EFFECT OF FLUCTUATION IN FOREIGN CURRENCY EXCHANGE RATES ON FINANCIAL PERFORMANCE OF FIVE STAR HOTELS IN NAIROBI

KARIUKI BELINDA WANJIKU

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DECLARATION

This research project is my original work and has not been presented for examination or award in any other University.

Signature…… Date……..…

KARIUKI BELINDA WANJIKU

D61/79290/2015

This research project has been submitted for presentation with my approval as University Supervisor.

Supervisor's Signature…… Date……

DR. WINNIE NYAMUTE

DEPARTMENT OF FINANCE AND ACCOUNTING

SCHOOL OF BUSINESS

UNIVERSITY OF NAIROBI

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DEDICATION

This project is dedicated to my family and friends for their continued support.

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LIST OF ABBREVIATIONS

CBK	:	Central Bank of Kenya
FDI	:	Foreign Direct investments
GDP	:	Gross Domestic Product
IPR	:	Interest Rate Parity
USD	:	United States Dollar
IDC	:	Industrial Development Corporation

ABSTRACT

For the organizations to remain competitive and thrive, they are necessitated to evaluate their external factors, which include foreign exchange market variability. Fluctuations in the exchange rates may impact on the external operations of a country, mainly through their impact on foreign trade transactions. Failure of organizations to manage their foreign exchange exposure will have negative impact on financial performance due to foreign exchange losses and gains. The study objective was to determine the effect of fluctuation in foreign exchange currency rates on the financial performance of hotels in Nairobi. This study adopted the descriptive research design. The target population was all the five star hotels operating in Nairobi Kenya. Due to the population being small, a census sampling approach was employed and all the ten five star hotels in Nairobi studied as per Tourism Regulatory Authority classification. The study used secondary data. Secondary data was obtained from the monthly management reports of the hotels which was analyzed on quarterly basis for the period between 2012 and 2016. Data obtained related to financial performance of five star hotels as measured by return on assets. Data relating to exchange rates, economic growth and information was obtained from Central Bank of Kenya. The study used quantitative data analysis techniques where Statistical Package for Social Sciences version 23 was used to analyze data. Test of significance of the results was done using Analysis of Variance. The findings obtained showed that Exchange Rate Fluctuations had a significant positive impact on the performance. Thus, depreciation of Kenya Shilling against the USD will lead to increased hotel financial performance. Inflation had a negative relationship on the financial performance of five star hotels. GDP on the other hand had a positive relationship. An improvement in the GDP translates to an improvement in other economy sectors. The study concluded that increased depreciation of Kenya shilling against the USD (increased exchange rate fluctuation) will cause an increase in the performance. This could be due to the hotels receiving much of revenues in USD. Further depreciating local currency improves exports and makes imports expensive. However, macrocosmic theory requires determination of optimal value for a currency and a stable exchange rate environment. The study therefore recommended that Central Bank of Kenya to come up with policies that will ensure stable exchange rate environment. Further studies were recommended to be done on other sectors and not entirely the hotel sector for instance firms in energy, manufacturing, agriculture, tourism and other sectors. This would provide a wide pool of research findings that can be compared across the business fraternity for optimal policy formulation. Future researchers can also undertake to ascertain the effectiveness of hedging strategies for instance usage of forwards contracts in reducing foreign exchange risks by the hotels.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Fluctuations in exchange rates among major currencies raises concern about how exactly the fluctuations affect organizations operations and performance (Farah, 2014). Trade and investment in a country are likely to be impacted by foreign exchange market. Stable currency environment is most likely to improve both the welfare of the business and the country's economy in general. In the smaller scale, the exchange rates are important in that they are a great determinant on how organizations perform, specifically the multinational companies (Hommel, 2003). These organizations ought to carefully evaluate their risks due to undertaking their business in the volatile international level.

Fluctuations in the exchange rates may impact on the external operations of a country, mainly through their impact on foreign trade transactions. Exchange rates also affect the cost of servicing on the country's foreign debt (Omagwa, 2005). Like most commodities, the exchange rates are based majorly on the demand and supply for a particular currency form. Country's fiscal and monetary policies are mostly responsible for the domestic currency supply (Berger and Bouwman, 2010).

The five star hotels host variety of customers from different countries, and are expected to not only meet the set standards of quality but also generate enough revenues to enable sustainable performance of the hotels. Due to most international organizations in Kenya having their regional offices located in Nairobi, most of these hotels are Nairobi based so as to host the large number of guests visiting the country. Majorly, hotel room rates are

quoted and paid in foreign currencies specifically the United States Dollar (USD). The value of foreign currency received is affected by exchange rate when converted to the local currency.

1.1.1 Foreign Exchange Rates Fluctuations

Exchange rate may be termed as how one currency is exchanged with another in the international market. Particularly, it may be used as a measure the value of the currency of a particular country compared to another country (O'Sullivan and Sheffrin 2003). In Kenya, the exchange rates have had a volatile trend over last years, with constant fluctuations being experienced. This raises concern as to what exactly has resulted in this exchange rates fluctuations.

For the past five decades, the Ksh. has been depreciating against the US Dollar from KShs. 84 in 2012 to a low of KShs 106 in September 2015 (CBK, 2016). The fluctuations may be triggered by a number of factors such as interest rates, public debt and inflation rates (Otuori, 2013). Swapping scale vacillations can likewise be because of changes in the request and supply of the cash in the forex showcase. At the point when request surpasses supply, the conversion standard will acknowledge and ascend in esteem.

In the recent, Kenya has been experiencing cases of insecurity such as terrorists from Somali-based militia group al-Shabaab undertaking attacks in Kenyan. This has reduced the tourist number in the tourism industry which forms a main foreign exchange earner. Hence drastically depreciating the strength of the shilling (Otuori, 2013). Likewise, the nation's political state and financial execution can influence its money quality. A nation with political dependability is more alluring to remote financial specialists. Consequently, the political unrests experienced in Kenya in 2008 contributed greatly to the depreciation

of the shilling. Also, re-introducing 5% tax on all income from sale of shares at the Nairobi Securities Exchange has had a negative impact on foreign investors leading to a change in the exchange rates (Frank, 2015).

1.1.2 Financial Performance

Financial performance refers to the ability to leverage operational and investment decisions and strategies to achieve a business' financial stability (Majok, 2015). It determines how well the business is doing in wealth creation and acquiring of resources (Komppula, 2004). Financial performance could also be termed as the ability of an organization to meet its set objectives effectively. The financial performance indicators such as profitability and liquidity enable the stakeholders to analyse the past, current and future financial stability of a particular organization.

Financial performance can be measured by varied approaches which have been adopted by various researchers including return on assets, liquidity, return on investments and cash flows (Wijewardena *et al*, 2004). Return on investment correlates the firm's investings to its level of gains, Return on Assets measures profitability in relation to total assets employed. Liquidity (cash flow) is capability of a firm to meet financial obligations in the short term basis, while cash flow comprises the amount of capital available to meet the financial requirements of the company (Farah, 2014).

In this manner, there are numerous changing techniques to survey monetary execution, yet all measures ought to be taken in thought. Line things like working salary, income from operations, or income from operations, and in addition add up to unit deals might be utilized. Moreover, the investigator or speculator may wish to look further into money related explanations and examinations negligible development rates or profit for

resources. Ultimately the most accepted measure of business performance is profits and the forms of this measurement are the final accounts of the company (Wagana, 2014).

