

**THE EFFECT OF EXCHANGE RATE FLUCTUATION ON
THE PROFITABILITY OF SMALL SCALE ENTERPRISE
IN GHANA**

A CASE STUDY OF BUDGET CITY LIMITED

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STATEMENT OF AUTHENTICITY

We have read the University regulation relating to plagiarism and certify that this report is our own work and do not contain unacknowledged work from any other source. We also declare that we have been under supervision for this report herein submitted.

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ABSTRACT

This work looked at the effects of exchange rate fluctuations on Small and Medium Scale Enterprise (SME's) in Ghana using Budget City Ltd as a Case Study. The study sought to establish the following;

1. To find the extend to which the depreciation of the Cedi against the major currencies affects the cost of operations of SME's.
2. To establish the extend to which the depreciation of the Cedi against the major currencies influences the strategies developed by SME's in order to be competitive and profitable.
3. To check the strength of association between the inflation rate and cash flow of the SME's.

To achieve the objectives above, the study sought answers to the following questions;

1. Is there any relationship between inflation and profitability of the SME's?
2. Are the SME's affected positively or negatively by the depreciation of the Cedi against the major foreign currencies especially the US Dollar?
3. How does the uncertainty of the exchange rate fluctuations affects SME's performance?
4. How do managers of SME's factor in the exchange rate risk factors in their strategic plans?
5. What managerial decisions are made to decrease impacts of exchange rate fluctuations and thus increase the firm's profitability?

Various methods were used in gathering the relevant data for this research work. A structured questionnaire was the main primary source of data collection. A brochure from Budget city Ltd , copies of the Graphic Business from January ,2010 to December,2011, and statement of cash flows of Budget City Limited served as the Secondary source of data collection for this research work.

Data collected were presented and analysed with the aid of Statistical Packages for Social Science (SPSS).

In summary, it can be said that foreign currency fluctuations increase the production cost of SME's with Budget City limited not being an exception.

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DEDICATION

Special dedication to the Almighty God , our help in ages past, our hope for years to come, our shelter through the stormy blast, and our eternal home .

To our families and friends for their prayers, love and support

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CHAPTER ONE

INTRODUCTION

1.0 INTRODUCTION

This chapter marks the introductory stage of the study. It presents the background, problem statement, research objectives, research questions, significance and limitations of the study. Finally, the chapter also presents the scope and organization of the entire study.

1.1 BACKGROUND OF THE STUDY

Exchange rate volatility has been one of the Achilles' heels of many small businesses. Since Ghana adopted open market exchange rate regimes, many businesses have suffered during free fall of the local currency. The inability of Small and medium Scale Enterprises (SMEs) to identify and manage the trend exposed them to the negative effects of exchange rate volatility. Recent high rate of firm mortality is a great concern to successive governments of this country trying many ways to arrest the situation.

The significance of exchange rates to the success (or failure) of a business entity in recent times cannot be overemphasized. The importance being attached to the issue of exchange rates is no doubt due to current trends in the business environment where domestic companies, regardless of size and segment could no longer 'mind their own businesses' due to globalization. That is, exchange rate is a major technical instrument upon which businesses can survive and make profit. According to Copeland (2005), "the increased importance being attached to exchange rates is to some extent a result of the internationalization of modern business, the continuing growth in world trade relative to national economies, the trend towards economic integration and the rapid pace of change in the technology of money transfer. It is also in large part a consequence of the fact that

exchange rates are not only variable, but highly volatile”. According to IFC's Sub Saharan Africa Regional Report 2003, Small and medium enterprises; companies with 10 to 300 employees and annual sales of \$100,000 to \$15 million are the lifeblood of developing economies, especially those that attract little foreign direct investment. Along with microenterprises, these businesses provide employment for vast portions of local populations and are a critical engine of economic growth and poverty reduction. Small businesses in this important sector of developing economies are however disadvantaged as a result of undue exposure to a number of risks associated with operating in an increasingly interdependent global environment. Prominent among these exposures are uncertainties about the magnitude of future cash flows due to possible changes in output and input prices which in turn is, to a great extent, a result of the variability and volatility of exchange rates.

In the face of increased trade liberalization and the move towards cost reduction through scale economies and mass production, the competitive edge of the Ghanaian local small/medium enterprise have been threatened by the influx of competing brands from industrialized countries like Japan, Korea, China, and neighboring Cote D'Ivoire and Togo.

1.2 PROBLEM STATEMENT

SMEs face a variety of constraints owing to the difficulty of absorbing large fixed costs, the absence of economies of scale and scope in key factors of production, and the higher unit costs of providing services to smaller firms (Schmitz, 1982; Liedholm & Mead, 1987; Liedholm, 1990; Steel & Webster, 1990). The viability of many small and medium enterprises in Ghana has been threatened by the volatile nature of the exchange rate of the Cedi against its major trading currencies - the US dollar, Euro and CFA Franc. Studies have shown that exchange rate volatility has real economic costs that affect price stability and firm profitability. Pricing of a product in the global market setting is much more than just

keeping an eye on the competition, but it is about the positioning of the product. Thus the global currency volatility does not only impact profitability and competitiveness, but can impact the product's perception in the consumers mind.

In spite of all government support and intervention towards the development of SMEs, it has been observed that lack of managerial competencies in developing and implementing effective strategic plans places significant constraints on Ghanaian Small and Medium-scale Enterprises in competing with substitute brands from foreign producers.

The myriad of challenges facing the typical Ghanaian small/medium enterprise has occasioned this study to ascertain the extent to which the volatility of exchange rates determine the policies adopted by these enterprises in order to remain competitive and profitable, maintaining a reasonable cover for the uncertainty associated with the cost of highly volatile foreign currency.

1.3 RESEARCH OBJECTIVES

This study seeks to establish following:

General Objectives

The effect of exchange rates fluctuations on small scale enterprises

Specific Objectives

- To find the extent to which the depreciation of the Cedi against the major currencies affects the cost of operations of SMEs,
- To find the extent to which the depreciation of the Cedi against the major currencies influences the strategies developed by SMEs in order to be competitive and profitable,
- To check the strength of association between the exchange rate and cash flow of the SMEs.

1.4 RESEARCH QUESTIONS

In this study we are concerned with the following questions:

- ✓ Is there any relationship between inflation and profitability of the SMEs?
- ✓ Are the SMEs affected positively or negatively by the depreciation of the cedi against the major currencies?
- ✓ How does the uncertainty of exchange rate fluctuation affect SMEs performance?
- ✓ How do managers of SMEs factor in the exchange rate risk factors in their strategic plans?
- ✓ What managerial decisions are made to decrease the impacts of exchange rate fluctuations and thus increase the firm's profitability?

1.5 SIGNIFICANCE OF STUDY

The impact of this study could be seen from different angles.

