FOREIGN EXCHANGE RISK MANAGEMENT PRACTICES AND
FINANCIAL PERFORMANCE OF CHINESE OWNED ENTERPRISES
OPERATING IN KENYA

A THESIS SUBMITTED TO THE SCHOOL OF BUSINESS IN PARTIAL
FULFILMENT OF THE REQUIREMENTS FOR THE AWARD OF DEGREE
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DECLARATION

This thesis report is my original work and has not been presented for a degree in any other university or for any other award.

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DEDICATION

This study is dedicated to my mother Liao Xiuli, father Chen Youping, wife Lin Liping and son Chen Linbo for their material and moral support.
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My deep gratitude goes to my loving family, they encourage and support me come to do the study, and give me a constant source of motivation. I am deeply obliged to my supervisors Dr. A. O. Jagongo and Dr. Ndede. F.W.S. Without their exemplary guidance and support, this study would not have been a success. I always thank GOD for blessing me throughout the study.
# TABLE OF CONTENTS

DECLARATION ............................................................................................................. ii  
DEDICATION ................................................................................................................ iii  
ACKNOWLEDGEMENT ................................................................................................. iv  
TABLE OF CONTENTS .............................................................................................. iv  
LIST OF TABLES ......................................................................................................... ix  
LIST OF FIGURES ....................................................................................................... x  
OPERATIONAL DEFINITION OF TERMS .................................................................... xi  
ABBREVIATIONS AND ACRONYMS ......................................................................... xii  
ABSTRACT ..................................................................................................................... xiii  

CHAPTER ONE: INTRODUCTION ............................................................................... 1  
1.1 Background of the Study ...................................................................................... 1  
1.1.1 Firms Financial Performance ........................................................................ 5  
1.1.2 Status of Chinese Owned Enterprises Operating in Kenya ......................... 6  
1.2 Statement of the Problem .................................................................................... 9  
1.3 Objectives of the Study ....................................................................................... 10  
1.3.1 General Objective .......................................................................................... 10  
1.3.2 Specific Objectives ....................................................................................... 10  
1.4 Hypothesis .......................................................................................................... 11  
1.5 Scope of the Study .............................................................................................. 11  
1.6 Limitation of the Study ...................................................................................... 12  
1.7 Significance of the Study .................................................................................... 12
## CHAPTER TWO: LITERATURE REVIEW

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.1 Introduction</td>
<td>15</td>
</tr>
<tr>
<td>2.2 Theoretical Literature</td>
<td>15</td>
</tr>
<tr>
<td>2.2.1 International Fisher Effect Theory</td>
<td>15</td>
</tr>
<tr>
<td>2.2.2 Interest Rate Parity Theory</td>
<td>16</td>
</tr>
<tr>
<td>2.2.3 Relative Version of Purchasing Power Parity Theory</td>
<td>18</td>
</tr>
<tr>
<td>2.2.4 Prospect Theory</td>
<td>19</td>
</tr>
<tr>
<td>2.2.5 Law of One Price Theory</td>
<td>20</td>
</tr>
<tr>
<td>2.3 Empirical Literature Review</td>
<td>20</td>
</tr>
<tr>
<td>2.4 Summary of Literature Review</td>
<td>28</td>
</tr>
<tr>
<td>2.5 Conceptual Framework</td>
<td>32</td>
</tr>
</tbody>
</table>

## CHAPTER THREE: RESEARCH METHODOLOGY

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.1 Introduction</td>
<td>33</td>
</tr>
<tr>
<td>3.2 Research Philosophy</td>
<td>33</td>
</tr>
<tr>
<td>3.3 Research Design</td>
<td>34</td>
</tr>
<tr>
<td>3.4 Target Population</td>
<td>34</td>
</tr>
<tr>
<td>3.5 Sampling Technique and Sample Size</td>
<td>35</td>
</tr>
<tr>
<td>3.6 Data Collection Instruments</td>
<td>36</td>
</tr>
<tr>
<td>3.7 Data Collection Procedure</td>
<td>37</td>
</tr>
<tr>
<td>3.8 Data Analysis</td>
<td>37</td>
</tr>
<tr>
<td>3.9 Diagnostic Tests</td>
<td>39</td>
</tr>
</tbody>
</table>

## CHAPTER FOUR: RESULTS, INTERPRETATION AND DISCUSSION

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>4.1 Introduction</td>
<td>40</td>
</tr>
<tr>
<td>4.2 Response Rate</td>
<td>40</td>
</tr>
<tr>
<td>4.3 Descriptive Statistics</td>
<td>41</td>
</tr>
</tbody>
</table>
4.3.1 Invoicing in Home Currency ............................................. 43
4.3.2 Leading and Lagging ....................................................... 44
4.3.3 Money Market .............................................................. 45
4.3.4 Forward Contract .......................................................... 46
4.3.5 Factors Affecting Foreign Risk Management Practices .............. 47
4.3.6 Operating Strategies ...................................................... 48
4.4 Residual Diagnostics ......................................................... 49
  4.4.1 Multicollinearity Test .................................................... 49
  4.4.2 Heteroskedasticity Test ................................................. 51
4.5 Results of the Regression Model .......................................... 51
  4.5.1 Translation Exposure Management Practices and Financial Performance .... 52
  4.5.2 Transaction Management Practices and Financial Performance ............ 52
  4.5.3 Economic Exposure Management Practices and Financial Performance .... 53
  4.5.4 Policy and Regulatory Requirements Management Practices and Financial Performance .... 54
4.6 Hypothesis Testing .......................................................... 55

CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS ....... 57
  5.1 Introduction .............................................................. 57
  5.2 Summary of the Study .................................................... 57
  5.3 Conclusions ............................................................... 59
  5.4 Contribution to knowledge ............................................. 59
  5.5 Recommendations ...................................................... 59
  5.6 Limitations of the study and suggestion for Further Studies .......... 60

REFERENCES ................................................................. 62

APPENDICES ................................................................. 66
Appendix I: Questionnaire .................................................. 66
Appendix II: List of Chinese Owned Enterprises Operating in Kenya .......... 69
Appendix III: Residual Diagnostic Tests .................................... 73
Appendix IV: Research Authorization ....................................... 74
Appendix v: Research Permit ................................................. 75
LIST OF TABLES

Table 3.1: The Target Population of COEs in Kenya........................................35
Table 3.2: The Sample Size of COEs in Kenya..............................................36
Table 3.3: Variable Definition and Measurement...........................................39
Table 4.1: Response Rate...............................................................................40
Table 4.2: Variable Basic Statistics...............................................................41
Table 4.3: Hedging Instrument Used to Manage Risk.....................................42
Table 4.4: Correlation Analysis.......................................................................50
Table 4.5: Regression Output.........................................................................51
LIST OF FIGURES

Figure 1.1 The Main Source of Foreign Exchange Risk

Figure 1.2 China Export Trade Value (US$) with Kenya (1992-2013)

Figure 1.3 USD/KES Exchange Rate Charts

Figure 2.1 Conceptual Frameworks

Figure 4.1: Invoicing in Home currency

Figure 4.2: Leading and Lagging

Figure 4.3: Money Market

Figure 4.4: Forward Contract

Figure 4.5: Factors affecting foreign risk management practices

Figure 4.6: Operating Strategies
OPERATIONAL DEFINITION OF TERMS

Foreign Exchange Risk Management Practices: Foreign exchange risk management practices are business activities of taking decisions which aim at minimizing or eliminating the negative effects of foreign exchange rate fluctuations. They include translation exposure management practices, transaction exposure management practices and economic exposure management practices.

Financial Performance: Financial performance is considered as a subjective measure of how well a firm can use assets from its primary mode of business and generate revenues. This term is also used as a general measure of a firm’s overall financial health over a given period of time, and can be used to compare similar firms across the same industry or to compare industries or sectors in aggregation. This study will focus on measurement of return on assets and net profitability.
ABBREVIATIONS AND ACRONYMS

COEs Chinese Owned Enterprises
CTA Cumulative Translation Adjustment
ERM Enterprise Risk Management
FP Financial Performance
IFE International Fisher Effect
IPR Interest Rate Parity
KEANS Kenya, Egypt, Angola, Nigeria and South Africa
NSE Nairobi Stock Exchange
NPV Net Present Value
PPP Purchasing Power Parity
PBIT Profitability Before Interest and Tax
RM Risk Management
ROA Return on Assets
VaR Value-at-Risk
ABSTRACT

Economic Liberalization has made it possible for investors to continue investing in other foreign countries across the globe. Chinese owned enterprises are some of the companies which have benefitted from the global liberalization. Like in the case of other foreign firms, Chinese owned enterprises operating in Kenya and elsewhere have been formed for purposes of profit making. But recent findings indicate that the firms’ profits are to the declines. This possibly is because of inadequate foreign risk management practices. Financial performance is a subjective measure of how well a firm can use assets from its primary mode of business and generate revenues. This term is also used as a general measure of a firm’s overall financial health over a given period of time, and also can be used to compare similar firms across the same industry or to compare industries or sectors in aggregation. There are various risks that influence the financial performance of most companies. Every business activity is confronted with many risks and coping with these risks has always been an important managerial function. Chinese owned enterprises operating in Kenya have challenge managing exposure to foreign exchange risk. The objective of this study was to investigate the effect of foreign exchange risk management practices and financial performance of Chinese owned enterprises operating in Kenya. The theories which the study relied on include; the international Fisher effect, interest rate parity theory, relative version of purchasing power parity prospect theory, and law of one price. The study adopted the positivism philosophy and employed descriptive research design. Out of the 82 Chinese enterprises operating in Kenya 41 firms were sampled. Stratified sampling technique was used. Primary and secondary data collected using a questionnaire. Multiple regression analysis was used to examine the magnitude of influence of the independent variables on the respective dependent variable. Correlation and descriptive analysis methods were used to determine the direction and general information on both independent and dependent variables. Regressors were estimated against two regressands, net profit and return on assets. The study found out that management practices under transaction exposure had a positive effect on the financial performance (ROA) of the enterprises. Conversely, economic exposure management practices had a negative influence on performance (both on ROA and Net profit). Also it was noted that the economic exposure variable had a greater negative magnitude to net profit. Firms’ strategies on mitigating economic exposure are either inadequate or inappropriate. No relationship was found between translation exposure practices, policy and regulatory requirements and financial performance. Based on the results, the study recommends that transaction exposure management practices should be critically examined; Chinese owned companies should embrace transaction exposure management practices to enhance performance. However it was noted that that different firms use different methods of calculating translation exposure, nevertheless this did not affect the findings since the discrepancy among firms was negligible. In the researcher’s insight, the enterprises can better mitigate the economic exposure effect through alternative approaches such as increasing sales volume, adjusting its sales price, altering product strategy, shifting production among plants or selecting low cost production sites. For further research, the study suggests a comparative relook on the foreign risk management practices between locally owned multinationals and their foreign counterpart’s practices. Further study is also suggested on effect of foreign risk management policy, probing the effect of passive management and active management approaches on financial performance.
CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Economic Liberalization has made it possible for investors to continue investing in other foreign countries across the globe. Business especially foreign businesses are often confronted with many risks and coping with these risks has always been an important managerial function. Chinese owned enterprises are some of the companies which have benefitted from the global liberalization. In recent years, however, risk management has received increasing attention in both corporate practice and literature (Jalilvand, Switzer and Tang, 2000). Foreign exchange risk has become more and more important in light of the globalization and internationalization of world markets and is one of the most difficult and persistent problems with which the financial executives must cope (Fatemi, 2002). Risk management is a new paradigm for managing business risks, which is highly strategic in nature and is an array of components (Psica, 2008), put together through due process within an organization that work together to manage risk efficiently and effectively over time (Moeller, 2007).

