DETERMINANTS OF ADOPTION OF HEDGING PRACTICES BY SMALL AND MEDIUM-SIZE BANKS IN KENYA, NAIROBI COUNTY

NG'ANG'A TERRY GATHONI
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A PROJECT SUBMITTED TO THE SCHOOL OF BUSINESS IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF MASTERS OF BUSINESS ADMINISTRATION (FINANCE) OF KENYATTA UNIVERSITY
DECLARATION

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

Signature: ..................................................
Date: ..........................................................

Student: Ng’ang’a Terry Gathoni

This report has been submitted for examination with my approval as the University Supervisor.

Signature: ..................................................
Date: 16/04/2013

Supervisor: Mr. Ndende F. W. S
Lecturer, Department of Finance and Accounting - Kenyatta University

Signature: ..................................................
Date: 22/04/2013

Chairperson, Department of Finance and Accounting-Kenyatta University
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I thank the Almighty God for the gift of life. I also wish to thank my parents Mr. and Mrs. Ng’ang’a for their financial support and my siblings Tony, Jimmie, Karanja, Ann, Emmah, and Lydiah for their encouragement. I cannot forget my dear husband Dr. Wanjohi who has supported me morally, spiritually and materially to pursue this worthy course. Much gratitude goes to my supervisor Mr. Ndende, with whose advice, guidance and counseling enabled me to complete this work.
DEDICATION

To my beloved parents for their unrelenting support, love and encouragement. God bless them.
ABSTRACT

Banks have distinct treasury departments, with clearly written manuals that guide its day-to-day functions. These differences tend to rationalize the way hedging has always been done and since there are procedures in place as and when the circumstances warrant that changes be implemented. Hedging has been a preserve of the big organizations as the earlier scholar’s portray. The problem in exchange rates has been due to the many transactions and various branches of foreign banks in a particular period. This creates many hindrances for a smooth operation of the organization especially in small and medium-sized banks. The study was guided by the following objectives; to evaluate the various hedging practices used by small and medium banks, to determine the factors in currency options as a hedging tool by Small and medium-sized banks, to identify factors that favour forward contracts as compared to the currency option contracts and to make recommendations on the usage of currency option by small and medium-sized banks as a hedging practice. The study used a descriptive research design to obtain. The location of the study was the small and medium-size banks in Kenya, Nairobi County. The population was 130 respondents. The researcher randomly sampled 15 organizations and 68 respondents. Both primary and secondary data was collected. Currency option data was collected from employees working for the small and the medium-sized banks. The main departments visited were administration, marketing, finance and accounting. Data was collected by use of questionnaires, observation and interview methods. The questionnaire were dropped and picked after a day by the researcher. Interview method was used on the respondents so that the researcher could be able to probe more some of the respondents, who if left with the questionnaire could delay completing them. Observation schedules were prepared and researcher recorded what was seen while
conducting the research. Both the qualitative and quantitative data were processed and analyzed by use of descriptive statistics to become meaningful to the users. The results were presented in form of frequencies tables, graphs and discussions. The study made a conclusion on the hindrances and aimed at making recommendations based on the findings with a view to accommodating all aspects of daily operation. The findings of this study helps and shows the factors favoring currency options usage by large banks and multinational banks, mainly for financial reasons while smaller and medium-sized banks need to protect themselves from exchange rate movements. The research can also help future researchers and investors in the field of finance and accounting.
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# ABBREVIATIONS

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<td>CO</td>
<td>Currency Options</td>
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<td>FC</td>
<td>Forward Contract</td>
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<td>MSKB</td>
<td>Medium Size Kenyan Banks</td>
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<td>SMSB</td>
<td>Small &amp; Medium Sized Bank</td>
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<td>SPSS</td>
<td>Statistical Package for Social Sciences</td>
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DEFINITION OF TERMS

**Exercise or Strike Price:** The predetermined price to buy or sell.

**Foreign Exchange Rate:** A measure of the price of one currency in terms of another e.g. the home currency priced of one unit of foreign currency.

**Forward Contract:** An agreement to buy/sell an asset at certain price and future time.

**Hedging:** To create a position which when added to an investor’s portfolio, will offset the risk of another. It is like insurance of investment against risk.

**Interest Rate Parity Theorem:** Knowledge concerned with the difference between the spot exchange rate and the forward exchange rate. The rate is applied for deliveries made at some future specified time between two currencies.

**Medium size bank:** are banks whose personnel numbers fall below certain limits. Those with assets of 5,001-30,000 legal minimum monthly salaries (around US$1.1-6.7 million) and 51-200 employees

**Option Contract:** An external hedging technique that confers the right but not the obligation to buy/sell a fixed amount of a particular currency at or between two specified dates in the future at an agreed exchange rate.

**Small Banks:** Banks with an equity base of less than Ksh. 500 millions.

**Spot Contract:** An agreement for immediate delivery of an asset at the current spot price.
CHAPTER ONE

INTRODUCTION

1.0 Background of the study

1.0.1 Historical background of Currency Option

Currency option is a contract, which gives the option to buy the right, but not the obligation, to buy or sell the underlying asset at a stated date and at a stated price. A call option gives the right to buy and a put option gives the right to sell. The most widely used external hedging technique is the forward contract. This involves pre-selling or pre-buying a specific amount of currency at a rate specified now for delivery at a specified time in the future. The basic function of forward markets is that they allow traders to insure themselves against exchange rate uncertainties and thereby facilitate international trade. It is thus a way of totally removing risk of currency variation by locking-in the rate quoted today by the forward market. Hicks (2000) states that there does, however, remain the risk of the customer defaulting and the risk of the bank that averages the deal (counter party risk).

The banks targeted as audience for this research are Medium Size Kenyan Businesses that trade internationally. With the expression ‘medium size’, we mean banks that do several deals a month and where each deal is large enough to reach the banks minimum level of interest. These banks have realized the potentially harmful effects of currency movements and have begun to consider hedging strategies, but have not yet become financially sophisticated. The hedges in question for this type of banks are mainly hedges payments on goods.
1.0.2 Importance of currency options

Currency options give one party the right, but not the obligation, to buy or sell a specific amount of currency at a specified exchange rate on or before an agreed-upon date. If the exchange rate moves in favor of the option holder, the option can be exercised and the holder is protected from loss. On the other hand, if the rate moves against the holders, it can let the option expire, but profit, by selling the foreign currency in the spot market. Consequently, options are best characterized with potential for gain and no downside risk. Hedging in the options market enables businesses and individuals to reduce loses caused by unfavorable exchange rate changes, while preserving gains from favorable exchange rate changes. However, this flexibility has a cost. Cross-hedging success depends upon the extent to which the major currency changes in value along with the minor currency. Although cross hedging is certainly imperfect, it may be the only means available for reducing transaction exposure.