1.1.3 Foreign Exchange Rates Fluctuation and Financial Performance

Business transactions undertaken where different currencies are involved, require the conversion of foreign currency to the local currency for reporting and running operations of the organizations. This is made possible by the exchange rates forex market (Corgel, *et al,* 2013). The rates are however, not static due to their ever changing nature and thus ought to be evaluated frequently.

Over the last decade, scholars and policy makers in both developed and developing countries have recognized that foreign exchange rates are critical for the establishment and survival of multinational companies (Biller, 2007). The exact role of foreign exchange rates on performance is what the scholars have tried to determine. Theoretically, the exchange rates have been established to have a significant relationship with the performance of organizations. Purchasing Power Parity theory compares the average costs of goods and services between countries while the Flow Oriented Model holds that the exchange rates changes affect real income and output in a country. But the theories do not put forward a definite framework to establish the exact relationship that exist (Kipchirchir 2011).

Empirically, studies have also confirmed the positive association between fluctuations in foreign exchange rates on financial performance. This is evidenced by the studies conducted by Otuori, (2013), Opati (2009) on inflation and exchange rates and Maina (2010) on exchange rate variability and investment decisions. However, other studies did not establish any significant relationship between the two variables (Nyamwange, 2009).

This shows that not all studies have been able to construct sophisticated measures of fluctuation in foreign exchange rates and definitively establish causal. As a result, it is difficult to determine the exact influence of fluctuation in foreign exchange on the performance of hotels in Nairobi.

1.1.4 Hotels in Nairobi

The capital city, Nairobi, has roughly 265 hotels extending from 5-to 1-star. According to the Kenyan Gazette Notice No. 3976 (Vol. CV-No. 62) there are as of now sixteen five star lodgings in the nation and eight of them are arranged in Nairobi. The inns have a bed limit running from forty six beds to seven hundred beds. Well known 5-star inns in Nairobi incorporate the Tribe, Nairobi Serena, Fairmont, Norfolk, Windsor Golf Hotel, InterContinental Nairobi and Panari Hotel (IDC, 2014).

The normal room rate for these inns extends the most reduced being USD 225 while the most noteworthy being USD 400 every night. This accordingly makes Kenya a most loved goal for both organizations and tourism visits. Around 2006, the responsibility for convenience foundations was primarily by the private area with the administration just owning couple of worldwide lodgings. Despite the fact that the inhabitance encountered an extraordinary drop in 2008 because of political shakiness, they later recouped a year later contributed by escalated promoting (IDC, 2014).

Most areas of the economy recorded positive developments of differing size in 2015, aside from the lodgings and eatery division whose development contracted (Frank, 2015). This was for the most part credited to low inn inhabitance rates emerging from instability worries by global guests. These worries have seen a decrease in visitor landings. In spite of this current, Nairobi's lodging inhabitance levels have remained moderately strong.

These hotels for the most part take into account the business vacationer. Accordingly, the achievement of an inn organization relies on upon various outer and inside components. Outside elements, for example, political, demographic, monetary, regular, and innovative and, in this manner, organizations have next to zero control over these elements (Gursoy and Swanger, 2007).

1.2 Research Problem

For the organizations to remain competitive and thrive, they are necessitated to evaluate their external factors, which include foreign exchange market variability. Failure of organizations to manage their foreign exchange exposure will have negative impact on financial performance due to foreign exchange losses and gains (Todani and Munyama, 2005). However, currently the exchange rates are dynamic and volatile as they are constantly fluctuating hence ought to be often evaluated in relation to organization's financial performance. Kenyan urban areas have a satisfactory appropriation of inns and different sorts of convenience (Juma, 2011). In spite of the fact that the five star hotels in the city have developed and extended their limits, regardless they stay defenseless against the adjustments in the trade rates (IDC, 2014). This is because of them being reliant significantly on the foreign guests and in this manner exchange rate fluctuations affect their performance.

Several studies have been done on the effects of exchange rate fluctuations on financial performance in other nations. Adjasi and Biekpe (2005) revealed that there was no relationship between the variables. Pitia and Lado (2015) revealed that there existed a unidirectional causality between exchange rates and inflation.

Kipchirchir (2011) examining financial performance and exchange rates found that there was a strong relationship. Runo (2013) examined the effects of exchange rate fluctuations on changes in retail oil prices in Kenya. Farah, (2014) explored the impact of foreign exchange rate volatility on oil companies and found that there existed no critical relationship between the two factors. Lagat and Nyandema, (2016) relating foreign exchange rate fluctuations and financial performance of commercial banks and found that there existed a strong positive relationship.

Empirical literature thus confirms inconsistency in the findings on the relationship between exchange rate volatility and financial performance. For the hotel industry which face the challenge of currency fluctuations attributable to the fact that there have been periods of rapid depreciation of the Kenyan currency, it would be important to explore how the fluctuations have affected financial performance of the hotels. This study was out to address this research gap while answering the research question; how does fluctuation in foreign exchange currency rate affect financial performance of hotels in Nairobi?

1.3 Research objectives

The objective of this study was to assess the effect of fluctuation in foreign exchange currency rates on the financial performance of hotels in Nairobi.

1.4 Value of the study

To the managers of the various hotels, the findings of this study will provide information to guide their management decisions following the changes in the exchange rate in Kenya

so as to enable a strong hotel industry. It will outfit them with the fundamental information for making the important move to secure the execution of their associations.

To the regulatory body that is the government of Kenya, the findings of this study will inform the formulation of policies and regulations for a strong and resilient hotel industry. The findings of this study would inform the fragile foreign currency reserves making it difficult for the hotels to transact freely.

To the future scholars, the discoveries of this study will be imperative in giving material to their reference other than proposing regions for further research. The future scientist who will do a comparable study will profit by the study and they will know more about the relationship between remote trade rates and budgetary execution and think of an alternate study to give more data as would be essential in connection to the theme.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter presents literature reviewed in order to provide a basis for the study and the concepts. In addition, the chapter highlights theories guiding the study, determinants of financial performance, empirical studies thereby illustrating the research gap after which it presents the summary of empirical literature.

2.2 Theoretical Framework

2.2.1 Purchasing Power Parity Theory

Purchasing Power Parity (PPP) theory was proposed by Gustav Cassel in 1918. It is a hypothesis of conversion standard assurance and proposes an approach to examination of exchange rates between nations (Reid, 2005). The theory states that homogeneous goods in different states cost the same in the very same state when measured in terms of the same currency. The theory is linked to the arbitrage hypothesis that states that if two homogeneous goods are purchased at different prices in different countries, it leads to Purchase Power Parity (Majok, 2015).

The theory assumes that there are no transactional costs, no barriers to trade and the commodities being traded are homogeneous. However, the main limitation of this belief is in measuring Purchasing Power Parity constructed from price indexes given that different countries use different goods to determine their price level (Reid, 2005). The hypothesis' suggestion to the study is that exchanges on a nation's present record

influence the estimation of the swapping scale on the remote trade (Forex) advertise. This suggests trade rates between monetary forms are in balance when their buying force is the same in each of the two nations. The theory suggests use of price indexes to determine the exact price of a homogenous commodity between countries.