All businesses trading overseas and increasingly in domestic markets will have some exposure to exchange rate movements either directly or indirectly. While exposure to exchange rate movements may be an inevitable part of everyday activity, the risk arising from such exposure can be controlled (Shapiro, 2003). Exchange risk management is an integral part in every firm's decisions about foreign currency exposure (Allayannis, Ihrig, & Weston, 2001). Currency risk hedging strategies entail
eliminating or reducing this risk, and require understanding of both the ways that the exchange rate risk could affect the operations of economic agents and techniques to deal with the consequent risk implications (Barton, Shenkir, and Walker, 2002).

According to Popov and Stutzmann (2003), foreign exchange risk is the exposure of an institution to the potential impact of movements in foreign exchange rates. Foreign exchange risk arises from two factors: currency mismatches in an institution’s assets and liabilities (both on and off balance sheet) that are not subject to a fixed exchange rate vis a vis the Kenyan shilling, and currency cash flow mismatches. Such risk continues until the foreign exchange position is covered. This risk may arise from a variety of sources such as foreign currency retail accounts and retail cash transactions and services, foreign exchange trading, investments denominated in foreign currencies and investments in foreign companies. The amount at risk is a function of magnitude of potential exchange rate changes and the size and duration of the foreign currency exposure (Shapiro, 2002).

Foreign exchange risk is the magnitude and likelihood of unanticipated changes in exchange rate (Brucaite and Yan, 2000). According to Shapiro (2007), exchange rate exposure is the degree to which a company is affected by changes in exchange rates. Foreign exchange risk can be further subdivided into three exposures (Figure 1.1): translation, transaction and economic exposures (Denzil and Antony, 2007). Eitman, Stone hill and Moffet (2004) state that translation exposure, results from the need to restate foreign subsidiaries’ financial statements into the parent’s reporting currency and is the sensitivity of net income to the variation in the exchange rate between a foreign
subsidiary and its parent. Currency fluctuations also affect a firm's balance sheet by changing the value of the firm’s assets and liabilities, accounts payable, accounts receivables, loans in foreign currency, investments in foreign banks; this type of exposure is called transaction exposure (Eitman, 2004). Economic exposure is the extent to which a firm's market value, in any particular currency, is sensitive to unexpected changes in foreign currency. Like in the case of other foreign firms, Chinese owned enterprises operating in Kenya and elsewhere need to use financial instruments to avoid foreign exchange rate risk which would result into operating losses.

Figure 1.1 The Main Source of Foreign Exchange Risk

*Source: Denzil and Antony, 2007*

Foreign exchange risk management is complex and requires a thorough understanding of an enterprise foreign exchange needs, its internal and external environment and exposures to the financial markets. Foreign currency risk management involves taking decisions which aim at minimizing or eliminating the negative effects of currency fluctuations on balance sheet and income statement values, a firm's receipts and
payments arising out of current transactions, and on long term future cash flows of a firm. Creativity by managers and innovations in financial instruments have made available to firms mitigating tools that can be followed in managing the impact of foreign currency rate fluctuations. These tools are commonly known as hedging techniques. Papaioannou (2001) explained that selecting the appropriate hedging strategy is often a daunting task due to the complexities involved in measuring accurately currency risk exposure and deciding on the appropriate degree of risk exposure that ought to be covered.

Enterprise exposed to foreign exchange risk have three options. First, they can choose to do nothing about their exposure and accept the consequences of variations in currency values or the possibility that their government may impose restrictions on the availability or transfer of foreign currency. Second, they can hedge against their exposure. For example, they can purchase a financial instrument that will protect the organization against the consequences of those adverse movements in foreign exchange rates. Finally, they can partially hedge against the risks, or limit their hard currency exposure to set levels. To manage the exchange rate risk inherent in multinational firms' operations, a firm needs to determine the specific type currency risk exposure, the hedging strategy and the available instruments to deal with these currency risks. Multinational firms are participants in currency markets by virtue of their international operations. To measure the impact of exchange rate movements on a firm that is engaged in foreign-currency denominated transactions, that is the implied value-at-risk from exchange rate moves. There is need to identify the type of risks that the firm is exposed to and the amount of risk encountered (Hakala and Wystup, 2002).
1.1.1 Firms Financial Performance

Adequacy of financial resources is key to sustainability if any business operations. According to Pandey (2008), financial performance is considered as a subjective measure of how well a firm can use assets from its primary mode of business and generate revenues. This term is also used as a general measure of a firm's overall financial health over a given period of time, and can be used to compare similar firms across the same industry or to compare industries or sectors in aggregation. Evaluating the financial performance of a business allows decision-makers to judge the results of business strategies and activities in objective monetary terms (Kinyogo, 2014).

There are many different ways to measure financial performance, but all measures should be taken in aggregation. Line items such as revenue from operations, operating income or cash flow from operations can be used, as well as total unit sales. Furthermore, the analyst or investor may wish to look deeper into financial statements and seek out margin growth rates or any declining debt. Some researchers use market measures (Alexander & Buchholz, 1978; Vance, 1975) and others put forth accounting measures (Waddock & Graves 1997; Cochran and Wood, 1984) and some adopt both of these (McGuire, Sundgren & Schneeweis, 1988). The two measures, which represent different perspectives of how to evaluate a firm's financial performance, have different theoretical implications (Hillman & Keim, 2001) and each is subject to particular biases (McGuire, Schneeweis & Hill, 1986). The use of different measures, needless to say, complicates the comparison of the results of different studies. Financial performance management is a series of processes used to monitor long-term and short-term financial
results. This term is most commonly applied to investment management but also can be applicable to business operations. The primary purpose of financial performance management is to compare actual results to budgets or forecasts and make adjustments to reach specific financial goals.

1.1.2 Status of Chinese Owned Enterprises Operating in Kenya

The People's Republic of China established the diplomatic relations with the Republic of Kenya on the day of December 14, 1963. Since the establishment of the diplomatic relations, the projects of aid and assistance provided by China to Kenya mainly include: Moi International Sports Center, methane-generating pit, the expansion project of Eldoret hospital, Gambogi-Serem Highway. The Chinese exports to Kenya mainly include: household electric appliance, industrial and agricultural tools, textile goods, commodities for daily use, building materials and drugs and so on. In recent years, the bilateral trade value increased greatly. The China export trade value with Kenya was going beyond 3217.48 million U.S. dollars in 2013 from 29.18 million U.S. dollars in 1992, and it has grown 109.25 percent (Figure 1.2).
Economic and Commercial Counsellor’s Office of the Embassy of the People’s Republic of China in the Republic of Kenya statistics (March 5, 2014), there were eighty two Chinese investment enterprises doing their businesses in Kenya. The South Africa’s biggest bank, Standard Bank, said in a report in 2012, Africa has become China’s fastest-growing export destination and trade partner. China’s trade with Africa has grown nearly twice as fast as its trade with Latin America. Chinese firms have recognized the importance of selling goods to the large emerging economies, especially the highly populated and increasingly wealthy ones in Africa. Demand from African countries, especially the largest ones such as Kenya, Egypt, Angola, Nigeria and South Africa (KEANS), has simply become even more important to Chinese firms.

Market imperfections, such as taxes, agency problems, asymmetric information, dead-weight costs associated with financial distress, however, may provide incentives for
corporations to hedge the exchange risk (Dufey and Srinivasulu, 1983; Stulz, 1984; Shapiro and Titman, 1985; Smith and Stulz, 1985; Froot, Scharfstein and Stein, 1992; DeMarzo and Duffle, 1995). It is widely recognized that as the volatility in exchange rates has increased dramatically after the breakdown of the Bretton Woods system of fixed exchange rates (Smith, Smithson and Wilford, 1990), multinational corporations may have become increasingly vulnerable to exchange risk since the short term movements in exchange rates are often not accompanied by offsetting changes in prices in the corresponding countries (Shapiro, 1992). Because of USD/KES risks remain to the upside (Figure 1.3), it is more and more important that foreign firms in Kenya use financial instruments to avoid foreign exchange rate risk. Like in the case of other foreign firms, Chinese owned enterprises operating in Kenya and elsewhere need to use financial instruments to avoid foreign exchange rate risk which would result into operating losses. It is against this background that the sought to find out how the foreign exchange risk management practices by Chinese owned enterprises operating in Kenya affect their financial performance.
1.2 Statement of the Problem

Allayannis, Ihrig, and Weston (2001) assert that exchange rate risk management is an integral part of every firm's decisions about foreign currency exposure. It requires understanding of both the ways that the exchange rate risk could affect the operations of economic agents and techniques to deal with the consequent risk implications. Companies that choose not to manage foreign exchange risk may be assuming that exchange rates will remain at their present levels or move in a direction that will be favorable to the company. However according to Zarb (2009), when dealing in foreign currencies, fluctuations in the exchange rates are bound to occur and this affects the firm's expected future cash flows.
Both the host country and the investor benefit from investments for provision of goods and services as well as creation of wealth and employment. In recent times there has an increase in the number of Chinese owned enterprises operating in Kenya. The operations have not without challenges as most of the firms tended to report losses. The losses have tended to be associated with exchange risk exposure of operational costs. Although there is a growing literature linked losses by foreign investments to foreign exchange rate risk management practices and firm decisions about foreign currency exposure there is, equally, a growing diversity of results (Kioko, 2012).

1.3 Objectives of the Study

1.3.1 General Objective

The general objective of this study was to investigate the effect of foreign exchange risk management practices and financial performance of Chinese owned enterprises operating in Kenya.

1.3.2 Specific Objectives

The specific objectives of the study were:

i). To determine the effect of translation exposure management practices on financial performance of COEs operating in Kenya
ii). To determine the effect of transaction exposure management practices on financial performance of COEs operating in Kenya.
iii). To determine the effect of economic exposure management practices on financial performance of COEs operating in Kenya.
iv). To determine the effect of policy requirements and regulatory requirements between foreign exchange risk management practices and financial performance of COEs operating in Kenya.

1.4 Hypothesis

The study tested the following hypothesis:

H₀₁: There is no relationship between translation exposure management practices and financial performance of COEs operating in Kenya.

H₀₂: There is no relationship between transaction exposure management practices and financial performance of COEs operating in Kenya.

H₀₃: There is no relationship between economic exposure management practices and financial performance of COEs operating in Kenya.

H₀₄: Policy and regulatory requirements have no relationship effect on financial performance of COEs operating in Kenya.

1.5 Scope of the Study

The study considers Chinese owned enterprises operating in Kenya from year 2010 to year 2014, content scope of the study is the effect of foreign exchange risk management on financial performance, and geography scope of the study is in Kenya, population scope of the study is Chinese owned enterprises operating.
1.6 Limitation of the Study

i). The reality of the foreign exchange market in Kenya is keeps on changing due to the influence of various factors at home and abroad.

ii). There could be some Chinese companies which have not selected the most appropriate tool in time to pursue foreign exchange risk minimization, because of their low level of foreign exchange risk management.

1.7 Significance of the Study

The study adds to the body of knowledge, specifically in regard to foreign risk management on foreign firms operating in Kenya and hopefully ignites the need for further research especially looking into other risks arising in the sector. There is significance of the study to academia, corporate decision makers and regulators.

Academia: A number of finance scholars and finance scholars have discussed how firms could use management practices to hedge foreign exchange risk (Mello, Parsons and Triantis, 1995). Thus the study adds to existing literature, and is an invaluable tool for students, academicians and institutions, by specifically narrowing down to foreign exchanges risks being experienced by foreign owned corporations in Kenya and how to hedge against them.

Corporate decision makers: Multinational corporations are often investing in various countries with prices denominated in corresponding local currencies, may have become increasingly vulnerable to exchange risk since the short term movements in exchange rates are often not accompanied by offsetting changes in prices in the corresponding
countries (Shapiro, 1992). Market imperfections, such as taxes, agency problems, asymmetric information, dead-weight costs associated with financial distress, may provide incentives for corporations to hedge the exchange risk (DeMarzo and Duffle, 1995). Like in the case of other countries, the effect of unexpected changes in exchange rates and foreign demand conditions on domestic currency value are hedged by similar changes in Kenya. Hence corporate managers and individuals who want to know more about foreign exchange risk management in Kenya benefit from this study as it will help them in understanding which management risk practices are effective to handle various exposures and how to minimize their effects. This study provides a tool that will help firms not only in comparing future profitability with their opponents but also in making decisions that will enable them outshine their competitors.