- First of all, views of management on how exchange rate uncertainties affect their operations can be of great help in taking appropriate measures to address the situation.
- It is also hoped that the findings of this study will assist management to device means to ensuring that the impact of exchange rate volatility is given prominence in strategy formulation.
- Further, stakeholders in the SME sector will be abreast with the need to develop the required managerial capabilities necessary to remain competitive and profitable.
- Again, managers and staff of SMES especially those in the manufacturing sector may use the result of this study to guide and improve upon practices that reduce cost and enhance the value of the organization.
- Also the model from this study can inform the management of the company ahead of time their input and their expected net cash flow.

- The result of this study could be of help to government and policy makers to plan and implement policies that will ensure that a favourable business environment exists for SMEs.
- Finally, the research will serve as essential source of reference to future researchers who will be researching into this problem and its related studies.

1.6 SCOPE OF THE STUDY

The study was conducted at Budget City Limited to identify bottle-necks and provide possible recommendations for improvement. The above institution consists of departments and employees. The writer chose this universe because it was accessible and owners were willing to volunteer information concerning the problem.

1.7 ORGANIZATION OF THE STUDY

In order to address the problem, the study has been organized into five chapters; each dealing with a specific aspect of the study.

Chapter one takes care of introduction which consists of the background of the study, statement of the problem, the objective of the study, research questions, significance, limitations and organization of the study.

Chapter two deals with the review of literature that is relevant to the study. In this, materials which have been written by other people and statements in relation to the study are reviewed.

Chapter three on the other hand considers the methodology employed in carrying out the study.

This is organized to indicate the research design, population, data collection procedure, sample and sampling procedure, instruments used, and data analysis. Intervention design and Implementation are also discussed in this chapter.

Chapter four considers the result of the study. It includes the description, analysis and interpretation of the data collected during the study.

Chapter five focuses on the summary, conclusion, recommendations and suggestions for further studies.

CHAPTER TWO

REVIEW OF RELEVANT LITERATURE

2.0 INTRODUCTION

The purpose of this research is to highlight the importance of exchange rates to the profitability of SMEs. To achieve this goal, this chapter of the study has been designed to deal with examination of existing literature in relation to the study. In this, research works, books, journals, etc. written by other people have been reviewed to obtain the relationships drawn between exchange rate volatility and profitability of SMEs. Available literature have been reviewed from two perspectives; the theoretical framework of the study, supported with the empirical basis upon which the study was carried out. This section, which is in five parts includes a review of basic theories and concepts of exchange rate, an overview of exchange rate history in Ghana, factors that determine the value of business, consumer perception of price and pricing to maximize business value.

2.1 BASIC EXCHANGE RATE CONCEPTS

The degree of variability in exchange rates in Ghana since the mid-1980s, following the removal of the fixed exchange regime has been enormous. The volatility experienced during the structural adjustments was unquestionably due to the negative effects left behind by the fixed exchange regime operated until 1984. The reasons and the underlying factors for subsequent upward trends in the rates then became the main focus of a number of scholars. Studies conducted in this area therefore took on mainly the macroeconomic dimensions. In contrast with previous researchers' focusing on financial impacts of exchange rate at the macro level, we emphasize on the rationality of firm strategies under exchange rate uncertainty. Even though our study is focused at its effects at the micro level, viz. the direct and indirect effects of the prevailing rates on the value of a specific business, this section

attempts to provide understanding for basic theories and concepts used in the field to facilitate understanding of the subjects of discussion in the study. (Trading and exchange market microstructure for practioners 2002)

2.1.1 Foreign Exchange Market

The foreign exchange markets, often referred to as forex markets are non-physical markets operating 24 hours to facilitate the trading or exchange of money used in one country or geographical area for the money used in another country or area. The foreign exchange market is the largest financial market in the world by virtually any standard. Average daily turnover in 2004 traditional foreign exchange markets was estimated at \$1,880 billion (Bank for International Settlements, 2005) and average daily global turnover in 2006 traditional foreign exchange market transactions totaled \$2.7 trillion (International Financial Service London, 2006). Recently foreign exchange trading increased by 37% from 2005 to 2006 and more than doubled since 2001 (International Financial Service London, 2006). This is largely due to the growing importance of foreign exchange. They operate as *secondary markets* in the sense that the products traded in - the currencies of various countries- are not produced by the markets, they are primarily issued by governments or central banks. The main *dealers* in the forex markets are banks which buy currency from customers and sell same to customers who require foreign currencies for their international business transactions. The customers of these banks could also be governments and other banks.

2.1.2 Exchange Rate

Cambridge Advance Learner's Dictionary defines Exchange Rate as the rate at which the money of one country can be changed for the money of another country. It is simply the price of a unit of a currency expressed in terms of another currency, or better still the price at which a foreign currency can be bought with a domestic currency.

2.1.3 Direct Quote

Direct Quote expresses the rate (price) in terms of the domestic currency. For example GHC 1.75 per US\$1.00

2.1.4 Indirect Quote

Indirect Quote is simply the reciprocal of the direct quote. For example US\$ 0.7897 per GH¢1.00

2.1.5 Bilateral Exchange Rate

Bilateral Exchange Rate is the rate between two countries, viz. one's currency in terms of the other.

2.1.6 Cross Exchange Rate

Cross Exchange Rate is an exchange rate between two currencies A and B in relation to a standard currency C. It is calculated as the ratio of the exchange rate of A to C divided by the exchange rate of B to C. For instance, Cross Exchange Rate of CFA to GH¢ = CFA to US\$/GH¢ to US\$.

2.1.7 Spot versus Forward Rates

Spot versus Forward Rates the spot rate, also known as the nominal rate refers to the price one pays, on the spot, to obtain a unit of a specified foreign currency. The spot rate is highly volatile. Businesses therefore enter into agreements based on agreed future prices of one currency in terms of another for a future date. These future prices are known as forward rates.

2.1.8 Buying and Selling Rates

The bid rate for currency A in terms of currency B is the rate at which dealers buy currency A (sell currency B). The **offer** or **ask rate** is the rate at which dealers sell currency A (buy currency B). The **Bid/Ask Spread**- is the gap between the offer and the bid rates. (Exchange rates and International Finance-Fourth Edition by Laurence Copeland 2005 p.8)

2.1.9 Effective or Trade Weighted Exchange Rate

Effective or Trade Weighted Exchange Rate is a weighted average of the exchange rates between countries based on the proportion of trade between the countries. It takes into account import and export taxes for specific commodities which influence the different effective prices of each of the commodities. Since a tariff (or a tax on imports) increases the domestic price of an imported good, and an export tax reduces the price of the good received by the exporter, the foreign currency prices of the goods become:

$$P_i = e(1+t_m)P_i^* \text{ for the imports and}$$

$$P_e = e(1-t_e)P_e^* \text{ for the exports,}$$

where P_i and P_i^* are the domestic and foreign prices of imports respectively; P_e and P_e^* are the domestic and foreign prices of exports respectively; e is the nominal exchange rate (in local currency unit per unit of foreign currency); t_m is the tariff levied on the commodity imported; t_e is the export tax on a specified commodity.