2.2.2 The International Fisher Effect

The international Fisher effect was introduced by the economist Irving Fisher in the 1930s. It holds that the difference in returns between two countries is just equal to the difference in inflation rates (Feldstein, 2007). As indicated by International Fisher Effect, ostensible hazard free loan costs contain a genuine rate of return and expected swelling. The International Fisher Effect hypothesis recommends that remote monetary forms with moderately high loan costs will have a tendency to deteriorate in light of the fact that the high ostensible financing costs reflect expected rate of expansion (Madura, 2000).

Along these lines, this hypothesis recommends that adjustments in the swapping scale between two nations will likewise have a tendency to liken the distinctions to their greatest advantage rates (Demirag and Goddard, 1994). This theory is relevant for this study as it explains the purchasing power of each currency which captures the inflation across countries to ensure that at equilibrium exchange rates, the basket of goods and services purchased by one unit of a country's currency equals to those purchased in the second country.

2.2.3 Flow Oriented Model

The Flow Oriented Model was at first created by Dornbusch and Fisher in 1980. According to the model, exchange rates determine greatly the international

competitiveness of a firm as well as the balance of trade position. Therefore the exchange rate changes affect real income and output in a country. This takes after subsequently that if swapping scale acknowledges, exporters are probably going to be influenced adversely. In a similar respect a valuation for the cash is probably going to bring about merchandise and ventures to be dearer on the global market. This will consequently realize a decrease in fares, as they will be viewed as costly by purchasers on the worldwide market. It implies in this manner that such products will lose their aggressiveness globally.

Stream situated models accept that a nation's present record and exchange adjust execution are two vital elements of conversion standard assurance, subsequently, stock costs and trade rates are decidedly related. It additionally accept that conversion scale gratefulness would be required to bring about stock costs to fall (Dornbush, et al 1980). This theory proposes that the performance of the hotels are influenced by exchange rate changes and future cash flows of firms. This implies that exchange rate changes lead to returns, and that they are positively correlated. Thus higher exchange rates are theorized to impact negatively on the performance of the hotels.

2.3 Determinants of Hotels' Financial Performance

2.3.1 Exchange Rate Fluctuations

Economists and policy makers often term to the exchange rate as a key macroeconomic variable. As a relative value, the conversion scale assumes a basic part in exchanges between open economies. The conversion scale changes influence the aggressiveness of firms through their effect on information and yield value (Joseph, 2002). This is explained by the fact that foreign investors will have more local currency to invest since

for every dollar, they will get more shilling. This will result in performance to reduce significantly.

2.3.2 Inflation

Inflation can be described as a decline in the real value of money or a loss of purchasing power. The expected rate of inflation is universally related to financial performance. In this way, an expansion in the general value level disintegrates the genuine estimation of cash and initiates a portfolio move. Accordingly, higher swelling rates lead individuals to move some portion of their riches from cash and monetary advantages for genuine resources which, thusly, implies that higher expansion rates are connected with lower interest for cash. A nation with a lower swelling rate than another's will see a gratefulness in the estimation of its cash. Likewise, the costs of products and enterprises increment at a slower rate where the expansion is low.

2.3.3 Economic Performance

The performance of an economy is measured by growth in Gross Domestic Product (GDP). Economic growth refers to the increase in the quantity of goods and services the whole economy can produce over and above what was produced the prior year. Improved living standards are achieved by the government accelerating the rate of economic growth. Economists prefer to measure the rate of economic growth by how much national income had increased each year, in a country. The benefits that come with economic growth and increased output may include high level of consumption of goods and services that includes more houses being rented and even extra money buys essential niceties of life. This comes with increased income (Biller, 2007).

Higher level of income from growth leads to provision for the basic requirements for food, clothing and housing. The improved income with the people due to economic growth implies that people have more power to purchase which improves profitability of businesses. Specifically for hotels, economic performance is sharply affected by changes in economic growth since more investor's visit the country for business, other industries performance better and individuals have more income to spend.

2.3.4 External factors

These are external environmental factors which determine whether the organizations either prosper or fail (Kiveu, 2013). These factors may include the number of competitors in the market and the competitive strategies they have employed. The factors have a strong impact on competencies and performance. Gaining of a competitive advantage against the rivals is very likely to have a strong impact on competencies and performance (Kuratko and Hodgetts, 2004). If the external factors outweigh the firm, this may cause massive losses and could end up in collapsing of the firm. This shows that external factors are a great determinant on firm performance.

Particular examples of external factors include outbreak of certain diseases. These diseases hinder the movement of people due to the travel restrictions issued such as Ebola, which affected certain parts of Africa in 2014. Additional factors restricting movements include the civil wars, terrorism and political instabilities thus lowering the amount of international visits to a particular country. This in turn affects the hotels' performance as they are dependent mainly on the number of foreigners visiting the country.

2.4 Empirical Literature

2.4.1 International studies

Egert and Zumaquero (2005) analyzed the impact of exchange rate volatility and changes in the exchange rate regimes on export volume for ten Central and Eastern European transition economies. Their results indicate that an increase in the exchange rate volatility decreases exports, and this impact has a delay rather than being instantaneous.

Deseatnicov and Akiba, (2011) examine the role of exchange rate and political risks in the Japanese outward Foreign Direct Investment (FDI) activities with a panel data of 30 developed and developing countries for the period of 1995-2009. They found that, the model with exchange rate, political risk factors and some traditional explanatory variables reasonably explains recent Japanese outward FDI flows and reveals new patterns in its behavior depending on the economic stage of development.

Taiwo and Adesola (2013) examined exchange rate volatility and bank performance in Nigeria. This study investigated the impact of unstable exchange rate on bank performance in Nigeria using two proxies for bank performance, namely loan loss to total advances ratio and capital deposit ratio. A core recommendation of this study is that a stable exchange rate is needed to improve the ability of the banking sector to channel credit to the economy.

Corgel, *et al* (2013) conducted a study on how Currency Exchange Rates Affect the Demand for U. S. Hotel Rooms. Analyses using chain scale and gateway city data, however, reveal that exchange rates strongly influence hotel demand in luxury, upper-upscale, and upscale segments, with a much weaker relationship among lower-price

hotels. Exchange rates had a significant, although minor, influence on U.S. hotel demand from 1992 Q1 - 2012 Q1.

2.4.2 Local studies

Irene (2011) did a study on the relationship between foreign exchange and financial performance of Airlines in Kenya whose objective was to establish the relationship between foreign exchange and financial performance of Kenya Airways. Currency fluctuations impact on prices hence negative impact on revenues and expenses denominated in foreign currency.

Musyoki, Pokhariyal and Pundo (2012) examined the impact of real exchange rate volatility on economic growth using Kenyan evidence. Data for the study was collected from Kenya National Bureau of Statistics, Central Bank of Kenya and International Monetary Fund Data Base by taking monthly frequency. The study found that Real Exchange Rate (RER) was very volatility for the entire study period.

Otuori, (2013) conducted a study on the determinant factors of exchange rates and their effects on the performance of commercial banks in Kenya. The results showed that interest rate and external debt had positive and significant effects on performance while inflation rate and external debt had negative and significant effects on performance.

Rutto and Ondiek (2014) examined the impact of exchange rate volatility on Kenya's tea exports. The results indicate that exchange rate volatility negatively affects performance of tea exports in the country. This paper recommends periodic monitoring of the exchange rate so as to reduce its impact and drawing of fiscal and monetary policy that would make exchange rate manageable.