Regulators: Since the Asian financial crisis, although the majority of emerging market economies in general the introduction of a floating exchange rate system, but it is not mean that they give up the exchange rate intervention. When speculators threaten to upset the relative values of the domestic currency or other foreign currencies, Regulators have intervened to put a floor on the value of the currency and got back to a managed rate system. So the transition from these economies to a more flexible exchange rate system is only an illusion. The floating exchange rate system and the managed floating exchange rate system more like pegged exchange rate system from the perspective of exchange rate movements and the practice of various economies, McKinnon (1996) summed it up as a "fixed-exchange-rate system without credibility". Regulators on their part through this study is able to understand the importance of foreign exchange risk management to firm’s performance, and formulate appropriate
policy requirements and regulatory requirements to support the public and external investors to maintain the confidence of monetary policy and foreign exchange rate management policies of the country.
CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter contains a review of the theoretical and empirical literatures relevant to the area of study. It sets out the theoretical rationale that guides the entire research including; theories of risk management. It further reviews empirical studies and evaluates of these studies to summarize the state of knowledge in this area. From the literature, a conceptual framework that guides the study is developed.

2.2 Theoretical Literature

This study was based on a number of theories which were to be relevant to the study. These theories include international fisher effect, interest rate parity theory, relative version of purchasing power parity theory, prospect theory, and law of one price.

2.2.1 International Fisher Effect Theory

This model was developed by Irving Fisher in his book The Theory of Interest (1896). It uses market interest rates rather than inflation rates to explain why exchange rates change over time. The International Fisher effect states that exchange rates changes are balanced out by interest rate changes. The Fisher theory simply argues that real interest rates across countries were equal due to the possibility of arbitrage opportunities between financial markets which generally occurs in the form of capital flows. Real interest rate equality implies that the country with the higher interest rate should also have a higher inflation rate which, in turn, makes the real value of the country's
currency decrease over time. The relationship between relative interest rates and foreign exchange rates is explained within the interest rate theory of exchange rate expectations.

Nominal interest rate differentials between two countries tend to reflect exchange rate fluctuations. Giddy (1977) called this the international Fisher effect, a close relationship to the Fisher effect, a phenomenon observed by Irving Fisher (1896). If the international Fisher effect holds, interest rates in appreciating currencies tend to be low enough, and in depreciating currencies high enough, to offset expected currency gains and losses.

The International Fisher Effect (IFE) theory suggests that foreign currencies with relatively high interest rates will tend to depreciate because the high nominal interest rates reflect expected rate of inflation (Madura, 2010). Does the interest rate differential actually help predict future currency movement? Available evidence is mixed as in the case of PPP theory. In the long-run, a relationship between interest rate differentials and subsequent changes in spot exchange rate seems to exist but with considerable deviations in the short run (Hill, 2004). The international Fisher effect is known not to be a good predictor of short-run changes in spot exchange rates (Cumby and Obstfeld, 1981).

2.2.2 Interest Rate Parity Theory

Interest Rate Parity theory (J. M. Keynes, 1923) is used to analyze the relationship between the spot rate and a corresponding forward rate of currencies. The IPR theory states interest rate differentials between two different currencies will be reflected in the premium or discount for the forward exchange rate on the foreign currency if there is no
arbitrage - the activity of buying shares or currency in one financial market and selling it at a profit in another. The theory further states size of the forward premium or discount on a foreign currency should be equal to the interest rate differentials between the countries in comparison.

Interest rate parity is a no-arbitrage condition representing an equilibrium state under which investors will be indifferent to interest rates available on bank deposits in two countries (Feenstra, Robert, Taylor and Alan, 2008). The fact that this condition does not always hold allows for potential opportunities to earn riskless profits from covered interest arbitrage. Two assumptions central to interest rate parity are capital mobility and perfect substitutability of domestic and foreign assets. Given foreign exchange market equilibrium, the interest rate parity condition implies that the expected return on domestic assets will equal the exchange rate-adjusted expected return on foreign currency assets. Investors then cannot earn arbitrage profits by borrowing in a country with a lower interest rate, exchanging for foreign currency, and investing in a foreign country with a higher interest rate, due to gains or losses from exchanging back to their domestic currency at maturity (Mishkin and Frederic, 2006). Interest rate parity takes on two distinctive forms: uncovered interest rate parity refers to the parity condition in which exposure to foreign exchange risk unanticipated changes in exchange rates is uninhibited, whereas covered interest rate parity refers to the condition in which a forward contract has been used to cover eliminate exposure to exchange rate risk. Each form of the parity condition demonstrates a unique relationship with implications for the forecasting of future exchange rates: the forward exchange rate and the future spot exchange rate.
Economists have found empirical evidence that covered interest rate parity generally holds, though not with precision due to the effects of various risks, costs, taxation, and ultimate differences in liquidity. When both covered and uncovered interest rate parity hold, they expose a relationship suggesting that the forward rate is an unbiased predictor of the future spot rate. This relationship can be employed to test whether uncovered interest rate parity holds, for which economists have found mixed results. When uncovered interest rate parity and purchasing power parity hold together, they illuminate a relationship named real interest rate parity, which suggests that expected real interest rates represent expected adjustments in the real exchange rate. This relationship generally holds strongly over longer terms and among emerging market countries.

2.2.3 Relative Version of Purchasing Power Parity Theory

The purchasing power parity hypothesis traces its origin to the writings of the Swedish economist Cassel (1918). The original theory states that equal goods in different countries cost the same in the very same countries when measured in terms of the same currency. Cassel declares that deviations from PPP imply that a country’s currency is incorrectly valued.

Even if the contemporarily examined forms of PPP are weaker than the original version of PPP, it is still based on the simple hypothesis of arbitrage. If two homogeneous goods are traded at different prices in different countries, this arbitrage opportunity will be utilized, which leads to convergence of the deviations from PPP towards zero (in the absence of arbitrage costs). Halflife is the generally applied PPP convergence measure.
Rogoff (1996) describes a consensus view in PPP research of three to five year half-lives, which is definitely too slow to be compatible with arbitrage opportunities. Therefore, an intense hunt for empirical half-life evidence, that supports this idea of arbitrage, has accelerated over the last few years.

Over the years, conclusions regarding the validity of PPP have been under constant debate. In some periods the research community has concluded that PPP holds, and in other periods that PPP is not valid. PPP was put forward as a long-run equilibrium condition in the post-war period, but after the breakdown of the Bretton Woods system in the early 1970s it was even advocated as a short-run equilibrium (Taylor, 2004). During the late 1970s and 1980s most research concluded that the theory was not valid (Krugman, 1978). According to Reid and Joshua (2004), this theory implies that the rate of change of the exchange rate equals the difference between the inflation rates in the two countries. If the percentage change is positive, then the foreign currency is appreciating and home currency is depreciating. If the percentage change is negative, the foreign currency is depreciating and home currency is appreciating.

2.2.4 Prospect Theory

This is a theory that describes decisions between alternatives that involve risk (alternatives with uncertain outcomes) where the probabilities are known. The model is descriptive: it tries to model real-life choices, rather than optimal decisions. The theory describes such decision processes as consisting of two stages, editing and evaluation. In the first, possible outcomes of the decision are ordered following some heuristic. In particular, people decide which outcomes they see as
basically identical and they set a reference point and consider lower outcomes as losses and larger as gains. In the following evaluation phase, people behave as if they would compute a value (utility), based on the potential outcomes and their respective probabilities, and then choose the alternative having a higher utility (Sundqvist, 2002).

2.2.5 Law of One Price Theory

According to Reid and Joshua (2004), the law states that in the absence of shipping cost, tariffs and other frictions to international trade—identical goods should trade for the same real price in different countries. That is when converted at spot exchange rate into common currency, the price of a homogenous commodity good will be identical across borders. As the exact price of the homogenous commodity is rarely known in two different countries, price indexes are used in empirical work. One difficulty in measuring PPP constructed from price indexes is that different countries use different goods to determine their price level; preference for the goods may vary widely across countries. Hence, even if the law of one price holds in each good, it may not hold overall for dissimilar consumption basket.

2.3 Empirical Literature Review

All businesses trading overseas and increasingly in domestic markets will have some exposure to exchange rate movements either directly or indirectly. While exposure to exchange rate movements may be an inevitable part of everyday activity, the risk arising from such exposure can be controlled (Shapiro, 2003). The adverse effects of foreign exchange risk on a company cash flow and eventually on a company value, is
usually broken down into three categories: translation exposure, transaction exposure and economic exposure. Foreign exchange risk management practices are an integral part in every firm’s decisions about foreign currency exposure (Allayannis, Ihrig, and Weston, 2001). Currency risk hedging strategies entail eliminating or reducing this risk, and require understanding of both the ways that the exchange rate risk could affect the operations of economic agents and techniques to deal with the consequent risk implications (Barton, Shenkir, and Walker, 2002).

Translation exposure is also called accounting exposure. This exposure arises from the effect that exchange rate fluctuations have on a company’s obligations to make or receive payments denominated in foreign currency in future. This type of exposure is short-term to medium-term in nature. The results from the need to restate foreign subsidiaries’ financial Statements into the parent’s reporting currency and is the sensitivity of net income to the variation in the exchange rate between a foreign subsidiary and its parent. Translation exposure, which is valid for only multinational companies, may occur while consolidating a subsidiary's financial statements in the parent company's currency. About translation exposure management practices, Marshall (2000) presents the view that the translation exposure should not be managed as it is purely an accounting concept not related to cash flows. On the contrary, Sucher and Carter (1996) point out that although there is no cash flow impact, hedging the translation exposure could be appropriate when a company is close to specified debt limitations and currency movements may lead the translated group accounts to show a breach of borrowing covenants. Additionally, the decision on hedging the translation
exposure is influenced by the financial reporting requirements at play in the reporting country (Marshall, 2000).

Dufey (1972) suggest another line of reasoning that foreign exchange risk management does not matter because of certain equilibrium conditions in international markets for both financial and real assets. These conditions include the relationship between prices of goods in different markets, better known as purchasing power parity (PPP), and between interest rates and exchange rates, usually referred to as the International Fisher Effect. However, deviations from PPP and International Fisher Effect can persist for considerable periods of time, especially at the level of individual firm. The resulting variability of net cash flows is of significant since it can subject a firm to financial distress or even default. Issues of risk management in banking sector have greater impact not only on the bank but also on the economic growth.

Transaction exposure is a form of short term economic exposure due to fixed price contracting in an atmosphere of exchange-rate volatility. On the other hand, it is the adverse effect of foreign exchange rate changes on cash flows, which is derived from the time lag between foreign currency-denominated contract date and the settlement date. As stated in the International Encyclopedia of Business and Management (1996), the concept of economic exposure links exchange rates to the value of the firm as it attempts to capture the impact of exchange rate movements on the net present value of its future cash flows. The most common definition of the measure of exchange-rate exposure is the sensitivity of the value of the firm, peroxide by the firm's stock return, to an unanticipated change in an exchange rate. This is calculated by using the partial
derivative function where the dependent variable is the firm’s value and the independent variable is the exchange rate (Adler and Dumas, 1984). Transaction exposure management practices aim at preserving or maximizing the current home currency cash flows of foreign currency-denominated contracts, it can be an effective tool for dealing with the impact of unexpected events on shareholder, hence receiving increased attention in Chinese owned enterprises operating in Kenya.