1.0.3 Role of currency options in the money market

Currency options have gained acceptance as invaluable tools in managing foreign exchange risk. They are extensively used and bring a much wider range of hedging alternatives as a result of their unique nature. Options are fundamentally different from forward contracts, as whereas the parties are committed or 'locked-in' to a future transaction in a forward contract, the buyer (holder) of an option contract has the right, but not the obligation to complete the transaction at some time in the future. Options are attractive financial instruments to portfolio managers and corporate treasuries because of this flexibility.
1.0.4 Status of use of currency options in Kenya

In relation to the Kenyan set up, some scholars have examined the development of the Kenyan market. Leiyan (2001) for example, studied the product innovations that banks could come up with to respond to the financial liberalization that was going on around the world. Options were one of the areas of innovation in the Kenyan market introduced as a tool to help companies reduce the exposure to currency risk. Such products provide clients with alternatives for hedging any exposure that they may be exposed to while engaging in international trade.

The financial markets have evolved to offer instruments like CO to investors who require to hedge transactions in foreign currencies. Below are some significant events that have occurred resulting in the present day CO markets in the world. During 1944, the world’s powers met at the Bretton Woods Conference to organize a world monetary system. This conference intended to alleviate the problems created by the World War and promote stable currencies and global trade (Vijay, 2000).

The banks targeted are the small commercial banks that work with medium size corporate customers in Kenya e.g. Daima Bank, Fina Bank and Bank of Baroda. These banks serve as market makers for the corporate customers. In order to trade with currency derivatives standardized agreements are signed between the banks and the company customers. According to Hicks (2000), banks make different types of trade, both for customers and for themselves. They continuously manage portfolios in most currencies, and they accept virtually all imaginable positions within the economic limits of the corporate customers. There is however, a lower limit while operating these investments as shown by this study.
1.1 Statement of the Problem

Mwangi (2003) studies on banking practices in Kenya has shown extraneous findings that in a sample of 38 commercial banks operating in Kenya, 37 of these borrowed funds from overseas where they hedged not using the CO. However, little is known of readiness of firms, financial market operators and management training institutions to face up to usage of CO. Are these parties aware of the existence of foreign currency risk to their operations? How are they prepared to manage such risk? And what attributes determine variability in degree of awareness and readiness to manage foreign currency risk among the individuals/firms? These are the principal research questions pursued in this study.

The banking sector plays an important role in shaping the Kenyan economy as compared to the capital market. Thus, foreign banks being more in number play a very significant role in the banking sector of our country hence the need for them to adopt the appropriate foreign exchange risk management strategies. Muthengu (2003) found out that foreign banks are more financially stable than locally incorporated banks despite the fact that they have a bigger magnitude of foreign transaction as compared to the locally owned banks.

Due to the current turbulent economic environment in Kenya, foreign exchange rates have been fluctuating significantly in the recent past. The researcher therefore has found it necessary to study the hedging practices employed by the small and medium-sized banks to mitigate the risk of foreign exchange loss. However, little is known of readiness of firms, financial market operators and management training institutions to face up to foreign currency risk and its management. Are these parties aware of the existence of foreign
currency risk to their operations? How are they prepared to manage such risk? And what attributes determine variability in degree of awareness and readiness to manage foreign currency risk among the individuals/firms? These are the principal research questions pursued in this study.

1.2 Purpose of the Study

This study’s purpose was to investigate the determinants of adoption of hedging practices by small and medium-size banks in Kenya, Nairobi County.

1.3 Objectives of the Study

The researcher formulated the following objectives:

i. To determine the hedging practices used by small and medium size banks.

ii. To determine the relationship between currency options and hedging tool used by small and medium-sized banks.

iii. To identify factors that favour forward contracts as compared to the currency option contracts.

iv. To make recommendations on the usage of currency option by small and medium-sized banks as a hedging practice.

1.4 Research Questions

The following research questions were the basis of this study.

i. What are the various hedging practices used by small and medium size banks?

ii. What is the relationship between currency options and hedging tool used by small and medium-sized banks?
iii. What are factors that favour forward contracts as compared to the currency option contracts?

iv. Which are the recommendations on the use of currency option by small and medium-sized banks?

1.5 Significance of the Study

The study expected to generate vital information useful to the institutional policy makers, employees, clients, affiliated financial institutions, researchers, government and the society. Thus, the study was useful to upcoming and new banking firms who may be able to set up structures within their treasury departments with a view to accommodate CO as a tool in hedging.

The study was also of utmost importance to policy makers as a guideline on future policy formulation and amendments. Individual investors may also find important aspects of using CO in international trade. The future researchers can use this research as a basis of their future studies.

1.6 Limitation of the Study

The researcher experienced the following limitations among others:

The busy schedule of the workers made it inconvenient thus leaving very little time for interview and/or to look for requested data. Booking appointments made it more convenient for the workers.
The researcher had no enough finance to cover a large sample size. The study was limited to a small number that affected the study outcome. The researcher tried to ensure the data collected reflects what is in the ground.

1.7 Scope of the Study
The researcher studied small and medium-sized banks operating in Kenya trading internationally by use of CO. The banks included Daima Bank, Fina Bank and Bank of Baroda. Thus, most of the organizations were located in Nairobi. The main departments visited are administration, finance and accounting. The researcher expected to visit at least 15 organizations making meeting over 68 individuals.

1.8 Assumptions of the Study
There was accessibility of the small and medium banks. It also assumed that all information necessary in CO and forward contracts were to be forthcoming.

It assumed that respondent’s jobs were not be threatened or put in jeopardy after giving the necessary financial information. Personnel sought did not influence each other in attitude, involvement, past experiences and future expectations. The study is useful to all participants involved and the stakeholders of the organizations by providing important financial information that may fill some gaps in their operations. The CO may be a lot and varied, but ultimately affect efficient service delivery in the organizations.

There is no significant relationship between a factor and adoption of CO.
CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

The chapter presents the concept of CO by small and medium-size banks. Theoretical framework, conceptual framework and the literature review presents previous studies and highlights the research gaps in them. It criticizes the previous work.

2.1 Theoretical Literature

Pandey (2004) states that the guiding principle for international financial management, like domestic financial management, is the shareholder wealth maximization. International financial management, however, differs from domestic financial management, as it has to deal with multiple currencies, interest rates, inflation rates and foreign exchange risks. There are various other written works on the CO, forward contracts and hedging in general as shown in the following sections. These areas include books, publications, and journals amongst others.

According to Pilbeam (1992), the need for a foreign exchange market arises because international trade in good/service and financial asset usually involve the exchange of different national currencies. Were the world to have a single currency then a foreign exchange market would not exist. The modern foreign exchange market is truly global and characterized by a high volume of daily transaction. Although exchange rates may move quite substantially at times this is not necessarily disruptive to international trade as traders can protect themselves against exchange risk by hedging in the forward exchange
For many countries, the depreciation or devaluation of their currencies is an important mechanism for maintaining their national competitiveness and trade volumes.

Prakash (2003) states that Forward Contracts and CO are some of the external techniques used to hedge different types of foreign currency exposure or simply put people are protecting the value of holdings and future cash flows denominated in a currency other than the domestic currency. However forward contracts are more commonly used than the CO yet from a financial point of view the option position is more advantageous.

2.2 Empirical framework

2.2.1 Hedging practices

Creativity by managers and innovations in financial instruments have, over the years, made available to firms a number of avenues that can be followed in managing the impact of foreign currency rate fluctuations. These avenues are known more commonly as hedging techniques. A hedge is a means of defense against possible loss. Hedging is the process of reducing exposure, and consists of a number of techniques intended to offset or minimize the exchange risk of loss on assets or liabilities which are denominated in a foreign currency. Some hedging techniques can be implemented within the firm, i.e. without involving any market-based financial instruments. These are known as internal hedging techniques. All other techniques necessitate taking recourse to market-based financial instruments. These are external hedging techniques.