For a commodity j which is both exported and imported, the effective exchange rate, e then is: $e = e^*(1+t_{mj}-t_{ej})$. This implies that there may exist in a single economy with variable tariffs and export tax multiple effective exchange rates representing each tradable commodity.

2.1.10 Real Exchange Rate (RER)

Real Exchange Rate (RER) may be defined as the ratio of the foreign price index converted at the nominal exchange rate to the domestic price index. It reflects the changes in the purchasing power of the foreign currency (for example, the US Dollar) by incorporating inflation differentials between countries, and adjusting to changes in the value of the foreign currency over time. It is also referred to as Purchasing Power Parity (PPP) Real Exchange Rate, RER_p , $RER_p = eP_f/P_i$

Where e is the nominal exchange rate, P_F is a general index of foreign prices, and P_I is a price deflator for the domestic currency (e.g. Consumer Price Index - CPI).

The RER may also be defined in terms of a weighted average of specific exchange rates of major trading partners {imports and exports},

An alternative way to define RER is that reflects resource allocation within an economy is to use relative prices of tradable (goods and services traded on the international market) and non-tradable (goods and services produced for the domestic market). This may be defined as: $RER = \frac{P_T}{P_{NT}}$ where P_T is the price tradable goods, and P_{NT} is the price of non-tradable goods. RER is basically an index of a country's competitiveness. An increase in RER implies an improvement in a country's competitiveness, and vice versa. Similarly, the RER affects resource allocation indirectly through the balance-of-payment (BOP) adjustment mechanism. For example, one consequent of an increase in the RER is to shift domestic demand in favour of domestic goods instead of imports, and subsequently induce domestic producers to shift resources in favour of tradable goods (both import and export) rather than non tradable goods. (Ghana: Exchange Rate Reforms and the Real Exchange Rate; Samuel Asuming-Brempong, 1998)

2.1.11 Purchasing Power Parity (PPP)

Purchasing Power Parity (PPP) theory holds that over the long term the average value of the exchange rate between two currencies depends on their relative purchasing power. (Lipsey & Chrystal 2004) Or better still, "the general level of prices, when converted to a common currency, will be the same in every country". (Copeland)

2.1.12 Absolute Purchase Power Parity

Absolute Purchase Power Parity is a straight forward concept consistent with the basic idea that a commodity costs the same regardless of what currency is used to purchase it or where it is selling. For example, if a bottle of beer costs £2 in London, and the exchange rate is

£.60 per dollar, then a beer costs £27.60 = \$3.33 in New York. In other words, \$1.00 will buy the same amount of a commodity anywhere in the world.

Let S_0 = the spot rate at Time 0; P_{US} and P_{UK} = current US and UK prices of a particular commodity respectively.

Absolute PPP says that $P_{UK} = S_0 \times P_{US}$, meaning the British price for something is equal to the US price for that same thing multiplied by the exchange rate. At exchange rate £.60, suppose apples are selling in New York for \$4.00 per bushel whereas in London the price is £2.40 per bushel. By absolute PPP concept;

£2.40 = $S_0 \times \$4$, implying that

$S_0 = £2.40/\$4.00 = £.60$ (the spot rate)

Assuming the actual exchange rate was £.50 instead, a trader could buy bushel of apple at \$4.00 in New York, ship it to London and sell it for £2.40, convert the proceed into dollars at the current rate of £.50 to obtain $2.40/.50 = \$4.80$ from the transaction; a gain of 80 cents. In response to this gain the forces of demand and supply would be set in motion to adjust the exchange rate and or apple price. Apple would begin moving from New York to London. The resultant reduction in supply of apples in New York would raise the price there, and the increased supply in London would cause a reduction in price of apple in London. In addition, traders would be converting pounds back to dollars to buy apple. The increased demand for dollars would adjust the rate upwards towards the original £.60 per dollar.

For the concept of Absolute PPP to hold, the following assumptions are made;

1. The transaction costs of trading apple - insurance, spoilage, shipping etc. must be zero.
2. There must be no barriers to trade - no tariffs, taxes and other political barriers.
3. An apple in New York must be identical to an apple in London.

In reality however, transaction costs are not zero and the other assumptions rarely exist. As a result, a relative version of PPP was evolved.

(Lipsey & Chrystal 2004)

2.1.13 Relative Purchasing Power Parity

Relative Purchasing Power Parity generally states that the change in the exchange rate is determined by the difference in the inflation rates of the two countries.

If S_0 = current (time 0) spot exchange rate - foreign currency per dollar, $E(S_i)$ = expected exchange rate in time i periods, s = inflation rate in the US, and foreign country inflation rate.

The expected percentage change in the exchange rate over the next year,

Relative PPP simply says that the expected percentage change in the exchange rate is equal to the difference in inflation rates.

(Lipsey & Chrystal 2004)

2.1.14 Arbitrage

"The simultaneous buying and selling of the same negotiable financial instruments or commodities in different markets in order to make an immediate profit without risk."

(Microsoft Encarta Encyclopedia 2009)

2.1.15 Floating Rates

Floating Rates exchange rate values are determined by market forces without government intervention.

2.1.16 Fixed Rates

Fixed Rates exchange rates are either held constant or allowed to fluctuate only within very narrow boundaries. They are subject to government interventions.

2.1.17 Managed floating this

Managed floating this combines the characteristics of the free floating and the fixed exchange rate regimes.

2.1.18 Pegged Exchange Rate System

Pegged Exchange Rate System this is where a home currency value is matched to a foreign currency or to some unit of account.

(Microsoft Encarta Encyclopedia 2009)

2.2 OVERVIEW OF EXCHANGE RATE BEHAVIOR IN GHANA

As far back as 1912 prior to independence in 1957, the British colonial administration instituted a West African Currency Board (WACB) in British West Africa (which included Ghana- then Gold Coast, Nigeria, Sierra Leone, and the Gambia) to oversee the financial administration of the colonies. The WACB was mandated to ensure stability in the exchange rate between the Pound Sterling and the Colonial Currency Unit which was facilitated by its convertibility into Pound Sterling, guaranteed by the British Treasury. Soon after independence, the government of Ghana established the Bank of Ghana (BOG) and introduced the Ghana Pound to replace the WACB Pound which was at par with the Sterling until 1965. The then Nkrumah led government, constrained by the growing balance of payment difficulties and declining external reserves, was prompted to pass the Exchange Control Act of 1960 which imposed some restraints on remittances abroad and regulated financial transactions to Sterling areas. This is usually cited to have heralded the emergence of the parallel (or black) market for foreign currency in Ghana

A new currency, the Cedi, was introduced to replace the Ghana Pound in 1965. After the overthrow of Dr. Kwame Nkrumah in 1966, the new government of the National Liberation Council (NLC), upon the advice of the Bretton Woods Institutions, the International Monetary Fund (IMF) and the World Bank, renamed the currency as the new cedi and devalued it by 30% against the Dollar and the Pound Sterling for the first time. The Russia

administration, which followed the NLC in 1969, further devalued the overvalued New Cedi by 45% against the Dollar in December, 1971.