Batten, Metlor and Wan (1993) focused on foreign exchange risk management practice and product usage of large Australia-based firms. The results indicated that, of the 72 firms covered by the Study, 70 percent of the firms traded their foreign exchange exposures, acting as foreign exchange risk bearers, in an attempt to optimize company returns. Transaction exposure emerged as the most relevant exposure. According to Clark (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. A firm need to have a financial risk management strategy that is effective and the employees should have a good understanding of financial instrument in addition to understanding the risks surrounding the firm.

Omagwa (2005) studied the foreign exchange risk management practices by foreign owned commercial banks in Kenya. The results of the study indicated that most banks employed a number of conventional foreign exchange risk management practices, bank-specific practices based on their views of what constitutes exchange risk best practice.
The documented risk management practices include: forecasting, speculating and taking individual positions in the currency markets with an aim of making financial gains, carrying out training programs on financial risk management and use of specific instruments to hedge against foreign exchange risk. Most banks carried out regular and systematic assessment of exposure measurement strategies and their risk management policies in general. Although some scholars have expressed reservations about the use of Value at Risk (VaR) as a risk estimate technique, the study found out that most banks used it extensively.

Ubindi (2006) carried out a survey on foreign exchange risk management practices by foreign exchange Bureaus in Kenya. His findings were not very different from those of Omagwa (2005) in that most foreign exchange bureaus employed a number of conventional foreign exchange risk management practices including: forecasting, speculating and taking individual positions in the currency markets with an aim of making financial gains, carrying out training programs on financial risk management and use of specific financial instruments to hedge against foreign exchange risk. The foreign exchange bureaus too carried out regular and systematic assessments of exposure measurement strategies and their exchange risk management policies in general.

Kipchirchir (2008) studied foreign exchange risk management practiced by motor vehicle industry, he found a positive relationship between managing foreign exchange risk and firms performance. Chira (2009) studied a survey of foreign exchange rate risk management practices by oil companies in Kenya, he found that most companies hedge
foreign exchange risk using forward contract, similar result were revealed by Okwoku (2010) who studied a survey of foreign exchange risk management practices in the energy sector in Kenya. Kisaka (2009) investigated the effect of enterprise risk management on the value of companies listed at the NSE. Their findings showed that companies can add to their shareholders value by implementing ERM thus have a competitive advantage over companies that have not implemented ERM or are at earlier stages of implementation. They further showed that regardless of the differences between developed and emerging markets, the implementation of ERM has a positive effect on the value of companies.

Njunge (2010) studied foreign exchange risk management practices by micro-finance institution; the study revealed that most companies use currency swaps and currency options as financial instruments to hedge against foreign exchange risk. Diffu (2011) carried out a study on the relationship between foreign exchange risk and financial performance of airlines in Kenya: a case of Kenya Airways, she found a positive relationship between foreign exchange risk and financial performance. Abiero (2011) in her study of the effect of market risk management on company value among firms listed at The NSE found that hedging does add value to the company however not all hedging activities are value adding. In her research it was found that usage of commodity and interest rate instruments do not add value to the share price of firms but it is only the use of exchange rate instruments where value is derived. Basing her research on the sixty listed firms at the NSE she showed that not all hedging activities add value but the form of hedging used matters. Firm value is thus contingent on the hedging strategy used. In a study investigating the relationship between foreign exchange risk management and
profitability of airlines in Kenya. Wekesa (2012) found out that foreign exchange rate risk management has a positive impact on the profits of airlines in Kenya. He established that foreign exchange risk accounts for 35 percent of the variability of the profits of airlines in Kenya hence most airlines had put up ways of mitigating the risk to curb nose diving of their profits.

Economic exposure is the extent to which a firm's market value, in any particular currency, is sensitive to unexpected changes in foreign currency. Currency fluctuations affect the value of the firm’s operating cash flows, income statement, and competitive position, hence market share and stock price. Currency fluctuations also affect a firm's balance sheet by changing the value of the firm's assets and liabilities, accounts payable, accounts receivables, inventory, loans in foreign currency, investments in foreign banks; this type of economic exposure is called balance sheet exposure. As Martin and Mauer (2003) put forward, economic exposure arises from changes in the sales prices, sales volumes, and the costs of inputs of the firms and its competitors as a result of exchange rate changes. Bradley and Moles (2001) argue that absence of foreign currency transactions does not automatically eliminate economic exposure as even purely domestic firms with foreign-domiciled competitors or with suppliers sourcing abroad are affected from foreign exchange rate movements. Economic exposure management practices are about maximizing firm value by preserving or maximizing the future cash flows from operations. Therefore, as Grant and Soenen (2004: 53) put forward, these two exposures bear relation to the management's supposed goal of shareholder's wealth maximization, due to their relevance to the wealth-maximizing firm.
Phillips (1995) in his study focused on derivative securities and derivative contracts found that Organizations of all sizes faced financial risk exposures, indicating a valuable opportunity for using risk management tools. The treasury professionals exhibited selectivity in their use of derivatives for risk management. Given the importance of risk management in financial institutions functioning, the efficiency of risk management is expected to significantly influence its performance (Harker and Satrros, 1998). Santomero and Babbel (1997) argue that risk management matters for financial performance of firms. Glaum (2000) observed that firms are exposed to foreign exchange risk if the results of their operations depend on future exchange rates and if exchange rate changes cannot be fully anticipated. He argued that measurement of exchange risk is an important aspect of foreign exchange risk management.


Rossi (2002) observed a reduction in the Brazilian firm’s foreign exchange exposure in the shift from the fixed exchange regime to the flexible exchange regime. The author verified that this change occurred due to the fact that many firms started using currency
derivatives to manage their exchange rate risk and to reduce the currency mismatch in their balance sheets. Judge (2003) summed up the results of 15 studies on the topic of effect of risk management on the value of the firm. He found low support for the importance of taxes, or the managers’ risk aversion, or the presence of bankruptcy costs to determine the use of derivatives. The study also pointed that the results related to the importance of imperfections in the finance market is mixed. Half of the studies confirmed the existence of a relationship between growth opportunities and the use of derivatives. The authors found strong evidence that scale economies and the volatility of cash flow in foreign currency are important determinants of derivative use. Larger companies, exporting companies or companies with subsidiaries abroad use derivatives more intensively. Tai (2004) concludes that some empirical evidence indicates that the past return shocks emanating from banking sector have significant impact not only on the volatilities of foreign exchange and aggregate stock markets, but also on their prices, suggesting that bank can be a major source of contagion during the crisis.

2.4 Summary of Literature Review

effect of enterprise risk management on the value of companies listed at the NSE. Diffu (2011) carried out a study on the relationship between foreign exchange risk and financial performance of airlines in Kenya: a case of Kenya Airways. Wekesa (2012) investigated the relationship between foreign exchange risk management and profitability of airlines in Kenya. But they did not include COEs operating in Kenya in study. This is the gap of this study suggest to fill.

Higher financial leverage, generally associated with high asset base, means lower average cost of capital and hence higher value. As such businesses can command a respectable price if a cash flow lender can be found, or if the Seller is willing to finance the transaction. Business with low financial leverage (generally associated with a low asset base, or an asset base with low borrowing capacity, or a tight lending market) will command a lower price due to lack of lower cost borrowing. If there are tax shield with relation to the payment of interest, or the debt soothes the dispute between shareholders manager and creditor, the impact is positive. If an increase in the leverage presents an increase in the likelihood of incurring payment of bankruptcy costs, the impact is negative. According to free cash flow hypothesis (Jensen, 1986), debt decreases the amount of cash available to managers, hence reducing their possibilities for wasting corporate resources. In such a way leverage serves as a commitment and incentive mechanism – it induces managers to pay out cash to firm’s investors and basically minimizes agency costs of external equity (consumption of perquisites, shirking from duties and undertaking negative NPV projects). Eventually, issuing debt instead of equity lowers agency costs and therefore increases finance performance.
According to pecking order theory, more profitable companies are likely to have low debt levels because they generate cash internally. Consequently, the relationship between debt and profitability will be negative as concluded by Rajan and Zingales (1995). Profitability is the primary goal of all business ventures (Hofstrand, 2009). Without profitability the business will not survive in the long run. Profitability results from the excess of income over expenses. A firm that is highly profitable has the ability to reward its owners with a large return on their investment. The firms therefore trade at a premium and are likely to generate a higher valuation.

Risk management entails assessing and managing the corporation’s exposure to various sources of risk through the use of financial derivatives, insurance and other activities. Hillier et al. (2012) Business risks can impact a company’s cash flows as well as its general health. In the event of corporations successfully managing its foreign exchange risks the benefits received from such effective execution will have a long-term positive impact in creating value for the corporations’ shareholders. Management of foreign exchange risk increases shareholders value through enhanced business performance and the reduction of the firms’ cost of capital. Since market value is conditioned by the company results, the level of risk exposure can cause changes in its market value.

Smith and Watts (1992) argued that future investment affect firm value. A firm with higher growth options will have a higher value as it’s favorable to investors who have higher prospects of recovering their investment. If a firm has lower growth options it is likely to be erased by competitors leading to eventual collapse hence a lower value.
Although no clear definition of firm size can be found, it can be measured by the size of corporate book value or the amount of sales. It is believed there is a high correlation between firm size and cash flow which is the foundation for calculating market capitalization. The size of a company can have a positive effect on financial performance because larger firms can use that advantage to get some financial benefits in business relations. Large organizations can obtain cheap funding hence a lower rate of capital. This generates a higher market capitalization rate. Hoyt (2008) observed that ERM usage is positively related to firm size. The larger the organization, the more complex its operations will probably be and the more its exposure to threatening events.

Firms facing financial constraints are unlikely to meet their investment obligations. The firm may be paying out more than it is receiving and more likely to go bankrupt. This implies that in the long run the chances of survival of the company are low and this would yield a lower valuation. On the contrary firms with adequate cash flow are likely to meet their financial obligations on time and hence have a higher value.
2.5 Conceptual Framework

The conceptual framework is presented in figure 2.1

![Conceptual Framework Diagram]

Figure 2.1 Conceptual Framework
CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter discusses the research methods used in conducting the research. It stipulates the research philosophy, the research design used, the population of the study, the sample as well as the procedures applied in data collection.

3.2 Research Philosophy

Research philosophy can be described as a paradigm which involves a broad framework, which comprises perception, beliefs and understanding of several theories and practices that are used to conduct a research (Cohen, Manion and Morrison, 2000). A paradigm is a way of thinking about and conducting a research it is important in the development of the research background, research knowledge and its nature (Saunders, Lewis and Thornhill, 2009). The research philosophy adopted is positivism as per the study. As a result of globalization and interdependence, China is strengthening her cooperation with other world nations including Africa and is keen to strengthen her trade relations with Kenya. China-Kenya bilateral cooperation has led to a fast comprehensive and profound development in terms of the frequent exchanges of high level and people-to-people visits as well as trade volume increased at an annual rate of over 30% in recent years. In the research background, Chinese owned enterprises operating in Kenya hedge foreign exchange risks using foreign exchange risk management practices. Moreover, Uses of foreign exchange risk management practices affect financial performance Chinese Owned enterprises.
3.3 Research Design

This study has employed a descriptive research design this is because according to Cooper and Schindler (2003), a study concerned with finding out who, what, when, where and how of a phenomenon is a descriptive study. Both Qualitative and Quantitative research methods will be used in the study. Both primary data and secondary data were used in this study. Primary data was collected using a pre-designed questionnaire administered to the managers of the companies in charge of finance or risk management. Secondary data was collected from the audited financial statements, documents, records and reports of others.