Usefulness of hedging activity as a tool of foreign currency risk management in increasing a firm's value has been a subject of some argument in literature. Critics of foreign currency risk hedging activity argue that it is ill conceived and has little or no
effect on the value of the firm. It is, they propound, at best irrelevant and at worst costly (Logue and Oldfield, 1977). This is because foreign currency fluctuations defy explanations (Van Horne, 1998). The argument against foreign currency risk management rests on the efficient market hypothesis as it relates to foreign exchange markets. Empirical findings have supported a "weak form" of efficiency in foreign currency markets. It was found that existing foreign exchange rates reflect all economically relevant information contained in past price changes (Giddy, 1977; Giddy and Dufey, 1975). As such, there is no opportunity for one to forecast accurately future exchange rates and systematically profit by looking at past exchange rates. In a world of free exchange rates, movements follow a random walk and one cannot consistently beat the market.

Movements in exchange rates tend to be influenced by two important variables; the relative prices of goods in two countries and relative interest rates. The Purchasing Power Parity (PPP) theorem explains the relationship between relative prices of goods and exchange rates. The PPP theorem propounds that under a floating exchange regime, a relative change in purchasing power parity for any pair of currency calculated as a price ratio of traded goods would tend to be approximated by a change in the equilibrium rate of exchange between these two currencies (Shapiro and Rutenberg, 1976).

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 in 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.

2.2.2 Forward Contracts

The key to forwards pricing calculations lie in the interest rate parity theorem. Built on the concept of purchase power, parity theory and the simple argument that no arbitrage possibilities should exist, it states that when there are floating exchange rates and free capital movement between two countries the real interest rates must be the same. Otherwise, if one country had a higher rate of interest then the other one could gain value by borrowing money in the country with lower rates and deposit in the county yielding higher rates of return. In reality, this is not possible. Mwangi (2002) states, that disregarding factors such as capital movement constraints as transaction costs, the difference in nominal interest rates, will be offset by a corresponding movement of the exchange rate. Worth mentioning is that comparing interest rates can be misleading if they differ in the way they are quoted.

Hull (2003) has said that even though forward contract hedging is seen as a risk free, a forward hedge could create both a positive and a negative payoff. This is due to the holder of the forward contract is obligated to buy a currency for a specified price if the domestic currency depreciates. If the foreign currency gets more expensive, the holder of the forward contract can buy the currency at a lower exchange rate then positive payoff is obtained. On the other hand, if the domestic currency appreciates, the spot exchange rate decreases. The company with a long forward contract is bound to buy at a higher exchange rate than the spot rate, and thereby gets a negative payoff.
When Oxelheim and Wihlborg (1998) were asked, ‘why haven’t currency options been more popular?’ They replied “the answer to this question is that they are growing in popularity and are being used more. Banks are even more active in trying to sell them to their major customers”.

Maximo et al (1998) says that an important factor limiting the use of options as compared with future is that they can be expensive to use. In other words, a substantial premium is paid, but the option may not be exercisable. For this reason, it is necessary to compare the options with alternative type of hedges. Hicks (2000), shows that in CO, the holder of the option may abandon it and use the spot market if the alternative is advantageous. It is applicable in situations where the volume and need to hedge foreign currency is uncertain in magnitude. It also provides a way to guarantee a minimum price for the firms’ contribution to the project should its bid be selective. According to Vanhoose (2000) CO allow banks to protect themselves against the downside exchange risk but to profit from any upside gain from favorable exchange rate movements.

At the same time Rivera Batiz et al (1989) observes that if management is very risk averse, the forward and money market hedges offers the means to simplify an uncertain world and to focus managerial and energies between non-financial decisions. However, if managers are prepared to pay a premium by hedging using the CO, they can create an extra degree of decision freedom relative to exchange rate changes.

Prakash (2003) also notes, that CO when used with the known mark of exposure, they offer the opportunity to speculate at a price and on the future spot rate.
Case et al (1996) observes that premium paid on CO is expensive but it allows negotiating deals in foreign currency knowing that the sales yet to be negotiated, if agreed produce certain cash flows. This removes a key source of exchange rate risk for the firm.

2.2.3 Currency Options

Currency option is similar to a forward contract, with the important difference that it is optional for one of the parties. If an option is not exercised, it lapses and the premium is on it lost. However, the appeal or good thing about an option is that the maximum loss is limited to the cost of the premium, while the purchaser retains the upside potential.

Oxeiheim and Wihlborg (1998) states that, the size of the premium on each option depends on:

i. The difference between the current exchange rate and the strike price,

ii. The volatility of the two currencies,

iii. The period to maturity and

iv. For over-the-counter contracts, the size of the contract is considered.

It is important to appreciate that options are like the zero-sum games because what the holder wins is the writer loses, and vice-versa. The appeal to the hedger is that the maximum loss is limited to the cost of the premium but the potential gains are unlimited. Heywood (1984) states that an option tends to be used to cover major isolated expenditures such as, the cost of completing the acquisition of an overseas company or the phased payments in a major overseas construction project.
There is one clear benefit to an option contract hedging as compared to a forward contract. When the hedge motive is a business transaction like the sale of goods, option is to be used in the same way as forward contracts to hedge for foreign exchange risks in trade. Still there is an important difference in the type of cover obtained, Forward contracts protect the financial risks only; not the commercial risk.

Heywood (1984) states that options protect against the actual commercial risk by protecting the downside while retaining the benefits of any upside movement in the exchange rate. For example, with a depreciation of the foreign currency, the company with a long position in a forward would still have to pay the exchange rate stated in the forward contract. However, Oxelheim and Wihlborg (1998) has it that, a competitor who uses option hedged or not could buy the currency much cheaper and gain more from an otherwise identical deal.

2.3 Conceptual Framework

The major variables of this study that hinders the usage of CO by small and medium-sized banks in Kenya include multiple currencies, interest rates, inflation rates, foreign exchange risks, premium cost, financial risks and lack of expertise. These are regarded the independent variables. The dependent variable is the frequency of using CO as a hedging technique.

The following diagram shows the major factors which most of the time influences frequency of using CO as a hedging tool. The higher the intensity of each factor in a given business environment as made up by the economic, social, technological, political and legal intervention the lesser the usage of CO by small and medium-sized banks.
Figure 2.1: Diagrammatical representation of the conceptual framework

Independent Variables

- Hedging practices
  - Creativity
  - Innovation
- Currency options
  - Cost
  - Return
- Forward contracts

Intervening Variables

- Currency option
- Cost
- Returns
- Risk
- Social aspect

Dependent Variable

- Currency Options adoption

Source: (Researcher 2012)
CHAPTER THREE
RESEARCH METHODOLOGY

3.0 Introduction
The main aim of the study was to investigate the factors hindering the usage of currency options by small and medium-sized banks in Kenya. This chapter describes the types of research designs to employ in the study. Both qualitative and quantitative data have been useful in investigating the financial hedging and management practices. In this report, the researcher’s methodology covered areas such as research design, population, sampling process, data collection procedures and instruments used, and the data analysis technique to apply.