All governments, since independence, functioned under a fixed exchange rate regime until the era of Economic Recovery Program (ERP) of the Provisional National Defense Council (PNDC) in 1983, which saw the onset of exchange rate reforms. Realignment of the nation's overvalued currency was a major concern for the government of the day following the decline of Ghana's economy in the 1970s and the early 1980s. Government effort towards exchange rate correction resulted in massive devaluations of the Cedi. The Cedi, which exchanged for the US dollar at a fixed rate of C2.80 per \$1.00 at the onset of the reform in 1983, declined in value over 90% to between C300 and C345 per \$1 in 1990. During the 1990s, the decline of the Cedi against the dollar continued and reached the C3550 per \$1 mark by the close of 1999

Meanwhile, these devaluations were carried out amidst a significant parallel forex market and neighbouring francophone countries (all of which belong to the CFA zone) that had no official devaluation until 1994. The CFA Franc had been pegged to the French Franc and was supported by the French Treasury making it strong and convertible while the cedi continued to decline and experienced problems with convertibility.

The liberalization of Ghana's exchange rate was implemented in three stages. Discrete exchange rate adjustments (devaluation) were pursued initially from 1983 to 1986 which was followed by an auction market for exchange rate in a two-tier system from 1987 to 1989; coupled with licensing of foreign exchange bureaus, with a view to absorb the parallel foreign exchange market. The final stage commenced in 1990 tried to unify the exchange

rate system through a composite interbank market supported by a weekly wholesale auction. Since 1990, when the rate has been determined more by market forces with little or no government intervention, the Cedi, has consistently declined at a rapid rate.

In spite of some significant gains in economic performance during the recovery period between 1983 and 1989; with annual GDP growth over 5% (on the average) and inflation declining from about 120% to 25% at the end of 1989, underdeveloped financial markets resulted in a build-up of currency outside the banking system (IMF, 1995). Government therefore implemented a financial sector reform and instituted a market-oriented system of control based on indirect instruments such as Treasury Bills among others.

The IMF estimated that following the Economic Recovery and Structural Adjustment Programmes, the annual growth in money supply declined from 72% in 1984 to about 43% by the end of 1988. It further declined to 23% by 1990. The average annual inflation rate fell from 73% in the early 1980s to about 37% in 1990 after intermittent fluctuations. During the same period, the average weekly variation in the Cedi exchange rate declined from 2% in 1986 to about 0.3% in the first quarter of 1990 (IMF, 1991). Following increases in growth of money supply from 1992, the Cedi exchange rate to its major trading currencies fluctuated upward till date.

(Ghana macroeconomic Review and outlook by centre for policy Analysis, Cepa publication, 2001)

2.3 DETERMINANTS OF BUSINESS VALUE

A business's value to shareholders depends fundamentally on the expected magnitude, timing, and risk associated with future net cash flows (cash inflows minus cash out flows) that will be available to provide shareholders with a return on their investment. Increases in

the expected size of net cash flows increase business value; decreases in expected net cash flows reduce value. The timing of cash flows affects value because a dollar received today is worth more than a dollar received in the future. A fundamental principle of business valuation is that risk reduces value and increases the expected return required by investors. If an enterprise's cost of risk is defined to include all risk-related costs from the perspective of shareholders, that enterprise can maximize its value to shareholders by minimizing the cost of risk. We define; **cost of risk = value without risk - value with risk**. In terms of the enterprise's value to shareholders in the presence of risk, **value with risk = value without risk - cost of risk**. It follows that as cost of risk increases, the value of the business declines.

In economics, finance, or accounting fields, it's common to examine the impacts of exchange rate uncertainty on firm performance or profitability (Amihud&Levich, 1992; Bhandari, 1985; Clarida, 1997; Dekle, 2005; Dominguez & Tesar, 2006). However at the organizational level, hardly can we find discussions about firms' strategies on exchange rate uncertainty. Starting from a specific organization's perspective, our research is aimed to investigate the various managerial strategies, with our emphasis on pricing strategies adopted to succeed in the turbulent environment of exchange rate uncertainty and reduce the impacts of exchange rate exposures on the survival of the enterprise.

Eun and Resnick (2001) define the exchange rate exposure as follows. There are three types of exchange rate exposures: translation exposure, transaction exposure, and economic exposure. Translation exposure, also called accounting exposure, refers to the effect that an unexpected change in exchange rates will have on the consolidated financial reports or environmental performance reports (Hart, 1995). Transaction exposure arises from contractual obligations denominated in a foreign currency (Eun & Resnick, 2001). Economic

exposure is defined as the extent to which the value of the firm is affected by unexpected changes in exchange rates. Shapiro (1974) predicted that changes in exchange rates negatively influence a multinational firm's cash flows, profitability, and therefore market value. Recent studies (Jorion, 1990; Choi & Prasad, 1995) also document U.S. stock returns are sensitive to exchange rate movements. Organizations with a higher share of foreign sales exposure have significantly better profitability (Clarida, 1997) and performance after depreciations.

Thompson (1967) specifies three types of uncertainties: generalized uncertainty, contingency uncertainty, and interdependence of components that pose major challenges to organizations. Exchange rate uncertainty represents generalized and contingency uncertainties and is a major source of uncertainty especially multinational firms (Jorion, 1990; Pantzalis, Simkins, & Laux, 2001). Researchers stress the fatalness of exchange rate uncertainties (Klassen & Whybark, 1999; Sawyerr, 1993; Shapiro, 1974) and the importance of dealing with external uncertainties (Jauch and Kraft, 1986).

Many countries experienced currency crises. Japanese Yen appreciated almost 50% in 1987-1989 (Whittaker & Kurosawa, 1998), Argentina experienced serious financial crisis during 1990s (Kaminsky & Reinhart, 1998), and Mexican Peso depreciated by at least 20% in 1994 (Sachs, Tornell, Velasco, Calvo, & Cooper, 1996). Several organizations went bankrupt because of currency crises. During Japan crisis, four major financial institutions collapsed in a single month of November 1997 (McCormack, 1998). Exchange rate or currency fluctuation is regarded as a major uncertainty of firms and most organizations try hard to stabilize with exchange rate management (Drazen & Helpman, 1987). Thompson's (1967) suggests organizations try to achieve predictability and self-control capability through

regulation of transactions at their boundaries, through negotiation, by buffering, or by varying their activities to match environmental fluctuations.

As businesses become increasingly globalized, more and more organizations find it necessary to focus more attention on FOREX exposures and appropriate managerial strategies for FOREX management (Bhandari, 1985; Eun&Resnick, 2001; Pantzais, Simkins, & Laux, 2001). There are many useful FOREX management strategies, such as international capital mobility, exchange market intervention under rational expectations, hedging, outsourcing, and foreign currency derivatives (Miller &Reuer, 1998).

Organizations seek to "anticipate" and adapt to environmental changes which cannot be buffered or leveled (Thompson, 1967). Usually, financial staffs estimate possible ranges for dollar strength or weakness over the five-year planning horizon, using statistic software (Eun & Pesnick, 2001) or buy forecasts from professional forecast organization (Financial Forecast Center, 2006).