3.4 Target Population

A population is a summation of all the organisms of the same group or species, which live in the same geographical area, and have the capability of interbreeding. In sociology, population refers to a collection of human beings. Demography is a social science which entails the statistical study of human populations. This research refers mainly the entire groups or individual, events or objects having common characteristics about which the researcher wishes to make generations, international statistic indicates the likelihood that what was true of the sample is also true for the population from which it is drawn. Thus the target population for this research was the managers in charge of finance and risk management of all the 82 Chinese Owned enterprises operational in Kenya (Table 3.1).
Table 3.1: The Target Population of Finance Managers of COEs in Kenya

<table>
<thead>
<tr>
<th>Categories</th>
<th>Numbers in each category</th>
</tr>
</thead>
<tbody>
<tr>
<td>Engineering &amp; Construction</td>
<td>38</td>
</tr>
<tr>
<td>Trading</td>
<td>13</td>
</tr>
<tr>
<td>Real Estate</td>
<td>8</td>
</tr>
<tr>
<td>Investment &amp; Production</td>
<td>8</td>
</tr>
<tr>
<td>Tourism</td>
<td>5</td>
</tr>
<tr>
<td>Communications</td>
<td>4</td>
</tr>
<tr>
<td>Banking</td>
<td>3</td>
</tr>
<tr>
<td>Medicine</td>
<td>2</td>
</tr>
<tr>
<td>Resource Development</td>
<td>1</td>
</tr>
<tr>
<td>Total</td>
<td>82</td>
</tr>
</tbody>
</table>


3.5 Sampling Technique and Sample Size

The study has adopted the stratified random sampling technique. The enterprises were categorized into strata which include enterprises engaged in engineering, construction, tourism, real estate, investment, production, communications, banking, medicine, resource development and trading as shown in the table 3.2 below. So for each stratum (category) a sample of 50 percent was considered adequate as indicated on table 3.2. This is because according to Lewis & Thornhill (2009), statistically a sample of 30 items is considered as sufficient. The formula to be used for calculating the sample was:

\[ n = \frac{50}{100} \times N \]
Where: \( n \) is the sample size

\( N \) is the total population

### Table 3.2: The Sample Size of COEs in Kenya

<table>
<thead>
<tr>
<th>Categories</th>
<th>Sample size in each category (50%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Engineering &amp; Construction</td>
<td>19</td>
</tr>
<tr>
<td>Trading</td>
<td>7</td>
</tr>
<tr>
<td>Real Estate</td>
<td>4</td>
</tr>
<tr>
<td>Investment &amp; Production</td>
<td>4</td>
</tr>
<tr>
<td>Tourism</td>
<td>2</td>
</tr>
<tr>
<td>Communications</td>
<td>2</td>
</tr>
<tr>
<td>Banking</td>
<td>1</td>
</tr>
<tr>
<td>Medicine</td>
<td>1</td>
</tr>
<tr>
<td>Resource Development</td>
<td>1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>41</strong></td>
</tr>
</tbody>
</table>

### 3.6 Data Collection Instruments

Data was collected in form of primary and secondary data. The primary data was collected by a questionnaire administered to the managers of the companies in charge of finance or risk management. The secondary data has constituted document analysis from websites of the companies and publications which are relevant to the topic being researched.
3.7 Data Collection Procedure

Data collection is the process of gathering and measuring information on variables of interest, in an established systematic fashion that enables one to answer stated research questions, test hypotheses, and evaluate outcomes. The goal for all data collection is to capture quality evidence that then translates to rich data analysis and allows the building of a convincing and credible answer to questions that have been posed. There are three types of data collection: surveys, interviews and focus groups are used to a formal data collection process (Fielding, 2001), it is necessary as it ensures that data gathered are both defined and accurate and that subsequent decisions based on arguments embodied in the findings are valid. In order to yield consistent results and applies to a measure when similar results, therefore survey was used in process of this research after development of the data collection instruments. This method of collecting data from multiple sources, termed data triangulation, assists the researcher not only to collect more comprehensive relevant information but also to cross-check their consistency in order to enhance the robustness of findings.

3.8 Data Analysis

Data collected from the survey has been sorted, edited and corded to have the required quality and accuracy. The study has used both qualitative and quantitative data. Qualitative data has been analyzed using the descriptive statistics while inferential statistics of correlation and regression analysis has used to analyze quantitative data. Statistical package for social studies (SPSS) has been used to generate information. Correlation analysis has been used to obtain the results of the relationship between the
dependent and the independent variables. The independent variables have been the extent of use of futures, options, swaps and forward contracts in the foreign exchange transactions. The dependent variable has been financial performance. Multiple linear regression analysis has been used to examine the magnitude of influence of the independent variables on the respective dependent variable. The goal for all data collection is to capture quality evidence that then translates to rich data analysis and allows the building of a convincing and credible answer to research questions of the study. Below is the analytical model that has been used.

\[ Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \epsilon \]

Where:

\( Y \) = Financial Performance

\( X_1 \) = Translation Exposure Management Practices

\( X_2 \) = Transaction Exposure Management Practices

\( X_3 \) = Economic Exposure Management Practices

\( \epsilon \) = Error Term

The independent and dependent variables were calculated as shown in the table 3.3 below:
Table 3.3: Variable Definition and Measurement

<table>
<thead>
<tr>
<th>Variable</th>
<th>Definition</th>
<th>Type of scale</th>
<th>Measurement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Y</td>
<td>Financial Performance Management Practices</td>
<td>Ratio</td>
<td>ROA &amp; NP</td>
</tr>
<tr>
<td>X1</td>
<td>Translation Exposure Management Practices</td>
<td>Ordinal</td>
<td>Cumulative Translation Adjustment (CTA)</td>
</tr>
<tr>
<td>X2</td>
<td>Transaction Exposure Management Practices</td>
<td>Ratio</td>
<td>Money Market Hedge</td>
</tr>
<tr>
<td>X3</td>
<td>Economic Exposure Management Practices</td>
<td>Ratio</td>
<td>Net Assets</td>
</tr>
</tbody>
</table>

3.9 Diagnostic Tests

According to Hatcher and O’Rourke (2013) non-normal data leads to incorrect conclusions in inferential analysis and may also have a biasing effect on correlation coefficients. To test for the problem, normality test was tested by Jarque Bera Statistics. Homogeneity of variance was tested using the Breusch-Pagan statistics as proposed by (Madansky, 2012), whereby the Breusch-Pagan null hypothesis states that there is constant variance. Multicollinearity of the independent variables increases the standard error of coefficients also making them less efficient. It also limits the size of R and makes it difficult to assess the individual importance of a predictor. Multicollinearity was tested using correlation tables. Lastly Autocorrelation was tested using Durbin Watson statistic as suggested by (Ho, 2007).
CHAPTER FOUR:
RESULTS, INTERPRETATION AND DISCUSSION

4.1 Introduction

The previous chapter presented the methodology used in concluding the study. This chapter presents the study findings, interpretation and discussion. The main objective of the study was to investigate the effect of foreign exchange risk management practices on the financial performance of Chinese owned enterprises operating in Kenya. The results are presented first by the response rate since the study used semi-structured questionnaires.

4.2 Response Rate

The response rate from Chinese owned enterprises operating in Kenya. Statistics as show below. The study adopted the stratified random sampling technique. The results are presented by table 4.1.

Table 4.1: Response Rate

<table>
<thead>
<tr>
<th>Categories</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td>41</td>
<td>100</td>
</tr>
<tr>
<td>Engineering &amp; Construction</td>
<td>19</td>
<td>46.34</td>
</tr>
<tr>
<td>Trading</td>
<td>7</td>
<td>17.06</td>
</tr>
<tr>
<td>Real Estate</td>
<td>4</td>
<td>9.76</td>
</tr>
<tr>
<td>Investment &amp; Production</td>
<td>4</td>
<td>9.76</td>
</tr>
<tr>
<td>Tourism</td>
<td>2</td>
<td>4.88</td>
</tr>
<tr>
<td>Communications</td>
<td>2</td>
<td>4.88</td>
</tr>
<tr>
<td>Banking</td>
<td>1</td>
<td>2.44</td>
</tr>
<tr>
<td>Medicine</td>
<td>1</td>
<td>2.44</td>
</tr>
<tr>
<td>Resource Development</td>
<td>1</td>
<td>2.44</td>
</tr>
</tbody>
</table>

Source: Research Data, 2015
The response rate as indicated in Table 4.1 was 100%. The response rate resulted from personal involvement by the researcher. Out of the 100 percent rate, 46.34 percent (n=19) came from Engineering and Construction, 17.06 percent (n=7) from trading, 9.76 percent (n=4) from real estate, 9.76 percent (n=4) from investment and production, 4.88 percent (n=2) from tourism, 4.88 percent (n=2) from communication and 2.44 percent (n=4) from banking, medicine and resource development. Hence majority of the response rate fall under the engineering and construction cadre, followed by trading, real estate and investment and production.

4.3 Descriptive Statistics

This section elaborates on basic statistics of the data variables. The results are presented by table 4.2.

Table 4.2: Variable Basic Statistics

<table>
<thead>
<tr>
<th></th>
<th>CTA</th>
<th>ECONOMIC EXPOSURE</th>
<th>NET PROFIT</th>
<th>ROA</th>
<th>TRANSACTION EXPOSURE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mean</td>
<td>9.026721</td>
<td>-76.8948</td>
<td>34317.49</td>
<td>1.204807</td>
<td>-16353.06</td>
</tr>
<tr>
<td>Median</td>
<td>0.604999</td>
<td>-48.90868</td>
<td>22445.45</td>
<td>1.435901</td>
<td>21863.05</td>
</tr>
<tr>
<td>Maximum</td>
<td>1430.86</td>
<td>1.997263</td>
<td>177342.1</td>
<td>3.309355</td>
<td>368349.4</td>
</tr>
<tr>
<td>Minimum</td>
<td>-6.778138</td>
<td>-479.4759</td>
<td>-1162.762</td>
<td>0</td>
<td>-731551</td>
</tr>
<tr>
<td>Std. Dev.</td>
<td>105.1263</td>
<td>92.8851</td>
<td>38371.56</td>
<td>0.530436</td>
<td>189811.6</td>
</tr>
<tr>
<td>Skewness</td>
<td>13.48204</td>
<td>-1.954488</td>
<td>1.317325</td>
<td>-1.087215</td>
<td>-0.7788</td>
</tr>
<tr>
<td>Kurtosis</td>
<td>182.8461</td>
<td>7.323233</td>
<td>4.49332</td>
<td>4.940584</td>
<td>3.980581</td>
</tr>
<tr>
<td>Jarque-Bera</td>
<td>254927.6</td>
<td>261.8554</td>
<td>70.69608</td>
<td>65.47467</td>
<td>26.1132</td>
</tr>
<tr>
<td>Probability</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0.000002</td>
</tr>
<tr>
<td>Sum</td>
<td>1669.943</td>
<td>-14225.54</td>
<td>6348736</td>
<td>222.8893</td>
<td>-3025315</td>
</tr>
<tr>
<td>Sum Sq. Dev.</td>
<td>2033483</td>
<td>1587603</td>
<td>2.71E+11</td>
<td>51.77067</td>
<td>6.63E+12</td>
</tr>
<tr>
<td>Observations</td>
<td>185</td>
<td>185</td>
<td>185</td>
<td>185</td>
<td>185</td>
</tr>
</tbody>
</table>

Source: Research Data, 2015
Table 4.2 above presents basic statistics on variables. The mean cumulative translation adjustment for the firms is 9.03 meaning that on aggregate the firms were exposed to appreciations in the foreign currency. The mean for economic exposure is -76.90, indicating a decline of the financial value of the companies due to changes in the exchange rate. Similarly the transaction exposure exhibited a mean negative value meaning that particular business transactions are adversely affected by the exchange rate movements. The skewness values for CTA and net profit are 13.48 and 1.31 respectively meaning the data is positively skewed. Economic exposure, return on assets and transaction exposure variables are negatively skewed. The P-values for Jarque-Bera static for all the variables reject the null hypothesis of normality.