3.1 Study Research Design
The research design of this study is descriptive. According to Mugenda (1999), the design can deal with both observational and scientific description of technical financial management policies. Kothari (2003) has it that the design can also render itself to an accurate description of the variables or characteristics under which the hedging practices lead to effective or optimal service delivery to clients.

According to Mugenda (1999), researchers when describing an individual, an organization and the industry as a whole, can use descriptive research design. Thus, this study applied descriptive design on all parties and organizations in hedging. The financial management data was obtained by use of questionnaire, observation and interview methods.
3.2 Population

According to Mugenda & Mugenda (2003) population is the entire group of individuals, events or objects with some common observable characteristics. The target populations for this study were small banks and medium-size internationally trading company owners/managers/employees in Nairobi province. There are 31 small banks and 4 medium sized banks in Nairobi County. The study involved the small and medium sized banks because they are the ones that are affected most by avoiding the use of CO. The study population was made of managers, heads of department, Auditors, bank Inspectors and Financial Accountants. The organizations is made up of a population of 30 managers, 60 heads of department, 20 auditors, 15 bank inspectors and 5 financial accountants. This gave a population of 130 respondents.

3.3 Sampling Procedures

Sampling technique according to Orodho & Kombo (2002) is the procedure a researcher uses to gather people, places or things to study. The study used stratification sampling. The two strata were the small and the medium size banks in Nairobi County. The respondents were randomly sampled. Respondents refer to those who responded to the research instruments (Kothari, 2004).

3.4 Sample Size

A sample is a part of the target or accessible population that has been procedurally selected to represent it. Kothari (2008) defines a sample size as the number of items to be selected from the universe or the population to constitute a sample.
The study sampled 14 small and medium size banks. From all these organizations, the researcher concentrated on the 14 organizations. The researcher collected data from all departments or units involved with hedging. The sample unit of over 75 persons was determined randomly from the list of all organizations and employees sought from each department or unit. The sample unit included managers, heads of department, Auditors, bank Inspectors, Financial Accountants and other persons involved in hedging management.

Table 3.1: Sample size of persons

<table>
<thead>
<tr>
<th>Sample unit</th>
<th>Population of staff</th>
<th>Sample percentage</th>
<th>Sample size</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>N</td>
<td>(S)</td>
<td>N/S</td>
</tr>
<tr>
<td>Managers</td>
<td>30</td>
<td>50</td>
<td>15</td>
</tr>
<tr>
<td>Heads of department</td>
<td>60</td>
<td>50</td>
<td>30</td>
</tr>
<tr>
<td>Accountants</td>
<td>20</td>
<td>75</td>
<td>15</td>
</tr>
<tr>
<td>Inspectors/Auditors</td>
<td>15</td>
<td>75</td>
<td>10</td>
</tr>
<tr>
<td>Others</td>
<td>5</td>
<td>100</td>
<td>5</td>
</tr>
<tr>
<td>Total</td>
<td>130</td>
<td>58%</td>
<td>75</td>
</tr>
</tbody>
</table>

The researcher expected to visit at least 15 organizations that collected data from over 75 individuals. Researcher collected data by use of questionnaires, observation and interview. The questionnaires were dropped to various research points then were picked latter after a day by the researcher. Interview method was used on the respondents so that the researcher could be able to probe more some of the respondents, who if left with the
questionnaire delay completing it. Observation schedules were prepared and researcher recorded occurrences while conducting the research.

3.5 Validity of the Sample

The validation involved determining if the sample is representative of the population. The sample of the small and medium-size banks taken represents some of the strongest in the country. The sample units chosen are the key determinants of well established and implementation of financial hedging practices. The researcher visited organizations in Nairobi province who are involved in hedging. The other organizations in the country have more or less similar hedging activities. The research did not contradict earlier researches carried out in the financial management and hedging activities.

3.6 Data Collection Procedures

The nature of the study demanded that Questionnaires, Observation and Interview guides was used while collecting the data to be analyzed. Kothari (2003) both primary and secondary data as well as qualitative and quantitative data be collected. These data collection tools was structured in a manner to allow the researcher probe further on any issue concerning small and medium-sized banks financial hedging practices.

Questionnaires contained personal data and obligatory data of each respondent to obtain information regarding academic, skills, experience, duties and others. It had questions on hedging practices and how they affect business operations. The questionnaires were delivered in person to the stakeholders themselves once adequate permission has been sought from the respective management or authority.
Through observation the researcher systematically watched, listened and recorded the activities in a schedule made up of rows of departments/units and columns of hedging activities, challenges and others.

Mugenda (1999) states that interview involve collecting data through talking to the finance staff and other persons while recording their responses. Thus, a face-to-face interview was conducted to obtain in-depth hedging management information.

3.7 Data Analysis and Presentation

The quantitative data in numeric form was analyzed using Statistical Package for Social Sciences because Sekaran (1992) states it helps to determine existence of efficient and effective use of financial controls. Descriptive statistical techniques such as mean, median and standard deviation according to Kothari (2003) help in reaching a better conclusion and give well advised recommendation.

The data shall be organized in categories that try to bring out to the users, the various hedging practices. The inferential statistics according to Mugenda (1999) helped to create a general idea on what are the common decisions for a manager or employee involved in hedging management. The quantitative data included the number of employees, number of procedures, financial amounts and time estimates. The data presentation has include discussions, tables, graphs, and charts. Each presentation stand alone without being dependent on the others.

The qualitative data include description of hedging procedures, general view of hedging controls. Qualitative data also included legal provisions, sources of finance and functions
of the parties in hedging activities. All calculations were made in the Excel-based software, where the inputs exchange rate, domestic interest rate, foreign interest rate, time to maturity on the derivatives and volatility for each currency.
CHAPTER FOUR
DATA ANALYSIS, RESULTS AND DISCUSSION

4.0 Introduction

This chapter addresses the findings of investigation on the determinants of adoption of hedging practices by small and medium-size banks in Kenya, Nairobi County. The analysis and presentation of the data into meaningful information has been construed using descriptions, tables, and graphs. A sample of 75% of all the organizations in the study County was taken and the data collected. Data collection was by use of questionnaire, observation and interview schedule. The results of the research was presented and interpreted as shown in the following sections.

4.1 Response rate

75 questionnaires were filled and returned. This represented a 100% response rate, which was considered satisfactory to make conclusions for the study. This can be related to Mugenda and Mugenda (1999) who said a 50% response rate is adequate, 60% good and above 70% rated very good. This implies that basing on this assertion, the response rate in this case of 100% is very good. The response was very good as shown by the following analysis in a table. The rate of response shows expected and the actual number of the organizations, department and the persons in each organization as a whole in the study.

