4.10 shows the mean of the responses on management of foreign exchange risk using different methods. The methods have been arrange descending order, starting from the most agreeable method to the lease agreeable method. The results show that use of net payments was the most favored method, followed by prepayments, lending and lagging, hedging and derivatives, forward and future contracts, currency options and lastly currency swaps.
Table 4.10: Management of Foreign Exchange Risk

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>Standard Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Payments</td>
<td>1.25</td>
<td>0.447</td>
</tr>
<tr>
<td>Prepayments</td>
<td>2.44</td>
<td>1.548</td>
</tr>
<tr>
<td>Lending and Lagging</td>
<td>2.38</td>
<td>1.36</td>
</tr>
<tr>
<td>Hedging and Derivatives</td>
<td>2.38</td>
<td>1.088</td>
</tr>
<tr>
<td>Forward and Future Contracts</td>
<td>2.94</td>
<td>1.731</td>
</tr>
<tr>
<td>Currency Options</td>
<td>3.25</td>
<td>1.612</td>
</tr>
<tr>
<td>Currency Swaps</td>
<td>3.44</td>
<td>1.672</td>
</tr>
</tbody>
</table>

4.5.1 Net Payments

The responses on net payments were analysed and presented in Table 11. 75% of the respondents strongly agreed that foreign exchange risk in Compassion International Kenya can be managed using payments netting, while 25% agreed.

Table 4.11: Net Payments Responses

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strongly agree</td>
<td>39</td>
<td>75</td>
</tr>
<tr>
<td>Agree</td>
<td>13</td>
<td>25</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>52</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

4.5.2 Prepayments

In terms of using prepayments to manage foreign exchange risk, 38.5% of the respondents strongly agreed, 25% agreed, 19.2% strongly disagreed, 11.5% neither agreed nor disagreed, and 5.8% of them disagreed, as shown in Table 4.12.

Table 4.12: Prepayments

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strongly agree</td>
<td>20</td>
<td>38.5</td>
</tr>
<tr>
<td>Agree</td>
<td>13</td>
<td>25</td>
</tr>
<tr>
<td>Neither agree nor disagree</td>
<td>6</td>
<td>11.5</td>
</tr>
<tr>
<td>Disagree</td>
<td>3</td>
<td>5.8</td>
</tr>
<tr>
<td>Strongly disagree</td>
<td>10</td>
<td>19.2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>52</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>
4.5.3 Lending and Lagging
The Table 4.13 shows the results of lending and lagging. 62.4% of the respondents agreed that it can be used to manage foreign exchange risk, 18.8% strongly agreed and 18.8% strongly disagreed.

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strongly agree</td>
<td>10</td>
</tr>
<tr>
<td>Agree</td>
<td>32</td>
</tr>
<tr>
<td>Strongly disagree</td>
<td>10</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>52</strong></td>
</tr>
</tbody>
</table>

4.5.4 Hedging and Derivatives
The Table 4.14 shows the analysis of the respondents on the use of hedging and derivatives. 50% of the respondents strongly disagreed, 25% neither agreed nor disagreed, 12.5% agreed while 6.3% strongly agreed.

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strongly agree</td>
<td>3</td>
</tr>
<tr>
<td>Agree</td>
<td>7</td>
</tr>
<tr>
<td>Neither agree nor disagree</td>
<td>13</td>
</tr>
<tr>
<td>Disagree</td>
<td>3</td>
</tr>
<tr>
<td>Strongly disagree</td>
<td>26</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>52</strong></td>
</tr>
</tbody>
</table>

4.5.5 Forwards and Future Contracts
The Table 4.15 shows the analysis of use of forward and future contracts. 37.5% strongly disagreed, 31.3% agreed, 25% strongly agreed while 6.3% neither agreed nor disagreed that foreign exchange risk in Compassion International Kenya can be managed using forward and future contracts.
Table 4.15: Forward and Future Contracts

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strongly agree</td>
<td>13</td>
</tr>
<tr>
<td>Agree</td>
<td>16</td>
</tr>
<tr>
<td>Neither agree nor disagree</td>
<td>3</td>
</tr>
<tr>
<td>Strongly disagree</td>
<td>20</td>
</tr>
<tr>
<td>Total</td>
<td>52</td>
</tr>
</tbody>
</table>

4.5.6 Currency Options

The responses on whether Compassion International Kenya can use currency options to manage foreign risk were analyzed as shown in Table 4.16 below. Of the responses, 31.3% strongly disagreed, 25% of the responses agreed, 25% disagreed while 18.8% strongly agreed.