Farah (2014) conducted a study on the effect of foreign exchange rate volatility on financial performance of local oil marketing companies in Kenya. In the same regard, the study revealed that there was no significant relationship between performance and interest rates with a p-value of (.497). Further the study showed no significant relationship between foreign exchange volatility and performance with a p-value of (.306).

Majok (2015) conducted a study on the effects of exchange rate fluctuations on financial performance of commercial banks in Kenya. The study found that there was a positive relationship between foreign exchange rate fluctuations and the financial performance of banks as measured by the returns on assets ratio.

Lagat and Nyandema (2016) studied the influence of foreign exchange rate fluctuations on the financial performance of commercial banks listed at the Nairobi Securities Exchange. The study found that there existed a strong positive relationship between foreign exchange rates and financial performance indicators. The positive relationship between exchange rate and financial performance may reflect how fluctuating and volatile exchange rate may have contributed to the growth of profitability of banks. The study recommends that the Government should put up more measures to increase the country's exports.

2.5 Conceptual Framework

The relationship between the study variables is presented in conceptual framework presented in figure 2.1. Exchange rate fluctuations will be the independent variable while

dependent variable will be hotel performance. The control variables were inflation rate and economic performance.

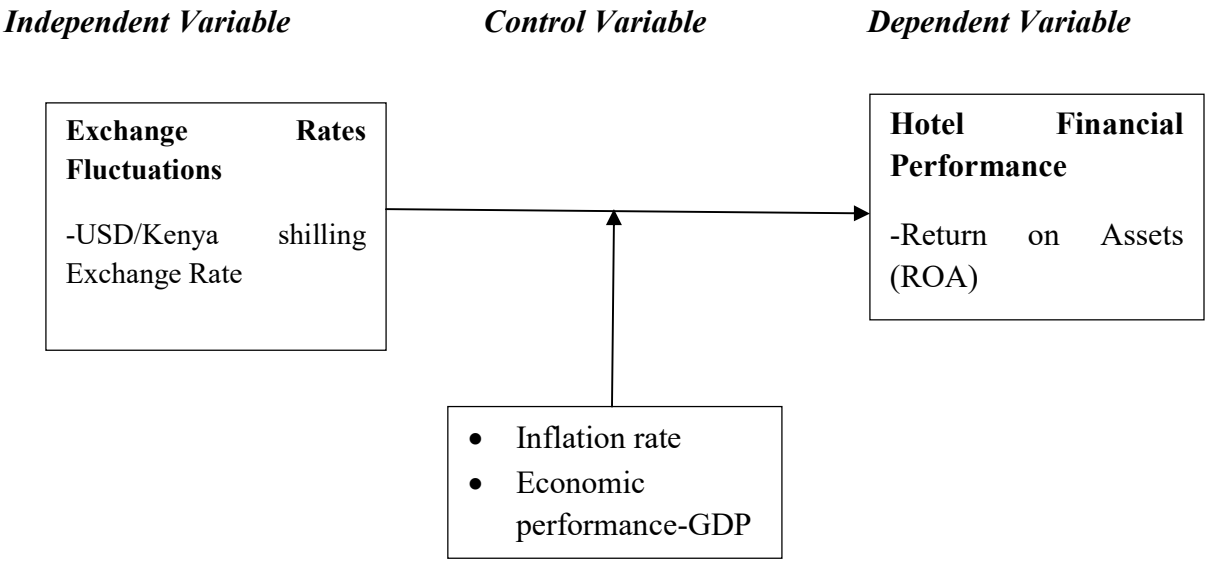


Figure 2.1: Conceptual Framework

2.6 Summary of Reviewed Literature

The five star hotels play a crucial role in enhancing the country's economy. This is accrued from the revenue obtained from their international business operations. Quite a number of studies have been carried out over the subject matter but there is still no consensus on the effect of fluctuations in the exchange rates on the financial performance of organizations. Some were unable to establish a relationship between exchange rates on

the financial performance of organizations while other studies found a negative relationship. There is therefore a gap as far as fluctuation in foreign currency exchange rate on financial performance by hotels is concerned. It is from the above background that this study sought to examine the effect of fluctuation in foreign exchange currency rate on the performance of hotels in Nairobi.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter provides the methodology that was used in the study. The chapter covers the research design, sampling design, target populations, data collection instrument and data analysis technique.

3.2 Research design

The research design refers to the scheme or procedure that was employed by the researcher so as to enable addressing the various research questions. This study adopted the descriptive research design. The design was appropriate, as it allowed the description, interpretation of existing relationships, and comparison of variables under study. Moreover, it was suitable because the study sought to build a profile on the effects of exchange rate fluctuations on financial performance of Hotels in Nairobi. Its purpose was to portray the state of affairs as they are.

3.3 Population

The population of the study entails the specific individuals or elements about which information is desired (Kothari, 2004). The target population for this study was all the five star hotels operating in Nairobi Kenya. As per the Kenyan Gazette Notice No. 3976 (Vol. CV- No. 62) they are ten in number as shown in appendix I. This population was targeted as they (five star hotels) mostly deal with international customers from various countries and thus most knowledgeable on the study topic.

3.4 Sample

Due to the population being small, a census sampling approach was employed and all the ten five star hotels in Nairobi studied. A census study is a complete enumeration of all items in a population (Kothari, 2004). It ensures that high accuracy is obtained as all items are studied and no elements of are left out.

3.5 Data Collection

The study used secondary data. Secondary data was obtained from the monthly management reports of the hotels which was analyzed on quarterly basis for the period between 2012 and 2016. Data obtained related to financial performance of five star hotels as measured by return on assets. The researcher booked appointments with the hotel management and also made personal visits to discuss on confidentiality of the information obtained. The data obtained was not be published and was only used for the purpose of the study. The data was collected through secondary data collection sheets. Data relating to exchange rates, economic growth and information was obtained from Central Bank of Kenya.

3.6 Data Analysis

The study used quantitative analysis techniques to obtain information on the study variables. Frequency distributions, trend analysis figures and percentages were used to present the study results. Statistical Package for Social Sciences (SPSS) version 23 was used to analyze data quantitatively. SPSS tool was chosen because of its clarity, preciseness, ease of understanding and interpretation.