The finding that firm-level exchange rate exposure is not stable over time should not be surprising, because it suggests organizations dynamically adjust their behaviors in response to exchange rate risk. Other factors influence the impacts of exchange rate on firm performance, such as firm size, multinational status, export rate, foreign sales, international assets/foreign ownership, foreign listing, degree of industry-level competitiveness and trade, and book-to-market value (Dominguez &Tesar, 2006).

2.4 CONSUMER PERCEPTIONS OF PRICE

Thomas Nagle and Reed Holden in their book, *The Strategy and Tactics of Pricing* outline nine laws or factors that influence how a consumer perceives a given price and how price-sensitive the consumer is likely to be with respect to different purchase decisions. These factors include:

1. **Reference Price Effect** buyer's price sensitivity for a given product increases as the product's price relative to perceived alternatives is higher. Perceived alternatives can vary by buyer segment, by occasion, and other factors.
2. **Difficult Comparison Effect** buyers are less sensitive to the price of a known / more reputable product when they have difficulty comparing it to potential alternatives.
3. **Switching Costs Effect** the higher the product-specific investment a buyer must make to switch suppliers, the less price sensitive that buyer is when choosing between alternatives.
4. **Price-Quality Effect** buyers are less sensitive to price where higher prices signal higher quality. Products for which this effect is particularly relevant include: image products, exclusive products, and products with minimal cues for quality.
5. **Expenditure Effect** buyers are more price-sensitive when the expense accounts form a large percentage of buyers' available income or budget
6. **End-Benefit Effect** the effect refers to the relationship a given purchase has to a larger overall benefit, and is divided into two parts: *Derived demand*: The more sensitive buyers are to the price of the end benefit, the more sensitive they will be to the prices of those products that contribute to that benefit. *Price proportion cost*: The price proportion cost refers to the percent of the total cost of the end benefit accounted for by a given component that helps to produce the end benefit (e.g., think CPU and PCs). The smaller the given components share of the total cost of the end benefit, the less sensitive buyers will be to the component's price.

- 7 **Shared-cost Effect** the smaller the portion of the purchase price buyers must pay for themselves, the less-price sensitive they will be.
- 8 **Fairness Effect** buyers are more sensitive to the price of a product when the price is outside the range they perceive as "fair" or "reasonable" given the purchase context.
- 9 **The Framing Effect** buyers are more price-sensitive when they perceive the price as a loss rather than a forgone gain, and they have greater price sensitivity when the price is paid separately rather than as part of a bundle.

(Thomas Nagle and Reed Holden in their *book, The Strategy and Tactics of Pricing* outline)

2.5 PRICING TO MAXIMIZE BUSINESS VALUE

What makes doing business interesting are the challenges businesses are faced with and the solution we choose to address the situation. McKinsey, one of the best professional management firms on the subject of pricing talks about a pricing strategy across a product's life cycle. The managers of SMEs should note that whatever impact the global currency volatility is having, a long-term pricing strategy-should always be the framework to any pricing strategy in any circumstances. Entire industries can suffer when companies fail to grasp the importance of pricing products or services across the life cycle, particularly in innovation-intensive sectors such as consumer electronics and consumer durables, IT hardware and software, medical devices, and pharmaceuticals. That's especially true today. Companies introduce products more regularly, with life cycles often measured in months, not years. There's external pressure for low prices from customers expecting more for less and internal pressure from the belief that pricing is a make-or-break factor when products launch. And a company may have a number of related products in the marketplace simultaneously, which complicates their life cycle pricing.

Two points are essential to price effectively throughout the life of a product or service. First, companies should actively manage the trade-off between price and volume (or profit and market share) to maximize returns. Most businesses fail to test customer value perceptions and price sensitivity after products launch and have no idea how the critical trade-off between price and volume shifts over time. Second, companies must make pricing decisions in the context of their broader product portfolios because when they have multiple generations of a product in a market, a price move for one can have important implications for others.

With these two principles in mind, companies should consider how they respond to pricing challenges during the three major phases in the life cycle of a product or service: launch, midlife, and late life.

(Mckinsey Quarterly, online business journal, 2002)

2.5.1 The launch phase

Correctly setting the launch price for a product or service can reset market price expectations and boost the profit trajectory across the remainder of that offering's life cycle. In the launch phase, it's critical to concentrate on three imperatives: setting a launch price that maximizes the long-term capture of value, avoiding "anchor effects" from older products, and working the product portfolio to a company's advantage

One prerequisite for setting a launch price that maximizes long-term value is conducting scenario-based analyses that incorporate different pricing models, potential responses by customers and competitors, and the implications for earnings. This approach can help companies avoid common mistakes, such as setting the launch price too low or reducing a product's price soon after launch. The careful adjustment of prices for existing products also can minimize the degree to which they drag down prices for new ones. More broadly, businesses should assess

New product pricing in the context of their existing product portfolio

(Walter L. Baker Michael V. Marn, and Craig C. Zawada, *Marketing & Sales Practice*)

2.5.2 Pricing new products in a portfolio

With the right pricing strategy, a company can avoid discounting and instead compete at higher average price points based on product benefits.

Consider the case of a medical-device manufacturer that launched new versions of all major products every 6 to 18 months. Each version whether it was a significant innovation or a minor improvement was priced only a few percentage points above the existing one, in an effort to encourage migration and mitigate potential customer backlash. The company would then drop the price of older products precipitously (by 20 to 40 percent) while continuing to sell them for an extended period because of ongoing demand from some customers and the company's desire to provide a lower-cost alternative to the new products.

This approach dragged down the prices of new products because their incremental value versus the old ones remained more or less constant. As happens at many companies, the average price for each product line declined every year despite annual R&D investments in the hundreds of millions of dollars. In other words, the company was rapidly innovating itself from a market leader into an average performer. Once the company recognized what was happening, it eliminated "fire sales" on older products, changed the incentives of the sales force to support the new life cycle-pricing strategy, and carefully launched subsequent products at greater premiums.

(Walter L. Baker Michael V. Marn, and Craig C. Zawada, *Marketing & Sales Practice*)

2.5.3 The midlife phase

Once a product has launched and gained stable market acceptance, it enters the midlife phase. This phase presents both opportunity and risk: it often occurs when companies earn a majority of a product's operating profit but also when "me too" products may appear and

when price compression is most extreme. Organizations rarely revisit their price-volume trade-offs or value maps at this point, nor do they undertake essential market-based customer research. If they did, they could more effectively fine tuning price-volume trade-offs, anticipate internal and external pricing triggers, and identify and adopt new pricing models that capture more value. In this phase, companies should undertake that fine tuning, anticipate trigger events, monitor market conditions, and consider new pricing models that may change the game.