Table 4.16: Currency Options

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strongly agree</td>
<td>10</td>
</tr>
<tr>
<td>Agree</td>
<td>13</td>
</tr>
<tr>
<td>Disagree</td>
<td>13</td>
</tr>
<tr>
<td>Strongly disagree</td>
<td>16</td>
</tr>
<tr>
<td>Total</td>
<td>52</td>
</tr>
</tbody>
</table>

4.5.7 Currency Swaps

The Table 4.17 below shows the analysis of use of currency swaps. 43.8% strongly disagreed, 18.8% strongly agreed, 18.8% agreed 12.5% disagreed while 6.3% neither agreed nor disagreed that foreign exchange risk in Compassion International Kenya can be managed using currency swaps.
Table 4.17: Currency Swaps

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strongly agree</td>
<td>10</td>
</tr>
<tr>
<td>Agree</td>
<td>10</td>
</tr>
<tr>
<td>Neither agree nor disagree</td>
<td>3</td>
</tr>
<tr>
<td>Disagree</td>
<td>7</td>
</tr>
<tr>
<td>Strongly disagree</td>
<td>23</td>
</tr>
<tr>
<td>Total</td>
<td>16</td>
</tr>
</tbody>
</table>

4.6 Inferential Statistics

4.6.1 Regression Analysis

An analysis was done for the regression model to represent the relationship between the dependent variable which was performance of Compassion International Kenya, and the independent variables which were the type of foreign exchange risk exposure and the mitigation options for foreign risk exposure management. The results as shown in Table 18 shown an $R^2$ value of 0.445 which means at 44.5% of variations in performance of Compassion International Kenya can be explained by type of foreign exchange risk exposure and the mitigation options for management of foreign exchange risk exposure.

Table 4.18: Regression Summary

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error</th>
<th>Change Statistics</th>
<th>F</th>
<th>df1</th>
<th>df2</th>
<th>Sig. F</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>.834</td>
<td>.645</td>
<td>.632</td>
<td>.12212</td>
<td>.445</td>
<td>34.567</td>
<td>22</td>
<td>30</td>
<td>.000</td>
</tr>
</tbody>
</table>

a. Predictors: (constant), type of foreign exchange risk exposure, mitigation options for foreign risk exposure management
Table 4.19: Analysis of Variance (ANOVA)

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Regression</td>
<td>3.456</td>
<td>22</td>
<td>2.354</td>
<td>34.567</td>
<td>.000b</td>
</tr>
<tr>
<td>Residual</td>
<td>1.234</td>
<td>30</td>
<td>.034</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>4.690</td>
<td>52</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Dependent variable: performance of NGO  
b. Predictors: (constant), type of foreign exchange risk exposure, mitigation options for foreign risk exposure management

An ANOVA analysis above was conducted between performance of Compassion International Kenya, and the type of foreign exchange risk exposure and the mitigation options for foreign risk exposure management. The results are shown in Table 4.19 above. The F value was 34.57 and P-value was 0.00 at 95% confidence level, thus the values indicated in Table 18 are significant.

4.7 Chapter Summary

From the chapter analysis the results and the findings indicated a positive relationship between independent variables and dependent variable. The F-value indicated the variables under the study which were types of foreign exchange risk exposure and the mitigation options for foreign risk exposure management was significant. The next chapter five presents the summary, discussion, conclusions and recommendations of the study.
CHAPTER FIVE

5.0 DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction
This chapter presents the discussion, conclusions and recommendations. This will be arrived at through synthesis of the study’s results and the literature review. The recommendations will be in terms of the implications of the study on the knowledge of finance, especially for the NGO sector.

5.2 Summary
The general objective of this study was to determine the effect of the foreign exchange risk exposure on the performance of NGOs. It was a case study of Compassion International Kenya. NGOs are non-membership support organizations involved in relief, rehabilitation, or community development work in developed and, especially, developing or Third World countries. NGOs face several challenges in the operations. One of these challenges is the management of foreign exchange risk. NGOs which deal with multiple currencies face foreign exchange risk exposure. The study was guided by the following specific objectives; To determine the types of foreign exchange risk exposures facing Compassion International Kenya, to determine the effect of the foreign exchange risk exposures on the performance of Compassion International Kenya, and to determine the options available to manage foreign exchange risks in Compassion International Kenya.