4.2 Demographic information

4.2.1 Number of organizations

The researcher sought to know the number of organizations, departments and persons responded.
Table 4.1: Number of organizations, departments and persons responded

<table>
<thead>
<tr>
<th>Research Units</th>
<th>Expected</th>
<th>Actual</th>
<th>Success Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of organizations</td>
<td>14</td>
<td>14</td>
<td>100</td>
</tr>
<tr>
<td>Departments per organization</td>
<td>2</td>
<td>2</td>
<td>100</td>
</tr>
<tr>
<td>Persons per organization</td>
<td>10</td>
<td>10</td>
<td>100</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>26</strong></td>
<td><strong>26</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

Despite the many difficulties encountered in the actual research work, the overall response rate was 100%. The highest response came from departments because the planned number achieved was 100%, which was made up of the number of persons who gave information per organization. The few organizations not fully researched are said to be either legally prohibited from individual researcher, unauthorized by their headquarters while others had closely guarded secrets that they feared could affect their operation if the researcher had them. Most response was obtained from the use of the questionnaire, observation and lastly the interview. Many heads of departments and managers of the organizations visited were contacted through appointments and many of whom went on postponing. The researcher ensured that all the hedging departments of each institution were well covered by use of the three data collection methods. The responses are presented in figure 4.2 as follows:
The following data was collected or obtained from the organizations where the researcher hoped to investigate within the Nairobi province. This revealed a success of 100% in the research process. The questionnaires were administered in all the 14 organizations visited. Observation was also 100% successful because the researcher visited all the organizations expected and talked to the authorities before any attempt to conduct the research. The researcher made notes on the arrangement of various working stations, procedure of the activities that took place at the particular research moment, and the questions that the clients posed as enquiries in each place visited. Interview method was over 50% successful because most respondents gave the necessary information but had little time to offer the researcher. The interview involved asking questions on the specific roles played in financial matters especially dealing with foreign currency, the functions and purposes of some policies in the financial hedging management practices. The following is a summary of where the research tools were applied in the research study among the various organizations.
Table 4.2: Categories of organizations visited and individual success achieved

<table>
<thead>
<tr>
<th>Organizations</th>
<th>Expected Number of organization</th>
<th>Researched Number of organization</th>
<th>Number of Tools Applied</th>
<th>Number of Expected Respondents</th>
<th>Number of Actual Respondents</th>
<th>Success</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small-banks</td>
<td>4</td>
<td>4</td>
<td>3</td>
<td>40</td>
<td>24</td>
<td>60%</td>
</tr>
<tr>
<td>Medium size banks</td>
<td>14</td>
<td>10</td>
<td>3</td>
<td>140</td>
<td>60</td>
<td>42.9%</td>
</tr>
<tr>
<td>Others</td>
<td>1</td>
<td>1</td>
<td>3</td>
<td>10</td>
<td>6</td>
<td>60%</td>
</tr>
<tr>
<td>Total</td>
<td>19</td>
<td>15</td>
<td>9</td>
<td>190</td>
<td>90</td>
<td>47.3%</td>
</tr>
</tbody>
</table>

This table shows that the respondents were responsive in a good degree. The response in agricultural-based organizations was low because the number of staff fell below the expected number. The tools of the research were fully utilized in all the organizations.

The above table can be presented in a graphical form as shown in the following bar graph. The difference in the size of the bars is due to non-response that was experienced.

Figure 4.2: The number of respondents from the organizations
4.2.3 Gender

The researcher sought to know the gender of the different respondents

Table 4.3: Gender of respondents

<table>
<thead>
<tr>
<th>Gender</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Female</td>
<td>42</td>
<td>47%</td>
</tr>
<tr>
<td>Male</td>
<td>48</td>
<td>53%</td>
</tr>
<tr>
<td>Total</td>
<td>90</td>
<td>100%</td>
</tr>
</tbody>
</table>

From the above table, majority of the respondents 48 (53%) were male while only 42 (47%) were female. It can therefore be deduced that the population of the respondents covered both gender. The gender of respondents show that it is important to have both gender to realize the adoption of hedging practices by small and medium sizes banks. This is because the adoption of hedging practices is a view of both gender.

After finding out the gender of respondents, the researcher found it important to find out the age of the respondents.

4.2.4 Age of respondents

The researcher sought to know the age of the different respondents. this indicated the experience and qualification of the respondents.

Table 4.4: Age of respondents

<table>
<thead>
<tr>
<th>Age of respondents</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>25 – 30</td>
<td>29</td>
<td>32%</td>
</tr>
<tr>
<td>31 – 40</td>
<td>41</td>
<td>46%</td>
</tr>
<tr>
<td>41 – 50</td>
<td>15</td>
<td>17%</td>
</tr>
<tr>
<td>Above 50 years</td>
<td>5</td>
<td>5%</td>
</tr>
<tr>
<td>Total</td>
<td>90</td>
<td>100%</td>
</tr>
</tbody>
</table>
From the above table, majority of the respondents lie between the age of 31 – 40 (46%), they are followed closely by the age bracket of 25 – 30 (32%), those between 41 -50 years covers 17% while the ones above 50 years are 5% of the total. The age depicts the experience that the respondents have in working in the small and medium sized banks in the adoption of hedging practices. The higher the age the more experienced the employees are in the adoption of the practice.

4.2.3 Education level of the respondents

The researcher sought to know the education level of the respondents. This showed the qualification of the workers on their jobs. This indicates the ability by the small and medium banks to use currency options.

<table>
<thead>
<tr>
<th>Education level</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Diploma</td>
<td>23</td>
<td>25%</td>
</tr>
<tr>
<td>Degree</td>
<td>52</td>
<td>58%</td>
</tr>
<tr>
<td>Masters</td>
<td>15</td>
<td>17%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>90</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

Table 4.5 shows that majority 52 (58%) of the respondents had degree as their highest level of education. While 23 (25%) had diplomas and 15 (17%) had masters degree as the highest level of education. This shows that the study sampled qualified respondents in terms of their work. The adoption of the hedging practice requires qualification in the sector so as to understand the challenges and benefits that comes with it. The study
indicated that the employees in the small and medium sized banks are qualified to understand the adoption of the hedging practice.

4.3 Various hedging practices used in the banks

This is one of the most important functions in any organization. This is because the future plans normally rely on the history that is mostly recorded in the books of accounts. The sensitive issue of the currency and financial management needs a pool of well-qualified personnel who can be able to produce professional work and solve the financial hedging problems while recording the various hedging transactions.

The following table shows a summary of qualification among the employees handling hedging transactions among the small and medium size banks.

Table 4.6: Experience among the employees handling finance

<table>
<thead>
<tr>
<th>Years of experience</th>
<th>Frequency</th>
<th>% of Employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 -5</td>
<td>8</td>
<td>11</td>
</tr>
<tr>
<td>5 - 10</td>
<td>17</td>
<td>23</td>
</tr>
<tr>
<td>10 - 15</td>
<td>11</td>
<td>15</td>
</tr>
<tr>
<td>15 - 20</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>20 - 25</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>25 - 30</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>Unknown</td>
<td>31</td>
<td>40</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>75</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

From the above table, it is observed that the employees had varied experiences from a few days at work to many years of service. The most experienced employees had over
thirty years at their current working station. Many employees as much as 17 had 6-10 years of service. A big number of employees did not know their exact years of their service under the financial management. This information is shown on a line-and a pie chart as follows.