3.6.1 Analytical Model

In order to the establish the effects of fluctuation in foreign exchange rate on financial performance of five star hotels in Nairobi, the following multiple regression model was used;

$$\mathbf{Y=\beta_0+ \beta_I X_1+ \beta_2X_2+ \beta_3X_3 +\varepsilon}$$

Where:

Y= Financial Performance of hotels measured by Return on Assets

β_0 = Regression constant (y-intercept)

X_1= Foreign exchange Rate fluctuations (Kenya Shillings changes against the United States Dollar)

X_2 = Inflation (Consumer Price Index)

X_3 = Economic performance as measured by Gross Domestic Product (GDP)

ε = Error term

CHAPTER FOUR

DATA ANALYSIS, FINDINGS AND DISCUSSION

4.1 Introduction

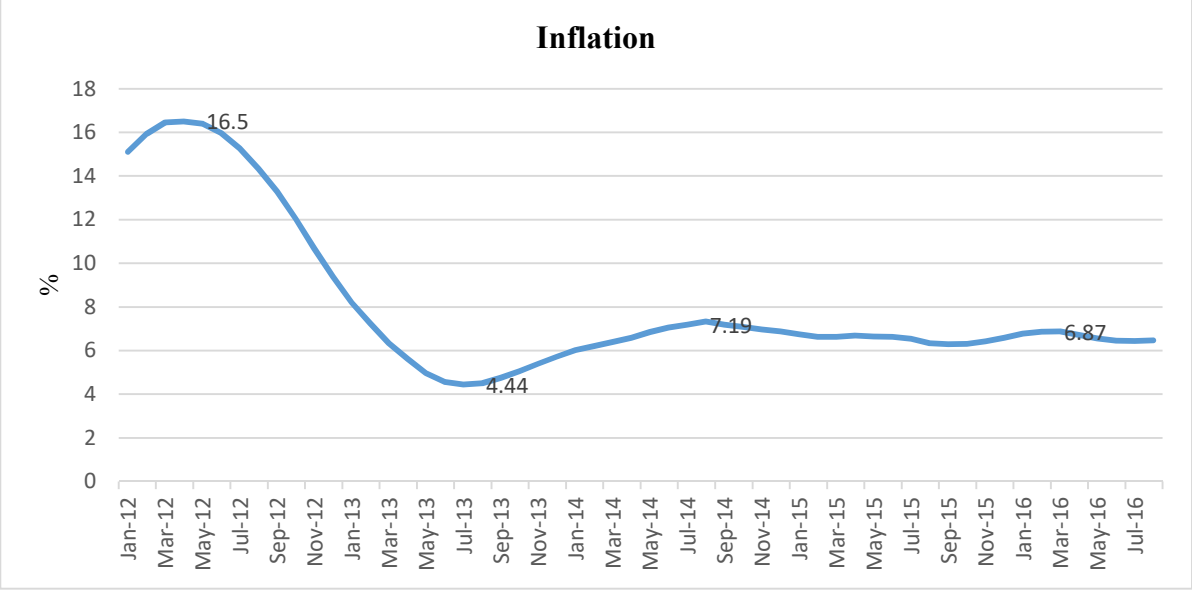
This chapter presents analysis, findings and discussion of the study on the effect of fluctuation in foreign exchange currency rates on the financial performance of hotels in Nairobi. Secondary data was obtained from the monthly management reports of the hotels related to financial performance of hotels as measured by return on assets.

4.2 Description of Study Variables

4.2.1 Inflation

This section sought to establish the inflation rates trends in Kenya over the study period. The results obtained are as presented in Figure 4.1. The inflation rates were significantly declining in the year 2012. Particularly, the rates dropped from 16.45% in 2012 to a rate of 4.4% in 2013, a total of 12.05% drop. The inflation rate closed at 6.87% in the end year 2015.

Figure 4.1 Inflation

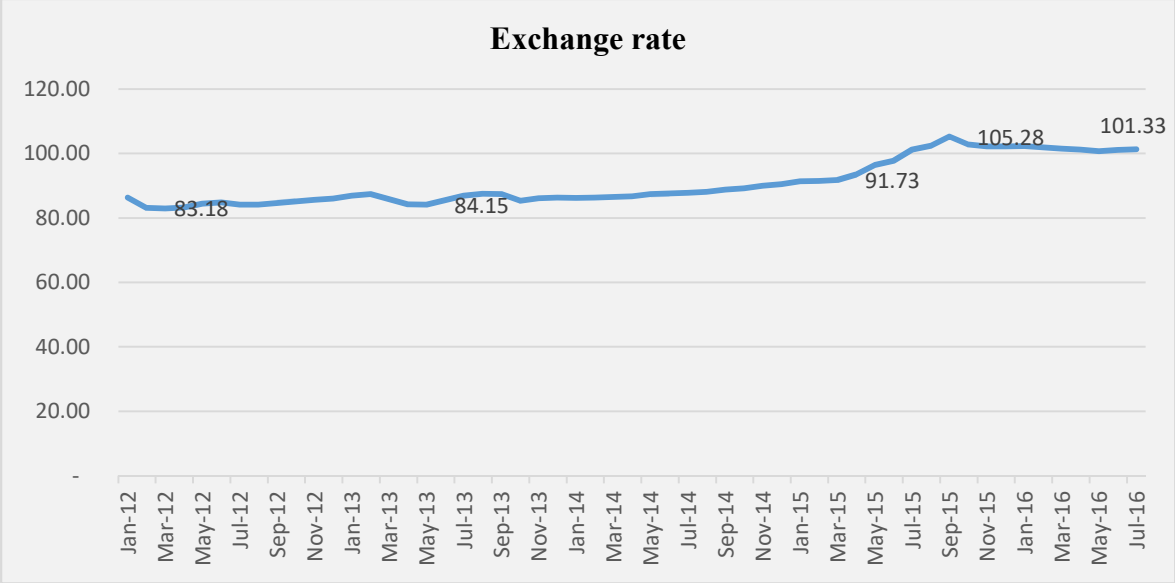


Source: Research Data, 2016

4.2.2 Exchange Rate

This section sought to establish the exchange rates trends in Kenya over the study period. The study concentrated on the USD Kenya Shilling exchange rate. The results obtained are presented in Figure 4.2. The exchange rates in Kenya over the study period were fairly volatile over the study period. The lowest Kenya shilling USD exchange rate was recorded in 2012, at 82.90. The Kenya shilling continued to depreciate against the USD to reach the highest at 105.28 in October 2015. The Kenya shilling USD exchange rate closed at 101.33 June 2016.