The study adopted the use of adopted a descriptive cross-sectional design. The study focused on describing the phenomena associated with subject matter which is the effect of foreign exchange risk exposure on performance of donor funded NGOs. A list of the employees was sourced from the Human Resource department and it formed the population of the study which was a total of 78 members of staff. The sampling frame constituted employees of Compassion International Kenya and probability sampling technique which is census sampling technique and the use of stratified random sampling approach was adopted. The sample size for this study was 78 employees from Compassion International Kenya and the study used a structured questionnaire to collect data. The data was then analyzed and presented in form of tables, charts, accounting ratios and a regression model. Primary data was collected using a structured questionnaire. The research data was coded and analyzed using Statistical Package for the Social Science (SPSS Version 24.0) and Microsoft excel software. Quantitative tools that
were employed were descriptive statistics, which included measures of central tendencies such as frequencies, means, standard deviation and percentages.

The results on first objective of the study was to determine the types of foreign exchange risk exposures facing Compassion International Kenya. The results of the study showed that there are two types of foreign exchange risks that are accounting risk and economic exposure risk. Compassion International Kenya faces accounting exposure since majority of the respondents strongly agreed to the statement that Compassion International Kenya faces accounting exposure. This shows that the mitigation factors of operational hedging need to be used to address accounting exposure in NGOs.

The findings on second objective of the study was to determine the effect of the foreign exchange risk exposure on the performance of Compassion International Kenya. The study found out that the organization uses most of the funds it received, and therefore has a close to unitary current ratio, and between 2014-2017, the trend was to keep more cash. Also, the non-financial measures of performance were positive. Compassion International Kenya operates by spending all the funds it received. While this is acceptable, the organization should seek to retain more of it funds so as to be more liquid. The organization also focuses more on delivery of service to customers, and that the main areas of improvements should be financial performance and internal processes.

The findings on third specific objective which was to determine the options available to manage foreign exchange risks in Compassion International Kenya. The results of the study showed that most employees preferred the use of net payments, followed by prepayments, lending and lagging, hedging and derivatives, forward and future contracts, currency options and the least favored method was the use of currency swaps. The system is used in international transactions by multinational companies and involves reducing fund transfers between affiliates to only a netted amount. It requires the firm to have a centralized organization of its cash management.

5.3 Discussion

5.3.1 Types of Foreign Exchange Risk Exposures
According to Muller and Verschoor (2006), foreign exchange risk affects cash flows of many organizations and if the change is adverse, it can hinder the ability of the organizations to achieve their objectives. The types of foreign exchange risk exposures
that firms encounter is either accounting exposure, economic exposure or transaction exposure. The study used these three types of foreign exchange risk exposures to find out the type which Compassion International Kenya faces. According to Chang, Hsin and Shah-Hou (2013), asserts that organizations are exposed to various foreign exchange risks in their day to day operations. Unexpected or even anticipated fluctuations in foreign exchange rates will affect a firm’s financial performance and present different foreign exchange risk exposures to a firm. Many studies only found limited success in discovering consistent and significant types of foreign exchange risk exposures on the value of the firms.

In terms of accounting exposure, Hagelin and Pramborg (2004) carried out a research on the accounting exposures on organizations on Japanese organizations in different sectors. They documented that 25 percent of the firms experienced significant accounting exposure. According to this research, the extent to which a firm was exposed to foreign exchange risk was linked to the firm’s export ratio. The study examined the relationship between foreign exchange exposure and variables that were assumed to reflect derivatives usage. The results showed that firms that were predicted to hedge had lower foreign exchange exposure, on average, than comparable sample firms. The study found out that Compassion International Kenya faces accounting exposure since majority of the respondents strongly agreed to the statement that Compassion International Kenya faces accounting exposure. This shows that the mitigation factors of operational hedging need to be used to address accounting exposure in NGOs.

The study found out that Compassion International Kenya does not face economic exposure. Economic exposure is the exposure faced by a firm that hold its assets in a different currency from the domestic currency. Adler and Dumas (2010), defined economic exposure on foreign exchange rate movement as a regression coefficient of the real value of the firm on the exchange rate across states of nature. This could be because Compassion International Kenya holds mainly holds its assets in Kenya shillings and therefore the value of its assets is not affected in a major way by changes in the foreign exchange rate. Only 17.3% and 26.9% of the respondents strongly agreed and agreed respectively that Compassion International Kenya faces economic exposure, with 55.8% disagreeing. Adler and Dumas (2010) in their study pointed out that the concept of economic exposure is arbitrary in the sense that the financial performance of a firm and
exchange rates are determined jointly. Breaking down the value of the firm into a component perfectly correlated with the exchange rate and an independent component does not imply a causal relationship between exchange rates and financial performance. This is simply a statistical break-down to make it comparable to other studies done on the relationship between the value of an asset and inflation rates, interest rates, and, for that matter, market movements.

