
Exchange Rate Risk Management Practice among Agricultural Firms in Kenya

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Abstract

The exchange rate is a major macro economic factor that affects all entities either directly or indirectly. Kenya has managed a floating exchange rate regime for a while. Varying exchange rates expose firms involved in international transactions to exchange rate risk. Management can structure operations and/or take risk mitigating measures to reduce or eliminate impact of risk exposure to a firm. Agriculture is the leading source of foreign exchange in Kenya. The purpose of the study was to find out how Kenyan agricultural firms manage exchange rate risk exposure and the challenges they face in the process. The study took a cross-sectional descriptive study to understand the exchange rate risk management practice among firms involved in the export of tea, cut flowers and coffee.

The study found that the Kenyan shilling (KES) exchange rates with the US dollar (USD), The Euro (EUR), The Great Britain pound (GBP) and the Japanese yen (JPY) have had an average variation of just over 15% for the period under study. The EUR had the least variability while the GBP had the highest variability. Close to 56% of Kenyan agricultural firms had established risk management function to deal with exchange rate risk. Risk management functions were mainly domiciled in the finance\accounting departments and at the board of directors' level. Transaction and operating exchange rate risk exposures were the most prevalent and hence most firms considered effects of exchange rate risk on sales, profitability and cash flows as the most important. About 63% of the agricultural firms set budget exchange rates but mainly used for corporate budgeting rather than for exchange rate risk management.

About 30% of the firms identified and estimated exchange rate risk exposure in advance and took appropriate hedge position. Sensitivity analysis, goal seeking analysis and past trends and experiences were the main techniques used to estimate exchange rate risk exposure. Nearly all the agricultural firms used currency substitution and natural hedging

techniques to manage exchange risk exposure. Only a small proportion (about 7%) were constantly using over the counter currency derivatives. Exchange traded currency derivatives are non-existent in the Kenyan financial markets. The main challenges faced in managing exchange rate risk are high exchange rates volatility, inability to adjust prices to compensate for adverse movements, difficulties in arranging hedge contract with banks, and difficulties in getting well skilled financial risk management labour.

The research recommends that agricultural firms establish and/or strengthen risk management function and further diversify export markets and billing currencies and promote local market consumption of their products. The study also points out the need to deepen the currency derivatives market through appropriate legislation and risk management products development and utilization.