Figure 4.2 Exchange Rate

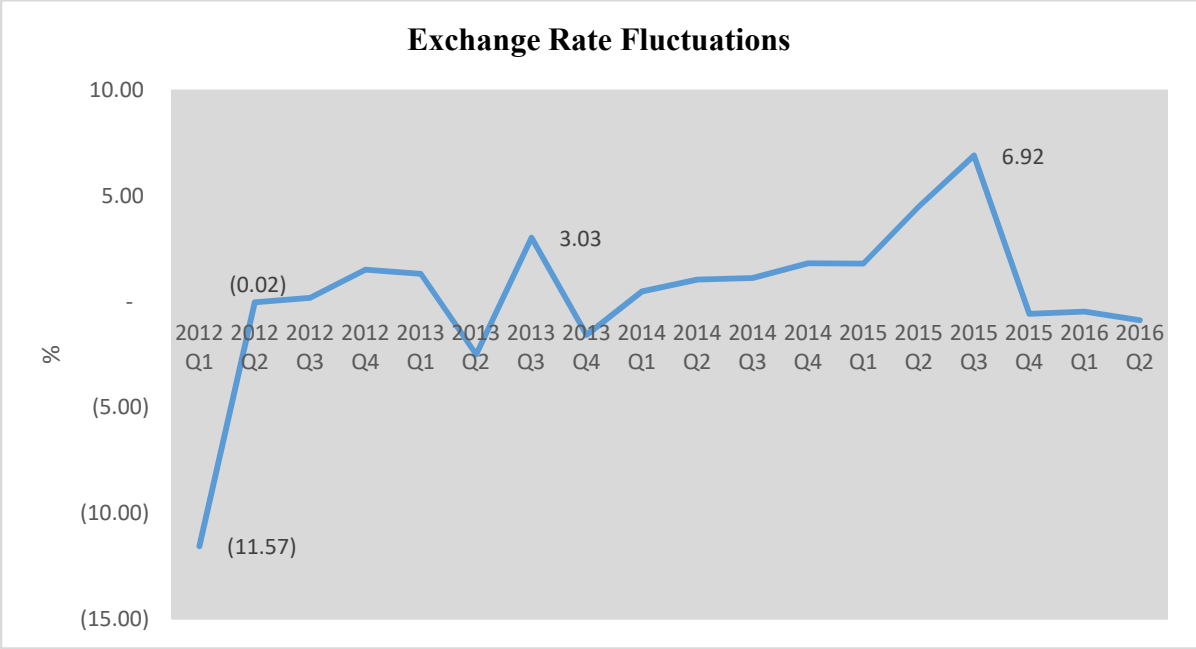


Source: Research Data, 2016

4.2.3 Exchange Rate Fluctuations

This section sought to establish the exchange rate fluctuations trends in Kenya over the study period. The findings obtained are as shown by Figure 4.3. The lowest fluctuation rate of -11.57% (indicating appreciation of Kenya shilling against the USD) was recorded in the first quarter of 2012. Since then the Kenya Shilling has been depreciating against the USD. In 2012, KES depreciated by 1.52% in the fourth quarter of the same year. It further depreciated by 3.03% and later to 6.92% in the years 2013 and 2015 respectively. This indicates the market volatility in KES versus USD where shilling continued to depreciate over the study period.

Figure 4.3 Exchange Rate Fluctuations

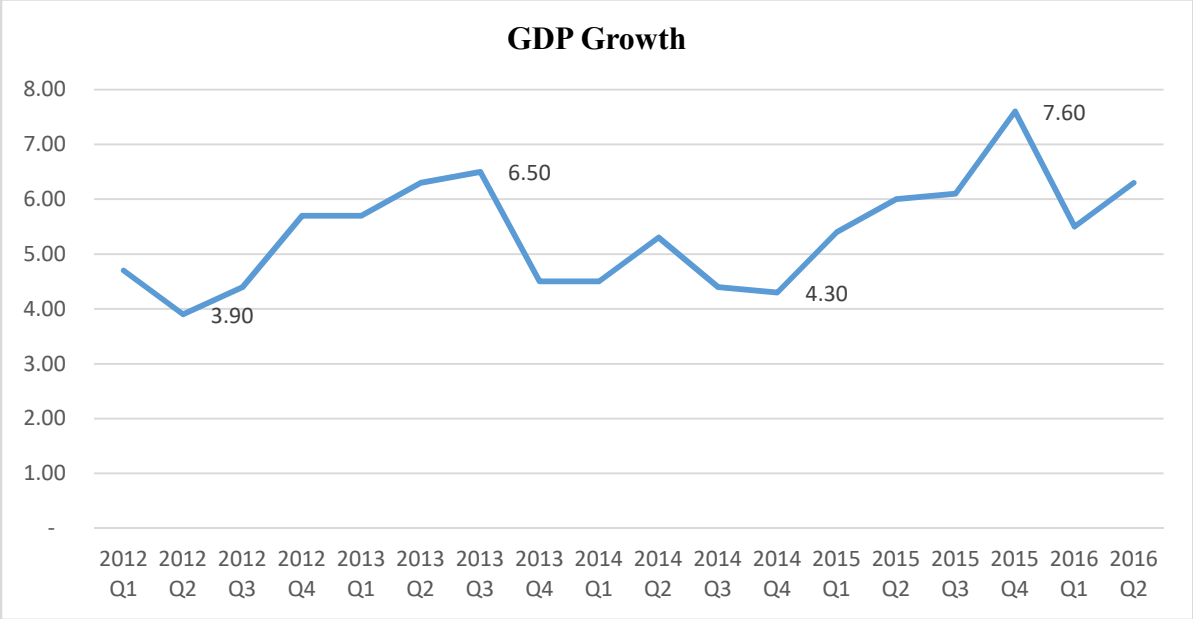


Source: Research Data, 2016

4.2.4 GDP Growth

This section sought to identify the trends in the GDP Growth over the study period. The findings are as presented in Figure 4.4. The lowest GDP growth of 3.90% was recorded in the second quarter 2012, after which it rose to 6.5% in the third quarter 2013. The further rose to reach the highest GDP of 7.60% in 2015. The low GDP growth in 2012 and 2013 could be as a result of various factors such political uncertainty due to 2013 elections and increased insecurity levels in the country.

Figure 4.4 GDP Growth



Source: Research Data, 2016

4.3 Descriptive Analysis

The descriptive statistics for the study are presented in Table 4.1. The Return on Assets had a minimum of -20.47%, maximum of 6.65%, mean of 0.7794% and standard deviation of 3.1488. This indicates that the hotel industry has not been much profitable since the average ROA was less than 1%. The minimum of Exchange rate fluctuations

was -11.57%, maximum of 6.92%, mean of 0.3444% and standard deviation of 3.6098%. This implied that exchange rates in Kenya remained volatile. The minimum of inflation rate was 3.53%, maximum was 16.87%, mean of 7.0911% and standard deviation of 2.9397%. Hence, over the study period, inflation continued to have high volatility. The minimum of GDP was 3.9%, maximum was 7.6%, mean of 5.3944% and standard deviation of 0.95573%.

Table 4.1 Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
ROA	108	-20.47	6.65	0.7794	3.14885
ER Fluctuations	108	-11.57	6.92	0.3444	3.6098
Inflation	108	3.53	16.87	7.0911	2.93976
GDP	108	3.9	7.6	5.3944	0.95573

Source: Research Data, 2016

4.4 Correlation Analysis

To establish the relationship that existed between the research variables, Karl Pearson's coefficient of correlation was used by the study. The correlation analysis results are presented in Table 4.2. Exchange Rate Fluctuations and hotel financial performance had a Pearson Correlation of 0.723 and p-value of 0.0000. The positive coefficient of correlation indicated that increase in exchange rate fluctuations will increase financial performance of the hotels. The p-value of 0.0000 indicated that the relationship was significant at 95% confidence level since it was less than 0.05. Therefore, depreciation of Kenya shilling against the USD will lead to improved financial performance of the hotels.

This could be due to the fact that most of hotel revenues are received in foreign currency and hence the hotels make more in local currency.

Inflation had a Pearson Correlation of -0.545 and p-value of 0.000 whereas GDP had a Pearson Correlation of 0.194 and a p-value of 0.045. This inflation rates have a negative relationship with the performance of the hotel while GDP growth has a positive effect. Thus an increase in GDP growth will lead to increased hotel returns while increased inflation will reduce the financial performance of the hotels. All the variables were significant at the 5% confidence level due to their p-values being less than 0.05.

Table 4.2 Correlation Analysis

		ROA	ER Fluctuations	Inflation	GDP
ER Fluctuations	Pearson Correlation	.723**	1		
	Sig. (2-tailed)	0.000			
Inflation	Pearson Correlation	-.545**	-.666**	1	
	Sig. (2-tailed)	0.000	0.000		
GDP	Pearson Correlation	.194*	.213*	-.377**	1
	Sig. (2-tailed)	0.045	0.027	0.000	
	N	108	108	108	108

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).