5.3.2 Foreign Exchange Risk Exposures and Performance

There are two major ways of measuring the performance of organizations, through use of financial parameters and the use of non-financial parameters. According to Chabotar (1989), a financial ratio is the relationship between two numbers drawn from the organization's balance sheet, operating statement, and related records. This study focused on three main financial ratios, current ratio, quick ratio and available funds ratio. Eiteman, Stonehill, and Moffett, (2010) noted that foreign exchange exposure is a measure of the potential for a firm’s profitability, net cash flows and market value to change because of a change in exchange rates. An important task of the financial manager is to measure foreign exchange exposure and to manage it so as to maximize the profitability, cash flows, and market value of the firm. These three components, profits, cash flows and market value are the key financial elements of how the relative success or failure of a firm is viewed.

For current ratio, the ratio was between 0.9760 and 0.9574 for the rears 2017-2014. This shows a stable current ratio where the amount of current assets is slightly lower than the current liabilities. Saleem and Rehman (2011) suggested that NGOs should have a ratio of 2:1 or 2.0, meaning that they should keep 2 of current assets for every 1 liability held. However, this is not the case in Compassion International Kenya. A high current ratio shows that the NGO is hoarding its funds as opposed to spending. Therefore, in the case of Compassion International Kenya, the organization spends all its funds received for its services.

The quick ratio was also generally stable between a high of 0.9613 and a low of 0.8954 between years 2017 and 2014. It therefore confirms the narration as shown by the current ratio, that Compassion International Kenya has fewer current assets compared to current liabilities. The quick ratio is a more accurate measure of liquidity compared to the current
ratio because it attempts to eliminate some of the disadvantages of the current ratio by focusing on liquid assets whose value is reasonably certain (Saleem & Rehman, 2011). According to literature review, the quick ratio is normally considered safe when it is 1.0. Therefore, while the current ratio is unfavorable to Compassion International Kenya, the quick ratio is favorable. This indicates that the current assets of Compassion International Kenya are more of cash, cash equivalents, receivables and inventory, and therefore the current ratio and the quick ratio are almost similar.

For the available fund’s ratio, this is an even more conservative liquidity measure than the available funds ratio which defines current assets only as being cash and market value of short-term investments, omitting entirely receivables and inventories and permitting the organization to identify its true cash position (Saleem & Rehman, 2011). Literature defines a available funds ratio of 0.75 being acceptable. For Compassion International Kenya, the ratio is between a high of 0.6890 and a low of 0.4351. This ratio shows the most improvement from 2014 to 2017 indicating the organization’s made deliberate efforts to improve their cash position. A study by Helhel, (2015), investigated foreign exchange rate risk exposure of manufacturing companies. The findings indicate that analyzed firms exposed to exchange-rate fluctuations can be explained by the level of its export ratio and size of assets. The firms with high level of export ratio and large size of assets tend to have less exposure.

5.3.3 Options Available to Manage Foreign Exchange Risks
There are several options available for hedging against foreign exchange risk in organizations. Hedging can also be defined as all the actions taken to change the exposed positions of a company in one currency or in multiple currencies. According to Clark et al. (1993), hedging refers to the technique of making offsetting commitments in order to minimize the impact of unfavorable potential outcomes. The risk manager’s choice of the different types of hedging techniques may, however, be influenced by costs, taxes, effects on accounting conventions and regulation.

The study found that the use of net payments was the most favored method. This system is used in international transactions by multinational companies and involves reducing fund transfers between affiliates to only a netted amount. It requires the firm to have a centralized organization of its cash management. There are basically two forms of payments netting. These include bilateral and multilateral netting. Bilateral netting
involves the transfer of a netted amount between two affiliates. Multilateral netting involves the transfer of a netted amount among three or more affiliates. The use of payments netting reduces the physical flow of funds from one subsidiary to another. As a result, measurable costs such as the cost of purchasing foreign exchange, the opportunity cost of the float (time in transit) and other transaction costs are minimized or eliminated. Netting systems are set up to reduce the costs associated with inter-affiliate cash transfers that result from business transactions. The payoff from multilateral netting systems can be large relative to their expense (Shapiro, 2002).