Companies should change product prices in midlife carefully. Managers need to analyze whether the changes are appropriate (for example, whether lowering prices will raise life cycle profits) and, if so, the most effective timing. One personal-computer company, for example, conducted weekly market price tests, implementing cuts only when unit sales had declined and the tests showed that a lower price would significantly increase unit sales. Managing prices in this way (rather than by steadily reducing them) during the midlife stage has allowed the company to generate tens of millions of dollars in additional operating profit over the lifetime of most of its computer models.

There are many midlife trigger events for pricing: internal (such as the launch of a new model or a change in cost position) and external (price moves and product introductions by competitors or shifts in customer demand, for example). Companies need to monitor the market so they can anticipate such events, or they will face the consequences of failing to take advantage of changes in their rivals' behavior. Take the case of a medical-device company that, after enjoying a period of product exclusivity, decided to lower prices simply because that had been its standard practice. The company then failed to respond when its two main competitors introduced products similar to its own but at much higher prices. Instead of raising prices to capture a larger margin-or at least maintaining them-the company

continued to discount, hurting prices and margins for everyone, without gaining market share.

Finally, strong performers are always searching for ways to capture value, and a new midlife-pricing model can reinvigorate a product. Maintenance services for jet engines, for example, were historically undertaken by engine manufacturers using a standard pricing model of "time and materials" associated with each visit to a service shop. As third-party service providers entered the market at lower prices and began to gain prominence, one engine manufacturer introduced long-term service agreements based on hours of flight operation, which roughly correlates with engine wear and tear. Airlines liked the new model because it made their service costs highly predictable, the manufacturer's volume and margins grew substantially, and industry price compression slowed.

(Walter L. Baker Michael V. Marn, and Craig C. Zawada, *Marketing & Sales Practice*)

2.5.4 The late-life phase

Counter-intuitively, the late life of a product may be an opportune time to raise rather than lower prices. The reason is that its "all in" costs may have increased or its inherent value for the remaining customers may not have decreased as much as it has for those that moved on. Indeed, its value may even have increased for some users. All this may translate into a willingness to pay higher prices. Whatever choice a company makes, it must have deep insight into the true cost of serving a market and the customer segments still buying the product. Organizations should be guided by three late-life pricing imperatives: capitalizing on pockets of customers with a high willingness to pay, minimizing competition with next-generation products, and actively working to reduce unfavorable product proliferation.

Certain customers may be fairly price insensitive for an older product because they are more comfortable with it, see more value in it, or regard switching costs as prohibitive. A semiconductor manufacturer that profitably managed the transition from a legacy product to

a new one wanted customers to adopt it but recognized that the older product still had strong value for some users. The company actually raised the price of the late-life legacy product after the new one launched. By continuing to sell the older product at significantly higher margins for several more quarters, the company captured at least \$250 million in additional profits. It would have given them up if it had followed its usual practice of reducing prices for legacy products when their successors were launched.

Even if a company's first instinct is to discount older products before or just after the launch of a new one, excessive markdowns may hurt newer offerings by making older products seem like a better value. A way to hasten the exit from older products and to achieve higher margins on their remaining sales is to follow the lead of the semiconductor manufacturer above by raising the price of older products, although companies must guard against the risk that higher prices will create obsolete or expired inventory. Another approach is simply eliminating products can reduce needless complexity in supply chains, service operations, and customer service.

Finally, many companies, especially those selling to businesses, do not manage product proliferation well: claims such as "we never kill a product" are not uncommon. In addition, few companies carefully evaluate their products' economics over time, especially during the late-life stage. While doing so is troublesome for all companies, it is especially problematic for those using a cost-plus methodology, in which prices are set by applying standard margins to standard product costs.

Companies that capture price advantages across the life cycle of their products have several distinct characteristics. Their perspective on pricing is not myopic: they continually strive to

think across life cycle stages, building all their questions and analyses into that framework. Managers regularly scan internally and externally for information about potential trigger events. Their level of energy and activity-the ability to undertake fast, deep customer research or to produce insightful analyses on a multitude of variables-is higher than that of most companies. In short, their capabilities reflect the more dynamic and interdependent pricing environment that prevails when companies manage product life cycles. Businesses can take a number of steps to manage and price their products in this way:

- ✓ Examine life cycle pricing up front. The pricing of new products at savvy companies is not a reactive, ad hoc process but a core competency undertaken at early stages of product development. Such companies consider alternative price-volume trade-offs and strategies over time and envision how each scenario might play out across different customer segments. The process explicitly incorporates price moves during the life cycle and anticipates internal or external triggers that might prompt the company to shift prices up or down.
- ✓ Maintain a longitudinal view. Nothing should fall between the cracks when a company manages prices over time and across products in its portfolio. Organizations that capture the price advantage escape the common "launch and forget" pricing pitfall once new products hit the market. Their review processes explicitly monitor life cycle pricing performance, while properly aligned incentives keep employees focused on the opportunity. Much of life cycle pricing inherently involves setting expectations about the way prices and volumes may play out. Sophisticated companies track these assumptions and regularly check performance against them.
- ✓ Find ways to increase life cycle value. Companies that manage life cycle pricing well are dynamic and adaptive. Often these qualities call for a level of cross-functional

coordination that transcends the pricing function: product development, marketing, competitive intelligence, sales, and operations may all be involved. Beginning with a high-level plan for managing a product to the end of its life cycle, these companies refine their approach by constantly monitoring market conditions, the moves of competitors, internal operational changes, and customer perceptions.

Companies that master pricing do so across the three phases of a product's life cycle-launch, midlife, and late life-and make decisions in the context of adjacent products in their portfolios. In this way, these companies ensure that they reap the full rewards of their innovations by creating price advantages for themselves.

(Walter L. Baker Michael V. Marn, and Craig C. Zawada, *Marketing & Sales Practice*)

CHAPTER THREE

METHODOLOGY

3.0 INTRODUCTION

This research is aimed at employing strategies to ensure that managers of SMEs in Ghana adopt the right management practices needed to mitigate the effects of exchange rate volatility in order to reduce the associated pricing risks involved in operating in a global setting. This section of the study is very sensitive since it is liable to affect the results and conclusions of the study. The chapter considers the methodology and research design employed for the study. It also defines the population, the sample and sampling procedure as well as the instrument used in collecting data for the study and discuss how the data is collected, analyzed and interpreted. Finally, the chapter also presents the intervention design and its implementation.

3.1 RESEARCH DESIGN

According to Grandhi (2004), 'a research design is the tentative outline of a proposed research work'. As a provisional outline of this research, the researchers employed a number of strategies to determine the appropriate research design.

The research is mainly descriptive and analytical since it involves investigating, recording, analyzing and interpreting data. Both quantitative and qualitative approaches were employed in data analysis. According to Gerber (2009), 'the aim of descriptive research is to verify formulated hypotheses that refer to the present situation in order to elucidate it'. This method sought to describe the phenomenal effect that exchange rates has on the pricing decisions of SMEs.

3.2 RESEARCH POPULATION

A research population is a group of individuals, persons, objects, or items from which samples are taken for measurement (Mugo, 2009).