**Figure 4.3: The number of employees and their relative experience**

![Graph showing the number of employees and their relative experience in years of financial management.](image)

**Figure 4.4: A pie chart showing the number of employees and relative experience**

![Pie chart showing the distribution of employees by years of financial management.](image)
The largest sector of the pie chart shows that many employees do not know the number of years they have worked in the financial department. This was attributed to the job rotation and change of their workstations. The number of permanently employed employees averaged three in each institution. The rest were on contract and/or casual basis. Their designation or job descriptions were accountants, assistant accountants, accounts clerk, finance administrators, branch executive and administrative assistants.

b) Separation of duties and responsibility

The separation of the duties is done according to the various qualifications that each employee possessed and the nature of work involved. The following is a summary of duties and responsibilities as identified by the researcher.

4.4 Factors in currency options as a hedging tool by Small and medium-sized banks

Table 4.7: Preference of forward contract by the small and medium size banks

<table>
<thead>
<tr>
<th>Experience</th>
<th>Frequency</th>
<th>% of Employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very often</td>
<td>8</td>
<td>11</td>
</tr>
<tr>
<td>Often</td>
<td>12</td>
<td>16</td>
</tr>
<tr>
<td>Undecided</td>
<td>21</td>
<td>28</td>
</tr>
<tr>
<td>Not often</td>
<td>34</td>
<td>45</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>75</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

The findings indicated that a majority 20 (27%) of the respondents of the small banks and medium size often prefer forward contract. Most of the hedging activities are normally
conducted in dollar where international trade activities involve huge cash flows of Kenyan currency and even other currencies. The other main hedging currency is the euro currency but all the other currencies are less frequently used in Kenya.

Table 4.8: Forward contracts is seen as more secure

<table>
<thead>
<tr>
<th>Experience</th>
<th>Frequency</th>
<th>% of Employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very true</td>
<td>10</td>
<td>13</td>
</tr>
<tr>
<td>True</td>
<td>35</td>
<td>47</td>
</tr>
<tr>
<td>Undecided</td>
<td>10</td>
<td>13</td>
</tr>
<tr>
<td>False</td>
<td>5</td>
<td>7</td>
</tr>
<tr>
<td>Very false</td>
<td>15</td>
<td>20</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>75</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

A majority 45 (60%) of the respondents said it's true that their banks find forward contracts as being more secure. The forward contracts acts as a right to exchange the money at the pre-agreed rate other than other instruments where an organization is obliged to trade at the rate that is offered.
4.5 Factors that favour forward contracts as compared to the currency option contracts

Figure 4.5 Benefit from favourable movement in the exchange rate

![Pie chart showing 76% Yes and 24% No]

A majority 57 (76%) of the respondents said agreed that they benefit from any favourable movement in the exchange rate. The forward contracts are user friendly in that we get to buy and sell the only amount that we had projected and the inflation won’t affect the transactions. The forward contracts acts as a right to exchange the money at the pre-agreed rate other than other instruments where an organization is obliged to trade at the rate that is offered.
A majority 57 (76%) of the respondents said agreed that they benefit from any favourable movement in the exchange rate.

**Table 4.9: Factors making forward contracts favourable**

<table>
<thead>
<tr>
<th>Statement</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>The organization is protected from any adverse effect on the movement of exchange rates.</td>
<td>60</td>
<td>15</td>
</tr>
<tr>
<td>The forward contracts are user friendly</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The forward contracts acts as a right to exchange the money at the pre-agreed rate</td>
<td>54</td>
<td>21</td>
</tr>
</tbody>
</table>

The findings indicated that a majority 60 respondents agreed that the organization is protected from any adverse effect on the movement of exchange rates. The study also found out that a majority 43 respondents agreed that the forward contracts are user
friendly in that we get to buy and sell the only amount that we had projected and the inflation will not affect the transactions. A majority 54 agreed that the forward contracts acts as a right to exchange the money at the pre-agreed rate other than other instruments where an organization is obliged to trade at the rate that is offered.

4.4 Operation of the organizations

The researcher had keen interest in the operational capacity of the organizations studied. It was found that many organizations had not been in operation for a long period especially those that had branches in the country.

The researcher grouped the period into three main categories i.e. less than ten years, between 11 and twenty years and for more than twenty-one years. This has been shown in the following diagram.

Table 4.10 Period the organizations have been in operation

<table>
<thead>
<tr>
<th>Period Years</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 10</td>
<td>7</td>
<td>47</td>
</tr>
<tr>
<td>11 – 20</td>
<td>5</td>
<td>33</td>
</tr>
<tr>
<td>More than 20</td>
<td>3</td>
<td>20</td>
</tr>
</tbody>
</table>
The above figure shows that most of the organizations have been in operation for a period of less than ten years. Very few organizations have been in operation for more than twenty years. Thus, the determination on the use of CO was very difficult. Many organizations had at one time only used the forward contracts but very few an idea of what benefits they can realize by use of currency options.

The researcher also sought to know the reasons making the organizations borrow money from the overseas. Some organizations had very good reasons as to why they don’t borrow from Kenya but, others had no reason as to why they would fetch money outsider the country.

The following are some of the reasons for borrowing money abroad:

1) To fund any major new projects
2) To increase the shareholding in the mother company

3) When there is need to expand existing new programmes or projects.

4) Where an organization lacks the experts and the foreigners provide for them.

4.5 Foreign exchange risk

The banking sector plays a more important role in shaping the Kenyan economy as compared to the capital market. Thus, foreign banks being more in number play a very significant role in the banking sector of our country hence the need for them to adopt the appropriate foreign exchange risk management strategies. The medium size banks are usually the pillars of our economy because they support the very big banks operating in and outside our country. When the researcher asked if the organizations had well established schemes to manage the risk involved in the international trade, most of them gave a positive consent though for those who were operating as branches risk management was centralized. Some organizations managed the hedging risks through their accounting function or the finance function but they did not have separate departments or units to manage the foreign exchange risk. Over 60% of all the banks researched had no risk management departments.

In managing the risk on foreign exchange, free float rate system was more exercised. In the use of the forward contract, it was more preferred because it involved less risk risk. Forward contracts are easily understood and as well easily applied. Foreign currency option is more complex according to the respondent because it cannot be easily applied or understood.
The researcher extended the search for the information by checking on the mostly used currency. The obvious answer was that the dollar was more preferred to any other currency. Many of the customers in the foreign trade attributed this to the fact that it is more available and acceptable. The Euro had equal chances but many customer had a longer history in use of the dollar. The use of the dollar reduced the risk involved in the foreign currency trade. The following is a summary of the exchange rate in dollars for the last six months up to December year 2012.

**Table 4.11: Summary of exchange rate in dollars for the last six months up to December 2011**

<table>
<thead>
<tr>
<th>March 2011</th>
<th>Exchange Rate</th>
<th>Strike price</th>
</tr>
</thead>
<tbody>
<tr>
<td>June</td>
<td>88</td>
<td>88.98</td>
</tr>
<tr>
<td>July</td>
<td>89</td>
<td>89.29</td>
</tr>
<tr>
<td>August</td>
<td>92</td>
<td>92.23</td>
</tr>
<tr>
<td>September</td>
<td>98</td>
<td>98.71</td>
</tr>
<tr>
<td>October</td>
<td>102</td>
<td>102.12</td>
</tr>
<tr>
<td>November</td>
<td>92</td>
<td>92.64</td>
</tr>
<tr>
<td>December</td>
<td>85</td>
<td>85.23</td>
</tr>
</tbody>
</table>

The researcher enquired on the ways of dealing with the risk, the answer to this was that the management had tried to implement management by exception where after suffering the risk of loss they would try to formulate strategies of risk management. Only a fifth of the organizations had any plan in place to manage the risk in foreign currency. The other
way to manage the risk involved investing in long term assets and short-term assets. The total assets involved in the risk management were distributed as follows.