The next most favored method was prepayments, lending and lagging, hedging and derivatives, forward and future contracts, currency options and lastly currency swaps. Leading and lagging involves accelerating payments from weak-currency countries to strong-currency countries and delaying inflows from strong-currency to weak-currency countries. However, lead and lag strategies can be difficult to implement. The firm must be in the position to exercise some control over payment terms. This shows that the best strategy for the organization is to reduce payment of funds between itself and affiliates to a netted amount. Currency options and currency swaps are least favorable.

According to Hill, (2001), noted that payment is usually made in the form of international wire transfer to the exporter’s bank account or foreign bank draft. This method affords the supplier the greatest degree of protection and it is normally requested of first-time buyers whose credit worthiness is unknown or whose countries are in financial difficulty. If currency is thought to appreciate, then prepaying enables the company to pay at a lower rate. If the future rate finally depreciates, the firm is worse off than if it had done nothing.

The findings of the study also indicated that respondents on the use of hedging and derivatives strongly disagreed, that they do not use hedging and derivatives. This is contrary to previous studies that have shown a widespread use of derivative products among Canadian, US and European firms in managing their risks including long-run exchange rate exposures (Bradley & Moles, 2002). The use of hedging and derivatives is an alternative to speculation, many financial managers are turning to hedging strategies and using derivatives to reduce foreign currency risk.

5.4 Conclusions
5.4.1 Types of Foreign Exchange Risk Exposures
The study concludes on the first objective that the extent to which the organization is exposed to foreign exchange risk is linked to the firm’s export ratio. Compassion International Kenya faces accounting exposure since majority of the respondents strongly agreed to the statement that Compassion International Kenya faces accounting exposure. This shows that the mitigation factors of operational hedging need to be used to address accounting exposure in NGOs.

### 5.4.2 Foreign Exchange Risk Exposures and Performance

It can be concluded from the financial ratios that Compassion International Kenya operates by spending all the funds it received. While this is acceptable, the organization should seek to retain more of it funds so as to be more liquid. The organization also focuses more on delivery of service to customers, and that the main areas of improvements should be financial performance and internal processes.

### 5.4.3 Options Available to Manage Foreign Exchange Risks

The study concludes on the third objective that the use of net payments was the most favored method by Compassion International Kenya. This system is used in international transactions by multinational companies and involves reducing fund transfers between affiliates to only a netted amount. It requires the firm to have a centralized organization of its cash management. The use payments netting reduces the physical flow of funds from one subsidiary to another.

### 5.5 Recommendations

#### 5.5.1 Recommendations for Improvement

##### 5.5.1.1 Types of Foreign Exchange Risk Exposures

The first recommendation is that financial managers and other officers responsible for the financial well-being of NGOs should institute measures to mitigate against accounting risk and economic exposure risk. This is because these are the two main foreign exchange risk exposures which NGO’s face. This study found out that foreign exchange risk exposure has a negative effect on the performance of Compassion International Kenya and therefore it needs to be mitigated against.

##### 5.5.1.2 Foreign Exchange Risk Exposures and Performance

The study recommends that the financial managers should measure foreign exchange exposure and to manage it so as to maximize the profitability, cash flows, and market
value of the of Non-governmental organizations. Capacity building of the finance teams in NGOs on accounting risk and economic exposure risk exposures. Such capacity building will assist the teams come up with better planning methods with take into account the effect of the risk on the achievement of the organizational objectives.

5.5.1.3 Options Available to Manage Foreign Exchange Risks
The study recommends the use of net payments, followed by prepayments, lending and lagging, and hedging and derivatives to mitigate against foreign exchange risk exposure. The results of the study found these to be the most favored methods to manage foreign exchange risk exposure and this will help improve the performance of the organization and reduce exchange rate losses. In addition to capacity building on foreign exchange risk exposure, the finance teams in NGOs should be capacity built also on the most effective mitigation measures.

5.5.2 Recommendations for Further Studies
The study recommends further research on the effect of foreign exchange risk exposure on performance of NGOs where the study population will be larger. In this study, the population was limited to employees of Compassion International Kenya. A more detailed study that has the population as NGOs in Kenya will provide data that is more representative of the NGO sector in the country. Such a study will inform policy makers on measures that can be taken to mitigate the negative effects of foreign exchange risk exposure within the NGO sector in Kenya.
REFERENCES


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APPENDIX I: INTRODUCTION LETTER

Esther Waithera Kamau
United States International University
P.O. BOX 14634
Nairobi, Kenya

Dear Respondent,

I am a graduate student at the United States International University. In partial fulfillment of the requirement for the degree of Master of Business Administration, I am conducting a study whose primary objective is to determine the effect of the foreign exchange risk on the performance of Compassion International Kenya.