In this regard, the researchers considered the operational efficiency and managerial effectiveness in dealing with loss reduction. This calls for two categories of people who are directly involved. Management and the entire Budget City Limited were therefore captured as the main population for the study. The choice of this population became necessary since it hoped to provide the researchers with relevant and immediate data needed for the analysis.

3.3 SAMPLE AND SAMPLING PROCEDURE

According to Grandhi (2004) 'a complete coverage of the units of the universe selected for Research, is not possible. Instead of complete coverage, selected units are studied'.

Lunsford and Lunsford (1995) also defined sample as a small subset of the population that has been chosen to be studied. Lunsford and Lunsford further cautioned that the sample should represent the population and have sufficient size.

In this regard, the researchers saw that considering the entire population-all SMEs in Ghana will not help instead part of the population-a case study was sampled to ensure reliability and validity of data collection.

The sample for the study was made up of 6 Workers and 2 Management staff Budget City limited located at Obuasi in the Ashanti Region. Stratified sampling technique was used to select the sample .Elements in the sample frame are divided into homogenous groups based on their respective roles in the organization. The method helped the researchers to identify and enumerate the finite population. To avoid selection bias it is important to guarantee that each of the candidates for inclusion in the study has an equal opportunity for selection

(Lunsford and Lunsford, 1995). According to Lunsford and Lunsford (1995), stratified sampling is 'a method by which subjects are grouped according to strata such as age, gender or diagnosis. Using this method, subgroups of interest can be defined and ... sampled for each group.

3.4 DATA COLLECTION TECHNIQUES

Research techniques refer to the methods for gathering reliable information to answer a question or support an experimental hypothesis (Microsoft Encarta, 2009). In view of this, the researchers employed various techniques and instruments to gather valid and reliable data in aid of rectifying the situation at hand. It must be emphasized here that good data is directly related to the questions; that is, they provide direct answers (Padak and Padak, 2009). The instruments used for data collection were questionnaire, interview, observation and participant observation.

3.4.1 Questionnaires

Questionnaire is usually more superficial than the interview. It is usually used in group work. The questionnaire is especially useful to obtain information about reasonably big groups. Questionnaire is usually characterized by relatively low cost, ease of interpreting information, and likelihood of answering each question. (Gerber, 2009).

The researchers therefore sat down to carefully plan, design and administer questionnaires to respondents (management and staff) to obtain information on the topic under discussion. These questionnaires were presented to respondents during the pre-intervention and post-intervention stages of the study. The items in the questionnaires were written in clear language to enable respondents understand and answer the questions objectively as possible. The choice of the questionnaire technique for the study was that many respondents could be reached within a short period of time. Respondents were hoped to answer every item in the questionnaire. It also required little time of respondents.

Notwithstanding, the respondents were given little opportunity to express their view as they were restricted to the questions and their corresponding answers.

3.4.2 Interview

Archer (2003) defines interview as 'a two person conversation initiated by the interviewer for the specific purpose of obtaining relevant information. During interview, the researcher talks to the respondent and obtains information directly (Gerber, 2009). The literature further gave the following as the advantages of interview method even though it is affected negatively by time, cost and subjectivity.

- i. Flexible.
- ii. In-depth.
- iii. Situation can be adapted.
- iv. Reasons for answers can be sought.
- v. Clues can be followed up.
- vi. Yields a higher percentage of answering

The researchers after careful consideration of the above merits and demerits saw the need to adopt interview technique to obtain information from some management and senior staff. The interviews were planned to embrace both structured and unstructured interviews with closed and open questions administered together. The recording of responds was done by hand writing. In the interview, the researchers inquired for the specific meanings of responses made by some respondents. This technique actually helped to obtain in-depth information from respondents. It also assisted the researchers to obtain information from respondents who could not understand some questions in the questionnaire.

3.4.3 Observation

According to Microsoft Encarta Dictionaries (2009) observation is careful watching and recording of something such as a natural phenomenon and noting developments

Observation means that a researcher studies or observes a specific situation or type of situation.

There are five steps which together make up the observation technique:

- i. The natural phenomenon is observed
- ii. Conclusions are drawn
- iii. Hypothesis and premises are formulated or predictions are made.
- iv. Subsequently a procedure is designed which may be used to test the hypotheses.

This method developed rapidly once observation was supplemented by classification, organization and structuring of the observed information and combining observation and an evaluation technique.(Gerber, 2009).

The researchers employed participant observation as a tool in gathering information from management and staff. This was carried out at the production floor and offices during working hours.

3.4 DATA ANALYSIS

Analysis according to Microsoft Encarta Dictionaries (2009) is 'the examination of something in detail in order to understand it better or draw conclusions from it.

Data analysis involves examination of the data in the order in which your questions have been answered.

If you have asked more than one question, you will want to sort the data according to question. And you may want to discard (or at least set aside) data that do not directly relate to the questions you have posed (Padak and Padak, 2009).

In an effort to make the presentation of the findings comprehensive and readable, the collected data was organized into tables, exploded pie charts and percentages for easy interpretation and analysis of results. This helped the researchers to make meaningful conclusions for the study.

3.6 RELIABILITY AND VALIDITY

Reliability is the term used to deal with accuracy. A scale measurement is considered reliable if it measures that which it is supposed to measure. Further refining of the term reliable is that, when a test is repeated by the same researcher, that is, with a different group representing the original group, the same results should be obtained.

Validity on the other hand is concerned with the soundness and the effectiveness of the measuring instrument. (Leedy, 1993 cited by Gerber, 2009) scrutiny, comments and suggestions.

3.7 COMPANY AND BUSINESS BACKGROUND

Budget City Limited is a limited liability company incorporated under Ghana's companies of 1963 {Art 179}.on the 18th july,1996 and commenced business on 25th July,1996. The business is into books manufacturing. The company is wholly owned by Mr Kofi Abrah. It has Mr. Kofi Abrah and Mr. Osei Owusu as directors.

It uses mainly imported raw materials such as, Art Paper, Chipboard, woodfree bond paper, Chromocote ,Vanguard blue, white ,yellow green colours, Newsprint and bank paper, that are dominated in US dollars.

3.8 LOCATION

Budget City Limited is located at Obuasi in Amansie West District of the Ashanti Region. It is along the Kumasi –Obuasi road near Post office.

The company can be reached through P. O BOX,1045.Obuasi.

The bankers of the company are , ECOBANK and First Allied Savings and Loans Limited, both in Obuasi Municipal .

CHAPTER FOUR

DATA ANALYSIS

4.1 INTRODUCTION

This section presents the results of the study analysed with aid of Statistical Packages for Social Science (SPSS) and Excel analysis tool pack. It presents the analysis of the results of the questionnaire secondary data from Budget City Limited. The result of the questionnaire and secondary data is represented in tables and graphs to ensure simplicity and ease of understanding. This segment is concerned with data collection, entry, presentation and analysis of variables from the company to investigate the extent to which exchange rate and inflation rate affect the cash flow and profitability. The statistical software SPSS and Excel analysis tool pack was used for the summary and presentation of the secondary data. The data is represented in graphs, bar charts and line graph. Questionnaire was self-administered and collected. Some of the items on the questionnaires were however not answered.