Source: Research Data, 2016

4.5 Regression Analysis

In this study, multiple regression analysis was used to determine the effect of Foreign exchange rate fluctuation on hotel performance in Kenya. Exchange rate fluctuations,

GDP and Inflation were used independent variables. The model summary results are presented in Table 4.3.

The findings indicated that there was a strong positive relationship between independent (GDP, Exchange Rate fluctuations and inflation) and dependent variable (Hotel financial Performance) with a coefficient of correlation of 0.728. The coefficient of determination of 0.53 indicated that the independent variables could explain 53% of changes in performance of the hotels. Thus 47% of the changes in the hotel performance would be accounted for by other factors not included in the model.

Table 4.3: Model Summary

R	R Square	Adjusted R Square	Std. Error of the Estimate
.728a	0.53	0.516	2.19015

a. *Predictors: (Constant), GDP , ER Fluctuations , Inflation*

Source: Research Data, 2016

The analysis of variance results are shown in Table 4.4. As shown in the table, the model developed was significant at 95% and 99% confidence level since the p-value of 0.000 is less than 0.5 and 0.1. This meant that the relationship between the dependent and independent variables were significant.

Table 4.4: Model Analysis of Variance

	Sum of Squares	Df	Mean Square	F	Sig.
Regression	562.069	3	187.356	39.059	.000a
Residual	498.864	104	4.797		
Total	1060.933	107			

a. Predictors: (Constant), GDP , ER Fluctuations , Inflation

b. Dependent Variable: ROA

Source: Research Data, 2016

The model coefficients obtained by the study are shown in Table 4.5. Exchange rate fluctuations had a coefficient of 0.565. Inflation had -0.115 while GDP had 0.049. This implied that exchange rate fluctuation and GDP had a positive effect on the hotel performance, while inflation has a negative effect. Exchange rate fluctuations coefficient was significant at the 95% confidence level while those of GDP and inflation were not significant.

The predictive model thus adopted by the study entail; $Y=1.133+ 0.565X_1+-0.115X_2+0.049X_3$ where; Y is the Financial Performance of hotels measured by Return on Assets, X_1 is the Foreign exchange Rate fluctuations (Kenya Shillings changes against the United States Dollar), X_2 is the Inflation (Consumer Price Index) and X_3 is the Economic performance as measured by Gross Domestic Product (GDP).

Table 4.5: Model Coefficients

	Unstandardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	t	Sig.
(Constant)	1.133	1.693		0.669	0.5050
ER Fluctuations	0.565	0.079	0.648	7.181	0.0000
Inflation	-0.115	0.102	-0.107	-1.125	0.263
GDP	0.049	0.239	0.015	0.206	0.837

a. Dependent Variable: ROA

Source: Research Data, 2016

4.6 Discussion of Findings

The study sought to establish the relationship that exists between foreign exchange currency rates on the financial performance of hotels in Nairobi. To attain this, Pearson correlation was used. The findings obtained showed that Exchange Rate Fluctuations had a Pearson Correlation of 0.723 and p-value of 0.0000. This implies that the exchange rate fluctuations have a positive impact on the performance. Thus, depreciation of Kenya Shilling against the USD will lead to increased hotel financial performance. This is brought about by the exchange rate playing a critical role in reporting financial performance of hotels. Most of the revenues for hotels are received in USD while the reporting currency is Kenya Shilling.

Inflation had a Pearson Correlation of -0.545 and p-value of 0.00. This implied a negative relationship and hence inflation will impact negatively on the financial performance. This could be due to increase in hotels operational costs as a result of the inflation. The revenues may not increase at the same pace with the costs. Biller's, (2007) argued that the negative effects of inflation are more pronounced than the positive ones.

GDP on the other hand had a Pearson Correlation of 0.194 and a p-value of 0.045. This implied a significant positive relationship. An improvement in the GDP translates to an improvement in other economy sectors. This is attributed to the benefits that come with economic growth and increased output may include high level of consumption of goods and services that includes more houses being rented and even extra money buys essential

niceties of life. This comes with increased income and more returns in businesses (Majok, 2015).

On the combined effect of the independent variables on the dependent variables, a significant positive relationship was obtained. This is due to the coefficient of correlation of 0.728 obtained. Particularly, the coefficient of determination of 0.53 indicates that the independent variables can explain 53 % of changes in performance of the hotels. Thus 47% of the changes in the hotel performance will be accounted for by other factors other than the ones mentioned above. The model was significant at 95% and 99% confidence level since the p-value of 0.000 is less than 0.5 and 0.1 thus confirming the relationship that exists. This findings concur with those of Otuori, (2013) who conducted a study on the determinant factors of exchange rates and their effects on the performance of commercial banks in Kenya.

From the model developed, Exchange rate fluctuations had a coefficient of 0.565. Inflation had -0.115 while GDP had 0.049. This thus implies that ER fluctuation and GDP have a positive effect on the hotel performance, while inflation has a negative effect. The findings however contradicted those of Farah (2014) who established exchange rate fluctuation to have a no effect on his study on the effect of foreign exchange rate volatility on financial performance of local oil marketing companies in Kenya. The predictive model thus adopted by the study was $Y=1.133+ 0.565X_1+-0.115X_2+0.049X_3$ where; Y is the Financial Performance of hotels measured by Return on Assets, X_1 is the Foreign exchange Rate fluctuations (Kenya Shillings changes against the United States Dollar), X_2 is the Inflation (Consumer Price Index) and X_3 is the Economic performance as measured by Gross Domestic Product (GDP).

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents a summary discussion on exchange rate fluctuations and hotel performance. A conclusion discussing the general findings of the research is highlighted followed by recommendation based on the findings of the study. The limitations of the study and suggestions on areas of further research are discussed at the end of the chapter.

5.2 Summary of findings

The study sought to determine the effect of fluctuation in foreign exchange currency rates on the financial performance of hotels in Nairobi. Secondary data was obtained from the monthly management reports of the hotels which was analyzed on quarterly basis for the period between 2012 and 2016. Due to the population being small, a census sampling approach was employed so as to comprise all the ten five star hotels in Nairobi as per Tourism Regulatory Authority classification.

The findings obtained showed that Exchange Rate Fluctuations had a Pearson Correlation of 0.723 and p-value of 0.0000. This implies that the exchange rate fluctuations have a positive impact on the performance. Thus, depreciation of Kenya Shilling against the USD will lead to increased hotel financial performance. This is brought about by the exchange rate playing a critical role in reporting financial performance of hotels. Most of

the revenues for hotels are received in USD while the reporting currency is Kenya Shilling.

Inflation had a Pearson Correlation of -0.545 and p-value of 0.00. This implied a negative relationship and hence inflation will impact negatively on the financial performance. This could be due to increase in hotels operational costs as a result of the inflation. The revenues may not increase at the same pace with the costs. As a result, uncertainty over future inflation rates may discourage investment and savings, and if inflation levels rise quickly it may cause reduced returns in organizations.

GDP on the other hand had a Pearson Correlation of 0.194 and a p-value of 0.045. This implied a significant positive relationship. An improvement in the GDP translates to an improvement in other economy sectors. This is attributed to the benefits that come with economic growth and increased output which may include high level of consumption of goods and services that includes more houses being rented and even extra money to buy essential niceties of life. This comes with increased income and more returns in businesses.