Table: 4.9 Assets distribution for risk management

<table>
<thead>
<tr>
<th>Asset size (sh.)</th>
<th>Number of firms</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 3 billion</td>
<td>12</td>
<td>80</td>
</tr>
<tr>
<td>Between 3.1 - 8 billion</td>
<td>2</td>
<td>13</td>
</tr>
<tr>
<td>More than 8 billion</td>
<td>1</td>
<td>7</td>
</tr>
</tbody>
</table>

Figure 4.8 Assets distribution for risk management

To reduce the foreign currency risk auditing is normally conducted in the various organizations. This has been seen to be of crucial essence since once an audit is conducted, it reduces chances of repeated mistake and errors. The researcher wanted to know the way books of accounts are maintained and whether they follow the stated standards. The auditors’ work is expected to be the investigation of all these records.
listed above. The investigation involved whether all of them are normally maintained and if maintained whether they carry all the necessary information. Thus auditors had to do an in-depth search of errors and omissions in their investigation.

The researcher inquired on the frequency of audits and inspection. The respondents were asked to state the number of times the researcher visited their organizations for the inspection and audit of the financial transactions. The respondent gave the following.

Table 4.12: Audit frequency and number of organizations investigated

<table>
<thead>
<tr>
<th>Frequency</th>
<th>No. Of organizations</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yearly</td>
<td>5</td>
<td>36</td>
</tr>
<tr>
<td>Half yearly</td>
<td>5</td>
<td>36</td>
</tr>
<tr>
<td>Quarterly</td>
<td>2</td>
<td>14</td>
</tr>
<tr>
<td>Daily</td>
<td>2</td>
<td>14</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>15</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

Figure 4.9: A pie chart on audit frequency and number of organizations investigated
This pie-chart shows that the auditing and inspection in most organizations was normally done half yearly and also after a whole year.

The auditors expect the procedures and systems of accounting to follow the International Financial Reputing Standards (IFRS), ISO standards, Cannon-law for church institutions, Income Tax Standards among other regulations.

The values observed and expected by the auditors include Honesty, Updated, Consistency, Transparency, Integrity, Accuracy and Accountability. The researcher enquired the reasons for having to audit the books of accounts and other financial documents or transactions: Reviewing of internal audit work to authenticate it, checking on the truth and fairness of results as provided by various documents, auditors are assumed independent and more capable (experts) in specific financial issues, auditors may help on how to maintain and keep proper financial records on different situations, the auditors help in providing solutions or suggestions to redress financial errors, auditing is a tool used by headquarters managers to exercise authority over branch managers in organizations as a way of checking or enhancing their performance and auditors are expected to come in handy to assist their clients or employees when experiencing difficult financial or accounting matters.

Benefits of inspecting and auditing financial management in the organizations were stated to be as follows: financial records are duly updated, management is able to assess financial status through auditors, the auditors help in establishing modern techniques in management of financial transactions, auditing reduces misappropriation of finances, auditing enhances transparency in management of finances, auditing ensures proper
maintenance of books of accounts, audit reports are useful finances management tools, auditing helps to discover or prevent financial errors and fraud before they become too expensive, auditing ensures compliance to rules and regulations in financial management, auditing strengthens financial internal control systems and ensures they are operational, it helps in compliance with statutory provisions, auditing improves values of financial management practice, assesses and evaluates performance of an institute, auditing identifies weakness inherent in financial management practice, auditing helps in predicting situations and strategizing for the future, it helps reduce unnecessary details and helps secure assets in custody of some employees.

4.6 Financial problems while managing foreign exchange transactions

The researcher found that there are various financial problems experienced by the financial employees on a monthly basis. The following information shows the nature of the problem and the frequency of occurrence in a period of one month.

Table 4.13: The nature and frequency of the problems in the financial management

<table>
<thead>
<tr>
<th>Code</th>
<th>Nature of the problems</th>
<th>Frequency of occurrence</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Double entries</td>
<td>11</td>
</tr>
<tr>
<td>2.</td>
<td>Receipting</td>
<td>6</td>
</tr>
<tr>
<td>3.</td>
<td>Banking</td>
<td>4</td>
</tr>
<tr>
<td>4.</td>
<td>Tallying (Totals)</td>
<td>16</td>
</tr>
<tr>
<td>5.</td>
<td>Accruals mismanagement</td>
<td>4</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>41</td>
</tr>
</tbody>
</table>
This table shows that the most common type of a problem involves the tallying the figures in the financial records. This is caused by the lack of automatic financial procedures in the various organizations. Banking of daily collection is done by the cashiers and due to the reduced number of transactions involving cash in the firms, banking problems are minimal.
CHAPTER FIVE
SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.0 Introduction
This chapter presents the summary of the study, conclusions and recommendations for possible policy implementation. It also gives suggestions for further suggestion.

5.1 Summary of the findings
The study observed that majority (55%) of the private and public organizations of this country have demonstrated the need for all to acquire necessary skills and knowledge that will enhance development of all sectors of the economy. Majority (60%) indicated that they have sought any kind of assistance, financial and otherwise, to help streamline the management of the financial sectors both locally and internationally.

In studying the relationship between currency options and hedging tools, majority (60%) of the respondents indicated that financing international trade and other activities in the organizations requires the government to engage all persons concerned in managing hedging. All (100%) of the small and medium banks have consumed many resources in construction of the infrastructure and development of all fields concerned with currencies.

The factors that favour forward contracts as compared to the currency option contract indicated that majority (55%) of the respondents finance their needs, (60%) indicated that their financial systems have been put in place to avoid misuse or misapplication of the financial resources. Majority (75%) observed that the systems are in place but some
managers and employees of the organizations ignore or do not even understand the various rules and regulation on hedging.

5.2 Conclusions

In conclusion, the researcher found out that forward contract are preferred and frequently used by the small bank and medium size banks. Forward contracts is seen as more secure, easy and simple to use, budgets are set knowing exactly how much the transactions costs and forward contracts are readily available to any size of a company dealing in any kind of an activity.

In the currency options, the studies from the secondary data have revealed that when the rate is not fixed, an organization may benefit from any favourable movement in the exchange rate. In the forward contract one can only abandon the whole contract. The organization is protected from any adverse effect on the movement of exchange rates. The forward contracts are user friendly in that we get to buy and sell the only amount that we had projected and the inflation won’t affect the transactions. The forward contracts acts as a right to exchange the money at the pre-agreed rate other than other instruments where an organization is obliged to trade at the rate that is offered.

Most of the hedging activities are normally conducted in dollar where international trade activities involve huge cash flows of Kenyan currency and even other currencies. The other main hedging currency is the euro currency but all the other currencies are less frequently used in Kenya.
Finally, it has been found that hedging is a very important activity because it helps in planning the banks projects and distribution of the funds that transcends the county’s border.