Table 4.3: Hedging Instrument Used to Manage Foreign Exchange Risk

<table>
<thead>
<tr>
<th>Type of Hedging</th>
<th>Never [%]</th>
<th>Sometimes [%]</th>
<th>Always [%]</th>
</tr>
</thead>
<tbody>
<tr>
<td>Invoicing in Home Currency</td>
<td>0</td>
<td>68.3</td>
<td>31.7</td>
</tr>
<tr>
<td>Leading and Lagging</td>
<td>2.4</td>
<td>78</td>
<td>19.5</td>
</tr>
<tr>
<td>Money Market</td>
<td>0</td>
<td>46.3</td>
<td>53.7</td>
</tr>
<tr>
<td>Forward Contract</td>
<td>24.4</td>
<td>70.7</td>
<td>4.9</td>
</tr>
<tr>
<td>Exposure Netting</td>
<td>26.8</td>
<td>68.3</td>
<td>4.9</td>
</tr>
<tr>
<td>Options</td>
<td>68.3</td>
<td>29.3</td>
<td>2.4</td>
</tr>
<tr>
<td>Swaps</td>
<td>0</td>
<td>61</td>
<td>39</td>
</tr>
</tbody>
</table>

*Source: Research Data, 2015*

As shown in the Table 4.3, enterprises do not always embrace a particular hedging instrument. Contractual hedging through money market hedge is mostly applied at most times (53.7 %). In respective hedging type categories, instruments such as invoicing in home currency (68.3%), Leading and lagging (78 %), forward contract
(70.7%). and exposure netting (68.3%) are occasionally used. Majority of the respondents indicated that Swaps and options (68.3% and 61% respectively) are not used by most firms.

In addition, the choice of the instrument depends largely on field of the enterprise. As shown in the preceding section Engineering and construction, real estate, banking and trading always use leading and lagging instrument to hedge against risk. Invoicing in home currency is rarely utilized by most companies. However it is always used in enterprises such as in trading, medicine and real estate. Also forward contract is never used in real estate firms.

4.3.1 Invoicing in Home Currency

The frequency of invoicing in home currency was used to manage foreign exchange risk in COEs operating in Kenya as shown by figure 4.1.

Figure 4.1: Invoicing in Home Currency

Source: Research Data, 2015
Figure 4.1 displays the applicability of invoicing in home currency instrument by firms. Tourism, real estate and medicine industries stated that they always use the instrument. Majority of firms under engineering and construction use the instrument occasionally. Moreover a larger percentage of firms under tourism always use the instrument. Hence the instrument is favourable in Trading, tourism, real estate and medicine.

4.3.2 Leading and Lagging

The frequency of leading and lagging were used to manage foreign exchange risk in COEs operating in Kenya as shown by figure 4.2.

Figure 4.2: Leading and Lagging

Source: Research Data, 2015
Figure 4.2 displays the applicability of leading and lagging by firms. Engineering and construction, real estate, banking and majority of firms under real estate always use the leading and lagging approach to mitigate against foreign risks. Majority of firms under engineering and construction, investment and production, real estate, resource development and tourism use the instrument occasionally. It was noted also that some firms under Communication have never used the instrument.

4.3.3 Money Market

The frequency of money market was used to manage foreign exchange risk in COEs operating in Kenya as shown by figure 4.3.

Figure 4.3: Money Market

Source: Research Data, 2015
Figure 4.3 displays the applicability of money market by firms. No firm indicated non-use of the instrument. 50% of the respondents under Engineering and construction indicated that they always use money market while the other half specified that it is hardly used. All firms under real estate and communication indicated that they rarely use the instrument. Under tourism, banking, medicine, resource development and trading all indicated that they always use money market.

4.3.4 Forward Contract

The frequency of forward contract was used to manage foreign exchange risk in COEs operating in Kenya as shown by figure 4.4.

Figure 4.4: Forward Contract

Source: Research Data, 2015
Figure 4.4 displays the applicability of forward contract by the Chinese by firms. Majority of the firms in trading, resource development, medicine, communication, investment and production and Engineering and construction business rarely use this instrument. However firms in real estate do not use the instrument, likewise under engineering and construction few firms indicated the inapplicability of forward contracts. Forward contracts was found to be used at all times in the banking sector. This can be attributed to the general nature of the banking business which is considered volatile and dynamic.

4.3.5 Factors Affecting Foreign Risk Management Practices

Factors affecting foreign risk management practices of COEs operating in Kenya as shown by figure 4.5.

Figure 4.5: Factors Affecting Foreign Risk Management Practices

Source: Research Data, 2015
On the factors affecting foreign exchange risk management practices, respondents were asked to rate among the three factors namely, management, inadequate finance and effect of bank quotations. Respondents indicated management deficiencies as the most hindering factor in having best practices of managing foreign exchange risk followed by inadequate financial resources. Generally the respondents were of the opinion that the above factors deter the enterprises’ efforts to have best foreign risk management practices.

**4.3.6 Operating Strategies**

Operating strategies were used to manage foreign exchange risk in COEs operating in Kenya as shown by figure 4.6.

**Figure 4.6: Operating Strategies**

![Operating Strategies Graph]

*Source: Research Data, 2015*
Respondents were asked to rank specific operating strategies used to manage the foreign exchange risks. From Figure 4.6, all respondents affirmed all the strategies. Notably, strategies such as ‘inquiring exchange rate between banks before effecting a transaction of huge amounts’ was affirmed most followed by ‘requesting banks to reconsider positions in case of adverse foreign exchange risk exposure’.

4.4 Residual Diagnostics

The residual diagnostics was assessed from multicollinearity, Heteroskedasticity, correlation. The results are presented below.

The P-values for Jarque-Bera static for all the variables were below 5% significant level therefore the null hypothesis of normality was rejected. The data was transformed to normal using the Box Cox power transformation. Correlation coefficients for most variables show weak positive or negative association. Since both problems were treated the test of hypothesis was carried out using regression analysis.

4.4.1 Multicollinearity Test

The section presents the correlation output for the variables and multicollinearity test. The results are presented by table 4.4.
Correlation analysis was carried out to determine the direction of the relationship between the independent variables and dependent variables. The results given in Table 4.4: Correlation Analysis above, show strong negative correlation between net profit and economic exposure (Correlation Coefficient is -0.9641), meaning that an increase or decrease on either variable results to a decrease or increase on the other variable. Translation exposure and transaction exposure show weak positive relationship with return on assets (Correlation Coefficient is 0.0243 and 0.3644 respectively) meaning that if management practices are improved under these exposures it would result to improved financial performance among the firms and vice versa. Correlation coefficients for most variables show weak positive or negative association. The weak associations between the independent variable indicate absence of multicollinearity. Economic exposure is independent variable while net profit is a dependent variable, therefore there is no multicollinearity concern.

Table 4.4: Correlation Analysis

<table>
<thead>
<tr>
<th></th>
<th>ROA</th>
<th>NET PROFIT</th>
<th>CTA</th>
<th>TRANSACTION EXPOSURE</th>
<th>ECONOMIC EXPOSURE</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROA</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NET_PROFIT</td>
<td>0.3266</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CTA</td>
<td>0.0243</td>
<td>-0.0613</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>TRANSACTION_EXPOSURE</td>
<td>0.3644</td>
<td>0.1494</td>
<td>-0.0192</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>ECONOMIC_EXPOSURE</td>
<td>-0.3276</td>
<td>-0.9641</td>
<td>0.0447</td>
<td>-0.1677</td>
<td>1</td>
</tr>
</tbody>
</table>

*Source: Research Data, 2015*
4.4.2 Heteroskedasticity Test

The problem of Heteroskedasticity was tested by Breusch-Pagan-Godfrey on both models. The findings rejected the Homoscedasticity assumption (Appendix III: Residual diagnostics Test). Huber-White covariance method was used to get the desirable standard errors.

4.5 Results of the Regression Model

The section presents the interpretation and discussion of findings on the study objectives. The variables were estimated in two regression models, against return on assets and on net profit. The results are presented by table 4.5.

**Table 4.5: Regression Output**

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Std. Error</th>
<th>t-Statistic</th>
<th>Prob.</th>
<th>Variable</th>
<th>Coefficient</th>
<th>Std. Error</th>
<th>t-Statistic</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>C</td>
<td>1.076422</td>
<td>0.077222</td>
<td>13.93939</td>
<td>0.0000</td>
<td>C</td>
<td>3326.124</td>
<td>1660.537</td>
<td>2.003041</td>
<td>0.0467</td>
</tr>
<tr>
<td>CTA</td>
<td>0.00023</td>
<td>0.000339</td>
<td>0.678031</td>
<td>0.4986</td>
<td>CTA</td>
<td>-651.0092</td>
<td>7.281425</td>
<td>-0.894068</td>
<td>0.3725</td>
</tr>
<tr>
<td>TRANSACTION_EXPOSURE</td>
<td>8.96E-07</td>
<td>1.94E-07</td>
<td>4.62267</td>
<td>0.0000</td>
<td>TRANSACTION_EXPOSURE</td>
<td>-3.02E-03</td>
<td>4.17E-03</td>
<td>-0.725201</td>
<td>0.4693</td>
</tr>
<tr>
<td>ECONOMIC_EXPOSURE</td>
<td>-4.001571</td>
<td>0.000387</td>
<td>-10.59817</td>
<td>0.0001</td>
<td>ECONOMIC_EXPOSURE</td>
<td>-399.111</td>
<td>8.323057</td>
<td>-47.95246</td>
<td>0.0000</td>
</tr>
<tr>
<td>CO_POLICY</td>
<td>0.02494</td>
<td>0.075365</td>
<td>0.330919</td>
<td>0.7411</td>
<td>CO_POLICY</td>
<td>-306.989</td>
<td>1620.604</td>
<td>-0.19492</td>
<td>0.85</td>
</tr>
<tr>
<td>REGULATORY_REQUIREMENT</td>
<td>0.00708</td>
<td>0.077465</td>
<td>0.997273</td>
<td>0.3243</td>
<td>REGULATORY_REQUIREMENT</td>
<td>767.471</td>
<td>1665.769</td>
<td>0.460731</td>
<td>0.6456</td>
</tr>
</tbody>
</table>

R-squared: 0.208309 Mean dependent var: 1.204807
Adjusted R-squared: 0.186194 S.D. dependent var: 0.530436
S.E. of regression: 1.395626
Sum squared resid: 40.9864
Log likelihood: -123.9594
F-statistic: 9.419642
Prob(F-statistic): 0

Notes: CTA: Cumulative Transaction Exposure, CO_POLICY: Company Policy, REGULATORY_REQUIREMENT: Regulatory Requirement

*Source: Research Data, 2015*
The results indicated that there were link between the independent and dependent variables. the study found that there were relationship between foreign exchange risk management practices and financial performance of COEs operating in Kenya.

4.5.1 Translation Exposure Management Practices and Financial Performance

One of the factors considered to have effect on financial performance of COEs in Kenya is translation exposure management practices. Translation exposure was analyzed on the basis of the RMB/KES current rate. Regression analysis was carried out to determine the direction and strength of influence. Table 4.5 above presents the regression output with return on assets (ROA) and net profit as the dependent variables. The coefficients for cumulative transaction adjustment variable is insignificant in both models at 0.000023; P- value 0.4986 in ROA and at -6.510092; P-value 0.3725 in Net profit model. The findings indicate that foreign risk management practices intended to mitigate against translation exposure do not drive performance of the companies. Therefore the translation exposure management practices do not have an effect on financial performance of COEs.

4.5.2 Transaction Management Practices and Financial Performance

Transaction exposure measures changes in the value of outstanding financial obligations due to exchange rate changes. The variable was measured by the difference between receivables and payables. Transaction exposure has a statistically positive significant coefficient 8.96E-07 at 5% significant level against ROA. This means that the management practices to mitigate transaction exposure improve the firm's capacity to efficiently use its assets to generate income. However the regression output on net profit
model generated insignificant results, coefficient -3.02E-03; 0.4393 p-value. The disharmony on the outputs implies that even though the practices enhance operational efficiency, it may not translate to overall firms' profitability.