Multiple regression model results indicated a correlation of 0.728. This implied a positive relationship between the study variables, which was significant at 95% confidence level p-value of 0.001 is less than 0.5 and 0.1. In addition, a coefficient of determination of 0.53 was obtained and this indicates that the independent variables can explain up to 53 % of changes in performance of the hotels.

From the model developed, Exchange rate fluctuations had a coefficient of 0.565. Inflation had -0.115 while GDP had 0.049. This implies that ER fluctuation and GDP have a positive effect on the hotel performance, while inflation has a negative effect. The

ER fluctuation model was significant at the 95% confidence level, however the inflation and GDP models were not significant at the 95% confidence level. The predictive model thus adopted by the study entail; $Y=1.133+ 0.565X_1+-0.115X_2+0.049X_3$ where; Y is the Financial Performance of hotels measured by Return on Assets, X_1 is the Foreign exchange Rate fluctuations (Kenya Shillings changes against the United States Dollar), X_2 is the Inflation (Consumer Price Index) and X_3 is the Economic performance as measured by Gross Domestic Product (GDP).

5.3 Conclusions

Based on the study findings, the study makes a number of conclusions. To begin with, the study concludes that based on the period under which the study was conducted (2012-2016), there has been volatility in the foreign exchange rates. This is evidenced by the frequent fluctuations. Hence an indication of instability of the Kenya Shilling against the US dollar. This may have been caused by a number of factors such as political instability/uncertainty, insecurity and in appropriate macroeconomic environment.

The study found that exchange rate fluctuations had a positive relationship with the performance of the hotel while GDP growth had a negative effect. The study concludes that increased depreciation of Kenya shilling against the USD (increased exchange rate fluctuation) will cause an increase in the performance.

The study obtained a negative relationship between inflation and hotel financial performance. Therefore, the study concludes that increased inflation rates in an economy will reduce the financial performance of five star hotels in Nairobi while reduced inflation rates will improve performance of the hotels.

Economic growth as measured by GDP growth was found to improve financial performance of the five star hotels. Therefore, the study concludes that increased economic growth will improve hotel performance. This is due to the increased ability of the people in an economy and hence increased hotel revenues.

On the relationship that exists between the variables, the study concludes the existence of a significant positive relationship. Hence the performance of the hotels will be highly influenced by the foreign exchange rate fluctuations, inflation and GDP growth. Therefore, unfavourable economic environment will significantly affect hotel performance.

5.4 Recommendations

From the findings, several recommendations are made. First, the study established the existence of fluctuating exchange rates in Kenya. The study thus recommends that the relevant authorities for instance, The Central Bank of Kenya should adequately put measures to safeguard the value of the domestic currency from much fluctuations. This would highly reduce the extent to which the currency fluctuates and retain its stability.

Foreign exchange rate fluctuations were found to positively improve financial performance of the hotels where depreciating Kenya shilling against the USD will lead to higher profitability for the hotels. This is due to the hotels receiving much of revenues in USD. Further depreciating local currency improves exports and makes imports expensive. While this is the case, macrocosmic theory requires determination of optimal value for a currency. While this may be debatable, it's commonly agreed that stable exchange rate environment is healthy for businesses. The study therefore recommends

that Central Bank of Kenya to come up with policies that will ensure stable exchange rate environment.

So as to control fluctuating inflation rates, the study recommends that inflation rate should be contained through sound policy measures as higher inflation rates may impact negatively on the performance of the hotel industry in Kenya. The study recommends for accelerated economic growth which will in turn improve hotels' financial performance.

5.5 Limitations to Study

The first limitation for the study was due to the time frame, the study was conducted for a short duration and therefore it was not possible to carry out an analysis on the financial performance for longer periods of time.

Secondly, there was the element of confidentiality given that the study focused on a sensitive area of financial performance. In addition, out of ten five star hotels studied, only one was a listed company. Most of the managers were not willing to provide detailed information on their financial performance sought by the study. The researcher however assured the respondents of the confidentiality of the data and that it was not to be published. Data sought was also on quarterly basis which was not easy to retrieve as would have been the case if data was sought on annual basis.

The study used secondary data that had not been primarily collected for the study purpose. Thus, the reliability of the data could not be ascertained. Normally, information provided is affected by the purpose for which the information is obtained. Further, accounting policies among the companies differ which may have affected the return on asset statistics obtained.

5.6 Suggestions for Further Research

This research used the Kenya Shilling US dollar fluctuation to measure the foreign exchange fluctuations. Future studies ought to be done using other international currencies for instance the Sterling pound or the Euro with reference to the Kenya shilling. This would ensure that comparisons in fluctuations with other currencies can be done and the effects of such changes studied against firm performance.

The study focused purely on the hotel industry. Further studies can be done on other sectors and not entirely the hotel sector for instance firms in energy, manufacturing, agriculture, tourism and other sectors. This would provide a wide pool of research findings that can be compared across the business fraternity for optimal policy formulation. Future researchers can also undertake to ascertain the effectiveness of hedging strategies for instance usage of forwards contracts in reducing foreign exchange risks by the hotels.

The research concentrated on the study period 2012 to 2016. The study period was therefore not entirely exhaustive in assessing the effects of exchange rate fluctuations on financial performance of hotels in Kenya. Research with a wider time span would be imperative in assessing the independent variables against the dependent variables.

The research used three independent variables (the inflation rate, exchange rate fluctuations and GDP growth) in assessing their effects on hotel financial performance. Therefore effects of the other economic variables were not analysed in this research. Additionally, the effects of non-financial paradigms on performance were not studied by this research; therefore the study did not address the effects of non-economic variables on performance. A future study maybe conducted taking this into consideration.

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APPENDICES

Appendix I: List of Five Star Hotels in Nairobi

1. Intercontinental Hotel Nairobi
2. Hilton Hotel Nairobi
3. Fairmont the Norfolk Hotel
4. Safari Park Hotel
5. Nairobi Serena Hotel
6. Laico Hotel
7. Windsor Hotel & Golf Club Kenya
8. Sarova Stanley Hotel
9. The Tribe
10. Villa Rosa Kempinski Nairobi

Sources:

http://kenyalaw.org/kl/fileadmin/pdfdownloads/RepealedStatutes/HotelsandRestaurants/Act_Cap494_pdf accessed August, 13, 2016.

Appendix II: Secondary Data

Year	Quarter	Exchange Rate	ER Fluctuations	Inflation	GDP
2011	Q4	93.87			
2012	Q1	84.14	-11.57	16.87	4.7
	Q2	84.12	-0.02	11.78	3.9
	Q3	84.28	0.18	6.38	4.4
	Q4	85.58	1.52	3.53	5.7
2013	Q1	86.72	1.32	4.08	5.7
	Q2	84.61	-2.50	4.37	6.3
	Q3	87.26	3.03	7.00	6.5
	Q4	85.91	-1.57	7.42	4.5
2014	Q1	86.33	0.49	6.78	4.5
	Q2	87.25	1.05	7.03	5.3
	Q3	88.24	1.12	7.54	4.4
	Q4	89.88	1.82	6.18	4.3
2015	Q1	91.52	1.80	5.82	5.4
	Q2	95.84	4.51	6.99	6
	Q3	102.97	6.92	6.14	6.1
	Q4	102.38	-0.57	7.35	7.6
2016	Q1	101.91	-0.46	7.02	5.5
	Q1	101.04	-0.87	5.36	6.3

Source: Central Bank of Kenya