5.3 Recommendations of the study

The researcher makes the following recommendations from the study objectives following:

i. Since most of the time the interest rates are not fixed the forward contracts should be given more prominence as it is better understood by many employees in various organizations.

ii. There are a multiple currencies in the international trade, the dollar followed by the euro currency is widely used, and thus many organizations should continue to apply them in their hedging activities.

iii. Forward contracts is user friendly because many organizations get to buy and sell the only amount that they had projected and the inflation rates does not affect the activities.

iv. Management of the foreign exchange risks should be improved by all the organizations whether small banks or medium-size banks. There should be policies governing Kenya Bankers Associations on capital option adoption.

5.4 Suggestion for further studies

Since this study focused only on small and medium sized banks, further and intensively researched should be done on other banks to determine the hedging practices used by those banks.
There should be another study on the relationship between hedging tool used and other currency options in the other types of banks. This will help us to understand the difference in the utilization of hedging tool and the relationships with the currency option.

The researcher suggests further research in the use of technology in hedging activities due to the increased use of e-commerce in the international trade. This will identify factors that favour forward contracts as compared to the currency option contracts in the banks.
REFERENCES


APPENDICES

APPENDIX I: BANKS IN KENYA

a) List of small commercial banks in Kenya

1. ABC Bank (Kenya)
2. Bank of Africa
3. Bank of Baroda
4. Bank of India
5. CFC-Stanbic Bank
6. Charterhouse Bank
7. Chase Bank
8. Citibank
9. City Finance Bank
10. Commercial Bank of Africa
11. Diamond Trust Bank
12. Dubai Bank
13. Ecobank
14. Equatorial Commercial Bank
15. Family Bank
16. Fidelity Commercial Bank
17. Fina Bank
18. Giro Commercial Bank
19. Guardian Bank
20. Habib Bank
21. Imperial Bank
22. K-Rep Bank
23. NIC Bank
24. Oriental Commercial Bank
25. Prime Bank
26. Prime Capital and Credit Finance Bank
27. Savings and Loan Bank
28. Transnational Bank
29. United Bank for Africa
30. Victoria Commercial Bank
31. Commercial and Savings Bank of Somalia
APPENDIX II: TRANSMITTAL LETTER

TERRY GATHONI N.
P.O. BOX 1282,
Thika.
Through:
Kenyatta University,
School of Business,
Department of Business Administration,
P.O. Box 43844,
Nairobi- Kenya.
1st February 2011.

Dear Sir! Madam,

DETERMINANTS OF ADOPTION OF HEDGING PRACTICES BY SMALL AND MEDIUM-SIZE BANKS IN KENYA, NAIROBI COUNTY

I am a postgraduate student pursuing MBA program at Kenyatta University. I am currently conducting research on the above-mentioned topic. You have been selected for this study. I kindly request you to take time, read and complete the questionnaire accompanying this letter. The information that you will provide will be used only for the study and confidentiality is assured.

Thanks in advance for your support in this endeavor. The filled questionnaire can be sent back to me using the address. Email: ngterrv80@yahoo.com.

Yours faithfully,

Terry Gathoni Ng’ang’a,

MBA student (Reg. No. D53/1071812004)
This questionnaire is to collect data for purely academic purposes. The study seeks to investigate the determinants of adoption of hedging practices by small and medium-size banks in Kenya, Nairobi County. All information will be treated with strict confidence. Do not put your name or identification on this questionnaire.

Answer all questions as indicated by either filling in the blank or ticking the option that applies.

1. Gender
   Male [ ] Female [ ]

2. Age
   25 – 30 yrs [ ] 31 – 40 yrs [ ] 41 – 50 yrs [ ] Above 50 yrs [ ]

3. Indicate your highest level of education.
   Primary [ ]
   Secondary [ ]
   Diploma [ ]
   Degree [ ]
   Masters [ ]

4. How many employees work in your department/section/unit?............................

5. Explain the Financial duties and responsibilities of your department.
   ............................................................................................................
   ............................................................................................................
   ............................................................................................................

6. Name of the Bank .................................................................
7. What compels your bank to borrow funds from overseas?

8. Does your bank have a risk management department?
   Yes. □
   No. □

9. Kindly tick the financial instruments used by your bank to hedge against the foreign exchange risk.
   a) Forward contract □
   b) Foreign currency option □
   c) Others (please indicate) .........................................................

10. Which particular currency has the greatest contribution to your bank’s foreign exchange risk?

11. Does your bank have training programme on risk managements?
    Yes □       No. □

12. What is the value of your bank’s total assets? (Please tick).
    Less than 3 billion shilling □
    Between 3.1 to 8 billion shilling □
    More than 8.1 billion shilling □
11. Which of the above instruments is most frequently used? Why?

............................................................................................................
............................................................................................................
............................................................................................................
............................................................................................................

12. How often does your bank measure the success of its exchange rate risk management policy?

............................................................................................................
............................................................................................................
............................................................................................................
............................................................................................................

13. Kindly give the following information for the months of June 2011-September 2011.

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Exchange rate</td>
<td></td>
</tr>
<tr>
<td>Domestic interest rate</td>
<td></td>
</tr>
<tr>
<td>Time to maturity on the derivative</td>
<td></td>
</tr>
<tr>
<td>Foreign interest rate</td>
<td></td>
</tr>
<tr>
<td>Volatility for each</td>
<td></td>
</tr>
<tr>
<td>Strike price</td>
<td></td>
</tr>
</tbody>
</table>

Thank you
### APPENDIX IV: OBSERVATIONAL SCHEDULE

<table>
<thead>
<tr>
<th>DEPARTMENT OR SECTION</th>
<th>HEDGING ACTIVITIES</th>
<th>REMARKS</th>
</tr>
</thead>
<tbody>
<tr>
<td>ADMINISTRATION</td>
<td></td>
<td></td>
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<tr>
<td>ACCOUNTING</td>
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<tr>
<td>AUDITING</td>
<td></td>
<td></td>
</tr>
<tr>
<td>CREDIT</td>
<td></td>
<td></td>
</tr>
<tr>
<td>MARKETING</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
APPENDIX V: INTERVIEW SCHEDULE

a) Name of the Bank.

b) How long has your bank been operating in Kenya? (Please tick)
   - Less than 10 years [  ]
   - Between 11 and 20 years [  ]
   - More than 21 years [  ]

c) What compels your bank to borrow funds from overseas?


d) Does your bank have a risk management department?


e) Kindly tick the financial instruments used by your bank to hedge against
   - Foreign exchange risk. [  ]
   - Forward contract [  ]
   - Foreign currency option [  ]
   - Others (please specify) [  ]

f) Which particular currency has the greatest contribution to your bank’s foreign exchange risk?


g) Does your bank have training programme on risk managements?
h) What is the value of your bank's total assets? (Please tick)

- Less than 3 billion shilling [    ]
- Between 3.1 to 8 billion shilling [    ]
- More than 8.1 billion shilling [    ]

i) Which of the above instruments is most frequently used? Why?

j) How often does your bank measure the success of its exchange rate risk management policy?