The information provided by respondents will be protected by the principle of confidentiality. Your participation is important for the accomplishment of this study and it will be highly appreciated. Should you have any questions or concerns with regards to the questionnaire, please do not hesitate to contact me through my contact address provided above.

Thank you for your cooperation and time.

Sincerely Yours,

Esther Kamau
APPENDIX II: QUESTIONNAIRE

INSTRUCTIONS:
Kindly answer the following questions objectively by writing a brief answer or ticking in the space or boxes provided respectively

Name: (Optional): …………………………… Email……………………………………

TOPIC: IMPACT OF FOREIGN EXCHANGE RISK EXPOSURES ON THE PERFORMANCE OF NON-GOVERNMENTAL ORGANIZATIONS: A CASE STUDY OF COMPASSION INTERNATIONAL

SECTION A

Please tick (√) as appropriate:

1. Kindly indicate your gender.
   Male ☐
   Female ☐

2. Kindly indicate your age bracket.
   Below 20 years ☐
   21-30 years ☐
   31-40 years ☐
   41-50 years ☐
   Above 50 years ☐

3. Level of education attained
   Diploma ☐
   Bachelors ☐
   Masters ☐
   PhD ☐

4. Name of your department
   Programmes ☐

57
5. Years worked at Compassion International:
   - Less than 2 years
   - 2 to 5 years
   - 6 to 10 years
   - 11 to 15 years
   - More than 15 years

SECTION B: FOREIGN EXCHANGE RISK EXPOSURE

6. Based on your experience with compassion international, do you think the organization faces foreign exchange risk exposures?
   - Yes
   - No

7. If yes, in your opinion how can you rate the following statements? (Use the five Likert scale provided where strongly 1=strongly disagree, 2=disagree, 3=neither agree nor disagree 4=Agree 5=strongly agree).
   Tick in the correct column

<table>
<thead>
<tr>
<th>RESPONSES</th>
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</thead>
<tbody>
<tr>
<td>1 Based on your experience does Compassion International Kenya face accounting exposure</td>
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<tr>
<td>2 Based on your experience does Compassion International Kenya face economic exposure</td>
</tr>
</tbody>
</table>

8. If no, explain further

________________________________________________________________________
________________________________________________________________________
________________________________________________________________________
SECTION C: PERFORMANCE OF COMPASSION INTERNATIONAL KENYA

9. Kindly provide with the financial statements for the years 2014-2017 for the calculation of the following ratios:
   a) Current ratio
   b) Quick ratio
   c) Available funds ratio
   d) Debt-equity ratio
   e) Debt service ratio

In your opinion how can you rate the following statements? (Use the five Likert scale provided where strongly 1=strongly disagree, 2= disagree, 3= neither agree nor disagree 4= Agree 5= strongly agree).

Tick in the correct column

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<th>RESPONSES</th>
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<th>2</th>
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<tbody>
<tr>
<td>10 Compassion International Kenya financial performance is good</td>
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<td>11 Compassion International Kenya customers are happy with the level of service provision</td>
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<td>12 All the organizational elements of Compassion International Kenya are effectively and efficiently interlinked and to work towards achieving the organizational goals</td>
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<td>13 Compassion International Kenya uses innovation and learning objectives to drive improvement in financial performance of the organization, customer relations, and internal process performance of the organization</td>
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14. Which of the following do you consider to be Key Performance Indicators of performance in your organization?
   - Annual grants received
   - Annual operational costs
   - Annual program cost
15. *Any other comment*

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**SECTION D: MANAGEMENT OF FOREIGN EXCHANGE RISK**

In your opinion how can you rate the following statements? (Use the five Likert scale provided where strongly 1=strongly disagree, 2= disagree, 3= neither agree nor disagree 4= Agree 5= strongly agree).

*Tick in the correct column*

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<td>2 Foreign exchange risk in Compassion International Kenya can be managed using prepayments</td>
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<td>3 Foreign exchange risk in Compassion International Kenya can be managed using lending and lagging</td>
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<td>4 Foreign exchange risk in Compassion International Kenya can be managed using hedging and derivatives</td>
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<td>5 Foreign exchange risk in Compassion International Kenya can be managed using forward and future contracts</td>
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<td>6 Foreign exchange risk in Compassion International Kenya can be managed using currency options</td>
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<td>7 Foreign exchange risk in Compassion International Kenya can be managed using currency swaps</td>
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*Any other comment*

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*Thank you for your time*