The return on assets model r squared coefficient is 20.8%, meaning that larger percentage of influence to the enterprises' performance is caused by other variables outside the model. Though the data is not closely fitted in the model, still the researcher can draw conclusions based on the significant coefficients. The r squared for net profit model coefficient indicates that the variable explains 93% of the changes in the firm's earnings.

4.5.3 Economic Exposure Management Practices and Financial Performance

Economic exposure variable was computed as the difference between the value of the cash flows during the pre-valuation rate and the post-valuation rates for the four years. The study sought to examine how COEs manage potential risk resulting from changes in future operating cash flows triggered by unexpected change in exchange rates. The results given in Table 4.5: On both models the variable had a significant effect, coefficient -0.0015; p-value 0.000 and coefficient -399; p-value 0.000 on ROA and Net profit models respectively. This means economic exposure management practices are either inadequate or the risk could be actually the difficult component to manage in foreign exchange risk. Previous studies on the same subject point out that multinationals have not taken keen consideration in managing economic exposure. Michael, (2007), in the study of European and American multinationals states that the numbers of firms managing economic exposure is unknown since majority of the firms are unwilling to
publicize or discuss their economic exposure management programs. This was alluded to two reasons; unwillingness to disclose information which could hurt their competitiveness and such disclosure might provide details of financial contracts and derivatives resulting to damaging scrutiny by both investors and financial analysts. Therefore the economic exposure management practices have an effect on financial performance of COEs operating in Kenya.

4.5.4 Policy and Regulatory Requirements Management Practices and Financial Performance

Two variables, policy and regulatory requirements were included to test the moderating effect to the firms’ financial performance. A telephone interview was conducted where the interviewees were asked to state whether they believed policy or regulatory requirements affects the company’s financial performance. All the coefficients for both variables in the models were significant. Meaning that both variables have significant effect to the firms’ financial performance. Previous studies such as Naila (2012) have examined the effect of regulatory compliance on financial performance. It is important to note that, compliance with the regulatory or policy requirements may involve additional compliance costs and such costs may be industry specific. For instance manufacturing firms may need to inject more funds to comply with Occupational Safety and Healthy Act in Kenya. Therefore the policy and regulatory requirements management practices have an effect on financial performance of COEs operating in Kenya.

The P-values for Jarque-Bera static for all the variables were below 5% significant level therefore the null hypothesis of normality was rejected. The data was transformed to
normal using the Box Cox power transformation. Correlation coefficients for most variables show weak positive or negative association. Since both problems were treated the test of hypothesis was carried out using regression analysis.

4.6 Hypothesis Testing

Regression analysis was carried out to test the hypothesis. Based on the findings both models (ROA and Net profit models) presented insignificant results for Translation Exposure (Cumulative Transaction Adjustment) coefficients 0.0023 with corresponding p-value of 0.4986 for return on assets model and -6.5101 with corresponding p-value of 0.3725 for net profit. The $H_{01}$ states; there is no relationship between translation exposure management practices and financial performance of COEs operating in Kenya. The study accepts the null hypothesis on both models. Fraser (2012) argues that though some variables logically belong to a model, they may be insignificant either due to no impact or because their influence is part of the joint influence of the correlated set of predictors that together influence the dependent variable. Since the correlation output (Table 4.4: Correlation Analysis) found no evidence of multi-collinearity, seemingly the management practices under these approaches do not drive performance on the dependent variable. Hence there is no relationship between management practices under translation and transaction exposure and financial performance.

Hypothesis $H_{02}$ states: no relationship between transaction exposure management practices and financial performance of COEs operating in Kenya. From the findings, Transaction Exposure has a statistically positive significant coefficient of 8.96 at 5%
significant level. Therefore the null hypothesis is rejected meaning the management practices to mitigate transaction exposure are effective in improving the firm's value.

The third hypothesis $H_{03}$ states: there is no relationship between economic exposure management practices and financial performance of COEs operating in Kenya. From the two models, regression against Net profit and Return on Assets, the economic exposure had a significant negative impact at -0.0015 and -399.11 at 5% significant level respectively. The null hypothesis is rejected indicating existence of negative relationship between economic exposure management practices and financial performance.

Lastly, the $H_{04}$ held that, there is no relationship that policy requirements and regulatory requirements between foreign exchange risk management practices and financial performance of COEs operating in Kenya. Both models presented insignificant output on variables, company policy, and coefficient 0.02494; P-value 0.7411 for net profit and -306.989; p-value 0.85 and regulatory requirement, coefficient 0.00708; p-value 0.09142 for net profit and 767.4711; P-value 0.6456 for net profit. Therefore the null hypothesis is not rejected.
CHAPTER FIVE:
SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction
This section discusses the final part of this study by presenting the summary of the study, conclusion, recommendations and limitations of the study. Likewise it outlines suggested area for further studies.

5.2 Summary of the Study
The study first objective was to determine the effect of translation exposure management practices on financial performance of COEs operating in Kenya, with the corresponding hypothesis $H_{01}$: no relationship between translation exposure management practices and financial performance of COEs operating in Kenya. Therefore study failed to reject the null hypothesis.

Transaction exposure management practices were found to have positive effect on financial performance of COEs in Kenya. This implies that the practices applied relatively minimize the foreign exchange risk among the firms. The study objective two was to determine the effect of transaction exposure management practices on financial performance of COEs operating in Kenya. The null hypothesis $H_{02}$: there is no relationship between transaction exposure management practices and financial performance of COEs operating in Kenya was rejected.
Moreover, economic exposure management practices resulted to effect to performance. This could result from inappropriate or inadequate instruments applied. The hypothesis $H_0$: no relationship between economic exposure management practices and financial performance of COEs operating in Kenya is rejected indicating existence of negative relationship between economic exposure management practices and financial performance.

Finally on the objective list, the fourth objective sought to determine the effect of policy requirements and regulatory requirements between foreign exchange risk management practices and financial performance of COEs operating in Kenya. Both models presented significant output on variables. Hence there was relationship between policy or regulatory requirements and performance.

Further from the findings specific instruments were found desirable by most companies. For instance contractual hedging through money market hedge is largely used at most times. Instruments such as invoicing in home currency, Leading and lagging, forward contract, and exposure netting seem to be used occasionally. Moreover, majority of the respondents indicated that Swaps and options are not used by most firms.

In addition, the choice of the instrument depends largely on field of the enterprise. Engineering and construction, real estate, banking and trading always use leading and lagging instrument to hedge against risk. Invoicing in home currency is rarely utilized by most companies. However it is always used in enterprises such as in trading, medicine and real estate. Also forward contract is never used in Real estate firms.
5.3 Conclusions

Base on the result, the following conclusions were drawn from the study. The study analysed both qualitative and quantitative data from 41 Chinese owned enterprises in Kenya using multiple regression analysis. The study examined translation, transaction and economic exposure management practices. In addition moderating effects of policy and regulatory requirements were examined. The regressors were estimated against two regressands, net profit and return on assets. Management practices on transaction exposure had a positive effect on financial performance of the enterprises, economic exposure management practices had influence on financial performance, and the relationship was found between translation exposure practices, policy and regulatory requirements. The findings were based on the objectives and hypothesis of the study.

5.4 Contribution to knowledge

The study has provided insights on the effect of foreign exchange risk management practices and financial performance of Chinese owned enterprises operating in Kenya.

5.5 Recommendations

From the findings, for practice it is recommended that transaction exposure management practices should be critically examined. The study found a positive effect of transaction exposure management practices to financial performance; hence COEs that have not fully utilized the instruments should embrace the approaches to enhance performance.
Secondly, the firm’s strategies on mitigating economic exposure are either inadequate or inappropriate. The study recommends the following practices to mitigate against this exposure: increasing sales volume, adjusting its sales price, altering product strategy, shifting production among plants or selecting low cost production sites.

From the findings, majority of the respondents indicated that foreign exchange risk management policy is largely defined by the chief executive officer, however best practices in risk management policy formulation requires a more active role from the top management beginning from policy formulation, monitoring and its implementation.

Lastly, considering the relationship between translation exposure management practices, policy and regulatory requirements and finance performance, hence COEs should consider changing focus on such areas.

5.6 Limitations of the study and suggestion for Further Studies

The reality of the foreign exchange market in Kenya is keeps on changing due to the influence of various factors at home and abroad, there is need for researchers to comparatively relook at the practices between the locally owned enterprises and the foreign counterparts to determine similarities and differences in managing the foreign risk and the net effect to performance.

Moreover it was noted that top level managers do not actively participate in the making of foreign risk management policies in respective firms. There could be some Chinese companies which have not selected the most appropriate tool in time to pursue foreign
exchange risk minimization, because of their low level of foreign exchange risk management.

The study makes valuable contributions to the academia by revealing specific foreign risk management practices employed and their effect to the performance of the foreign owed enterprises. Secondly the corporate decision makers benefit greatly from the findings of the study. For instance the decision makers are now able to direct resources to best practices that could mitigate losses such as transaction exposure management practices and into effect improve performance.

Also as it was noted in the study, economic exposure presents a challenge to most managers. The study suggests economic exposure as a lucrative area of study, to look at the extent and methods which the multinationals employ. It was noted that different firms use different methods of calculating translation exposure. The International Finance Reporting Standards should recommend an objective approach in reporting the annual financials. Further study is also suggested on effect of foreign risk management policy, probing the effect of passive management and active management approaches on performance.
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APPENDICES

Appendix 1: Questionnaire

Dear respondent, your participation in this study about foreign exchange risk management practices and financial performance of Chinese owned enterprises operating in Kenya is completely voluntary and you are free to decline to answer any or all of the questions.

Name of enterprise: ..........................................
Date............................

i. Which is the field of your enterprise?
   Engineering & Construction ( )  Tourism ( )
   Real Estate ( )  Investment & Production ( )
   Communications ( )  Banking ( )
   Medicine ( )  Resource Development ( )
   Trading ( )  Other ( )

ii. Who defines the foreign exchange risk management policy?
   Top Management ( )  Chief Executive Officer ( )
   Middle Level Management ( )  Basic Level Management ( )

iii. How often does your enterprise measure foreign exchange rate risk?
   Daily ( )  Weekly ( )  Monthly ( )  Quarterly ( )
   Semiannually ( )  Annually ( )  Rarely ( )

iv. Rank the following foreign exchange risk management practices applied in your enterprise:

<table>
<thead>
<tr>
<th>Summary</th>
<th>Not Applicable</th>
<th>Not Importance</th>
<th>Importance</th>
<th>Very Importance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Choose a good denominated in the currency</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Advance (delay) payment method</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Choose a good settlement</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hedging</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
v. Which hedging instruments does your enterprise use to manage foreign exchange risk as following:

<table>
<thead>
<tr>
<th>Summary</th>
<th>Never</th>
<th>Sometimes</th>
<th>Always</th>
</tr>
</thead>
<tbody>
<tr>
<td>Invoicing in home currency</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Leading and Lagging</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Money market hedge</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Forward contract</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exposure netting</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Options</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Swaps</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

vi. Rank the factors effecting foreign exchange risk management practices as following:

<table>
<thead>
<tr>
<th>Summary</th>
<th>Not Applicable</th>
<th>Not Importance</th>
<th>Importance</th>
<th>Very Importance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quotation of banks service is higher than expected return</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less financial instruments to be chosen</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Management deficiencies</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
vii. For each of the courses kindly indicate amounts in Kenya Shilling as following:

<table>
<thead>
<tr>
<th>Summary</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Receivables</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current Assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts Payables</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current Liabilities</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Liabilities</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Internal Techniques Amount</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Derivatives Amount</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign Exchange Gains</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Income</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Profit</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

viii. Please make your assertion as regards the level of agreement or disagreement about the following:

<table>
<thead>
<tr>
<th>Summary</th>
<th>Strongly Agree</th>
<th>Agree</th>
<th>Neutral</th>
<th>Disagree</th>
<th>Strongly Disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ask foreign exchange rate between different banks before deal with larger amounts of foreign.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Request our bankers to reconsider their positions in case of adverse foreign exchange risk exposures.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Make delay foreign currency payment to a later date if it is possible.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Minimize foreign exchange risk through early payments of foreign currencies before the maturity date.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Forego foreign currency denominated financing when its anticipated that exchange rates was volatile later.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Match costs with revenues denominated in similar currencies to reduce the effect of contractual foreign exchange risk.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Appendix II: List of Chinese Owned Enterprises Operating in Kenya

1. Representative Office for Southern & Eastern Africa, Export-Import Bank of China
2. Kenya Representative Office, China Development Bank
3. Kenya Representative Office, Bank of China
4. Huawei Technologies Co., Ltd. Kenya Branch
5. Kenya Representative Office, ZTE Corporation
6. Alcatel-Lucent Ltd.
7. Startimes Media
8. Kenya Office, China Road & Bridge Corporation
12. China Wu Yi Co., Ltd
13. Sinohydro Corporation Ltd.
15. Great Wall Drilling Company, China National Petroleum Corporation
17. China Zhongxing Construction Co., Ltd.
18. China Huashi Enterprises Company Limited
19. China Petroleum Pipeline Bureau
20. CITIC International Contracting Inc.
22. Kenya Office, China Railway Seventh Group Co., Ltd.
23. Kenya Office, China Railway Tenth Group Co., Ltd.
24. China National Electric Wire & Cable Import/Export Corporation
<table>
<thead>
<tr>
<th></th>
<th>Company Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>25</td>
<td>China Jiangxi Corporation for International Economic and Technical Cooperation</td>
</tr>
<tr>
<td>26</td>
<td>Jiangxi Zhongmei Engineering Construction Co., Ltd.</td>
</tr>
<tr>
<td>27</td>
<td>Jiangxi Nonferrous Engineering Co., Ltd.</td>
</tr>
<tr>
<td>28</td>
<td>BGP Inc., China National Petroleum Corporation</td>
</tr>
<tr>
<td>29</td>
<td>Fushun Constuction Corporation</td>
</tr>
<tr>
<td>30</td>
<td>China Aero-Technology International Engineering Co., Ltd.</td>
</tr>
<tr>
<td>31</td>
<td>China National Electric Engineering Co., Ltd.</td>
</tr>
<tr>
<td>32</td>
<td>Middle South Electric Power Transmission and Transformation Equipment Ltd.</td>
</tr>
<tr>
<td>33</td>
<td>Zhonghao Overseas Construction Engineering Co., Ltd.</td>
</tr>
<tr>
<td>34</td>
<td>China Henan International Corporation Co., Ltd.</td>
</tr>
<tr>
<td>35</td>
<td>Kenya Office, China Dalian International Corporation Group Holdings Ltd.</td>
</tr>
<tr>
<td>36</td>
<td>Transtech Engineering Corporation</td>
</tr>
<tr>
<td>37</td>
<td>Nanchang Foreign Engineering Corporation</td>
</tr>
<tr>
<td>38</td>
<td>Xuji Group Corporation</td>
</tr>
<tr>
<td>39</td>
<td>Kenya Branch of Sinopec Petroleum Service</td>
</tr>
<tr>
<td>40</td>
<td>China State Construction Engineering Corporation</td>
</tr>
<tr>
<td>41</td>
<td>HydroChina Huadong Engineering Corporation</td>
</tr>
<tr>
<td>42</td>
<td>Xi'an Electric Engineering Co., Ltd.</td>
</tr>
<tr>
<td>43</td>
<td>Weihai International Economic &amp; Technical Cooperative Co., Ltd</td>
</tr>
<tr>
<td>44</td>
<td>Guangxi Hydroelectric Construction Bureau</td>
</tr>
<tr>
<td>45</td>
<td>China Gezhouba Group Corporation</td>
</tr>
<tr>
<td>46</td>
<td>China National Offshore Oil Corp, Kenya Office</td>
</tr>
<tr>
<td>47</td>
<td>Beijing Electric Power Transmission and Transformation Company</td>
</tr>
<tr>
<td>48</td>
<td>AUCMA Electrical Appliance Co., Ltd.</td>
</tr>
<tr>
<td>49</td>
<td>Changhong Electric Co., Ltd.</td>
</tr>
<tr>
<td>50</td>
<td>Gold Clock International limited</td>
</tr>
</tbody>
</table>
51 Xianghui Ltd.
52 Wanda Motor Ltd.
53 Foton Motor Group
54 Goldlion International Ltd.
55 Jingu Group
56 Guanglin Industrial Ltd.
57 China Kenya Great Wall Industrial Ltd.
58 Tianyi Ltd.
59 Kenya Erdemann Real Estate Ltd.
60 China Huashi Enterprises Company Limited
61 Huayuan Real Estate Development Ltd.
62 Chengdu Third Construction and Engineering Company
63 China Petroleum Technology & Development Corporation, China National Petroleum Corporation
64 China Kenya Rickshaw Manufacturing Group
65 China Center for Promotion of Investment Development & Trade in Kenya Ltd.
66 Kenya Yuncheng Plate Ltd.
67 Zhengtai Co., Ltd.
68 Fly Horse Ltd.
69 Eastern Menghuan Home Textiles Co., Ltd.
70 China National Machinery Industry Complete Engineering Corporation
71 XCMG Group
72 Zoomlion Heavy Industry Science & Technology Co., Ltd.
73 Sany Heavy Industry (Kenya) Corporation
74 East Africa Center of China North Industries Corp.
75 Hao Ma Shi Ltd.
76 Holley-Cotec Pharmaceuticals
77  Tasly Group
78  Go Africa Travel Ltd.
79  Kenya China Travel & Tours Ltd.
80  Kenya Great Wall Tourism Company, Soluxe International
81  Long Ren Tours & Travel
82  Eastland Hotel

### Appendix III: Residual Diagnostic Tests

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Std. Error</th>
<th>t-Statistic</th>
<th>Prob.</th>
<th>Variable</th>
<th>Coefficient</th>
<th>Std. Error</th>
<th>t-Statistic</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>C</td>
<td>1.076422</td>
<td>0.077222</td>
<td>13.93939</td>
<td>0.0000</td>
<td>C</td>
<td>3326.124</td>
<td>1660.537</td>
<td>2.003041</td>
<td>0.0467</td>
</tr>
<tr>
<td>CTA</td>
<td>0.00023</td>
<td>0.000339</td>
<td>0.670831</td>
<td>0.4986</td>
<td>CTA</td>
<td>-6510.992</td>
<td>7281.425</td>
<td>-0.894068</td>
<td>0.3725</td>
</tr>
<tr>
<td>TRANSACTION_EXPOSURE</td>
<td>8.96E-07</td>
<td>1.94E-07</td>
<td>4.62267</td>
<td>0.0000</td>
<td>TRANSACTION_EXPOSURE</td>
<td>-3.02E-03</td>
<td>4.17E-03</td>
<td>-0.725201</td>
<td>0.4693</td>
</tr>
<tr>
<td>ECONOMIC_EXPOSURE</td>
<td>-4.00E-07</td>
<td>0.000387</td>
<td>-4.05917</td>
<td>0.0001</td>
<td>ECONOMIC_EXPOSURE</td>
<td>-399.111</td>
<td>8333.357</td>
<td>-0.479246</td>
<td>0.0000</td>
</tr>
<tr>
<td>CO_POLICY</td>
<td>0.02494</td>
<td>0.07365</td>
<td>0.338919</td>
<td>0.7411</td>
<td>CO_POLICY</td>
<td>-306.909</td>
<td>1620.604</td>
<td>-0.189429</td>
<td>0.085</td>
</tr>
<tr>
<td>REGULATORY_RQMENT</td>
<td>0.00708</td>
<td>0.077465</td>
<td>0.921402</td>
<td>0.3923</td>
<td>REGULATORY_RQMENT</td>
<td>767.471</td>
<td>1665.709</td>
<td>0.460731</td>
<td>0.6456</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>R-squared</th>
<th>0.208309</th>
<th>Mean dependent var</th>
<th>1.204807 R-squared</th>
<th>0.930044</th>
<th>Mean dependent var</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjusted R-squared</td>
<td>0.186194</td>
<td>S.D. dependent var</td>
<td>0.530436 Adjusted R-squared</td>
<td>0.92809</td>
<td>S.D. dependent var</td>
</tr>
<tr>
<td>S.E of regression</td>
<td>0.478513</td>
<td>Akaike info criterion</td>
<td>1.395625 S.E of regression</td>
<td>1028.971</td>
<td>Akaike info criterion</td>
</tr>
<tr>
<td>Sum squared resid</td>
<td>40.9864</td>
<td>Schwarz criterion</td>
<td>1.50007 Sum squared resid</td>
<td>19000000000</td>
<td>Schwarz criterion</td>
</tr>
<tr>
<td>Log likelihood</td>
<td>-123.0554</td>
<td>Hannan-Quinn criter.</td>
<td>1.437955 Log likelihood</td>
<td>-1968.65</td>
<td>Hannan-Quinn criter.</td>
</tr>
<tr>
<td>F-statistic</td>
<td>9.419642</td>
<td>Durbin-Watson stat</td>
<td>1.16233 F-statistic</td>
<td>475.9529</td>
<td>Durbin-Watson stat</td>
</tr>
</tbody>
</table>

| Prob(F-statistic)   | 0           | Prob(F-statistic)   | 0               |          |                    |

Notes: CTA-Cumulative Transaction Exposure; CO_POLICY-Company Policy; REGULATORY_RQMENT-Regulatory Requirement
Appendix IV: Research Authorization

KENYATTA UNIVERSITY
GRADUATE SCHOOL

Email: deqy-graduates@ku.ac.ke
Website: www.ku.ac.ke

P.O. Box 43844, 00100
NAIROBI, KENYA
Tel. 87104150

Our Ref: D58F/CTY/PT/21637/2012
DATE: 2nd September 2013

Director General,
National Commission for Science, Technology & Innovation
P.O. Box 36023-00100,
NAIROBI

Dear Sir/Madam,

RE: RESEARCH AUTHORIZATION CHEN NENGWU—REG. NO,
D58F/CTY/PT/21637/2012

I write to introduce Mr. Chen Nengwu who is a Postgraduate Student of this University. He is registered for M.Sc degree programme in the Department of Accounting & Finance.


Any assistance given will be highly appreciated.

Yours faithfully,

MRS. LUCY N. MBAABU
FOR: DEAN, GRADUATE SCHOOL
Appendix V: Research Permit

THIS IS TO CERTIFY THAT:
MR. CHEN NENG WU
of KENYATTA UNIVERSITY, 09282-00100
NAIROBI, has been permitted to conduct
research in Mombasa, Nairobi Counties

on the topic: FOREIGN EXCHANGE RISK
MANAGEMENT PRACTICES AND
FINANCIAL PERFORMANCE OF CHINESE
OWNED ENTERPRISES OPERATING IN
KENYA

for the period ending:
22nd October, 2016

Applicant's
Signature

Permit No: NACOSTI/P/15/88271/8302
Date Of Issue: 23rd October, 2015
Fee Received: USD. 350

Director General
National Commission for Science,
Technology & Innovation

CONDITIONS

1. You must report to the County Commissioner and
the County Education Officer of the area before
embarking on your research. Failure to do that
may lead to the cancellation of your permit.

2. Government Officers will not be interviewed
without prior appointment.

3. No questionnaire will be used unless it has been
approved.

4. Excavation, filming and collection of biological
specimens are subject to further permission from
the relevant Government Ministries.

5. You are required to submit at least two (2) hard
copies and one (1) soft copy of your final report.

6. The Government of Kenya reserves the right to
modify the conditions of this permit including
its cancellation without notice.