4.2 BACKGROUND OF RESPONDENTS

The background covers a number of respondents from each section captured under the research, age range, gender, and the number of years in the organization.

Table 4.1 Age range of respondents

Age Range	Frequency	Percentage
20-30	2	25%
31-40	4	50%
40 and above	2	25%
Total	8	100%

Source: Field survey, May 2012

Table 4.1 indicates the age range of respondents. 25% of the respondents were between the ages of 20-30 years, 50 % were between the age of 31-40 years and the remaining 25% were above the age of 40 years.

Table 4.2 Gender Distribution of Respondents in the Company

Gender	Frequency	Percentages
Male	6	75%
Female	2	25%
Total	8	100%

Source: Field survey, May 2012

As indicated in the table 4.2, 75% of respondents were male whilst the remaining 25% were females. This was representative of the population studied.

Table 4.3 Number of years spent in the organization

Range	Frequency	Percentage
1-5	4	50%
5-10	3	37.5%
10-15	1	12.5%
Total	8	100%

Source: Field survey, May 2012

The table indicates that 50% of respondents have spent between 1-5 years with the organization, 37.5% of respondents have spent between 5-10 years and the remaining 12.5% of respondents have spent 10-15 years with the organization.

4.3 ANALYSIS OF QUESTIONNAIRES

Table 4.4 Foreign Currency Acquisition

Source of Foreign Currency	Frequency	Percentage
Inter-Bank Market	Nil	-
Forex Bureau Market	Nil	-
Both	Nil	-
Inter-Bank and Parallel Market	8	100%
Total	8	100%

Source: Field survey, May 2012

Table 4.4, indicates that 100% of respondents said the company obtained its foreign currency requirement from both inter-banks and the parallel markets. Respondents left no doubts as to the source of the company's foreign currency requirement.

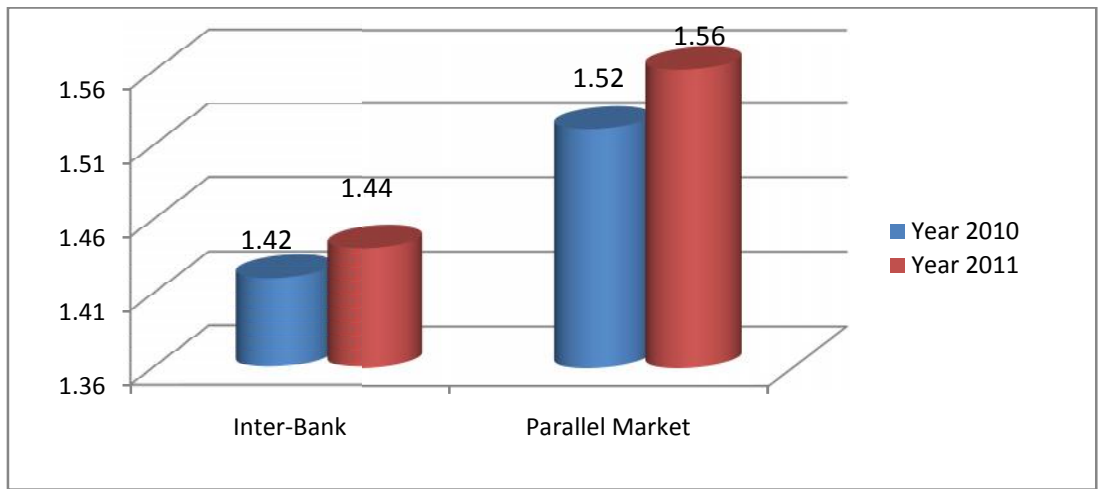
Table 4.5 Difficulty in Obtaining Foreign Currency

Response	Frequency	Percentages
Yes	8	100%
No	Nil	-
Total	8	100%

Source: Field survey, May 2012

100% of the respondents as indicated in the table above said the company found it difficult in obtaining its foreign currency requirement for the importation of raw materials for production.

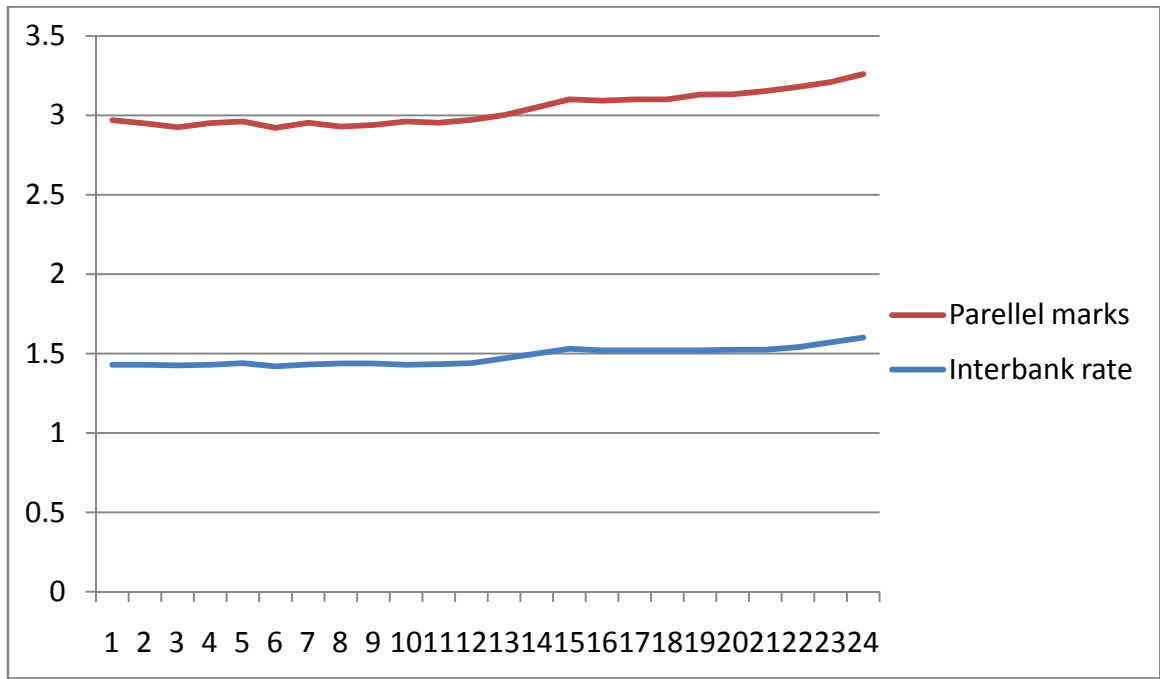
Figure 4.1 ACCESS TO FOREIGN EXCHANGE 2010 AND 2011



Source: Field survey, May 2012

From the study, it was realized that the company usually have difficulties in obtaining the required amount of forex for its operations. It therefore resorts to parallel as a way of supplementing that obtained from the inter-bank market.

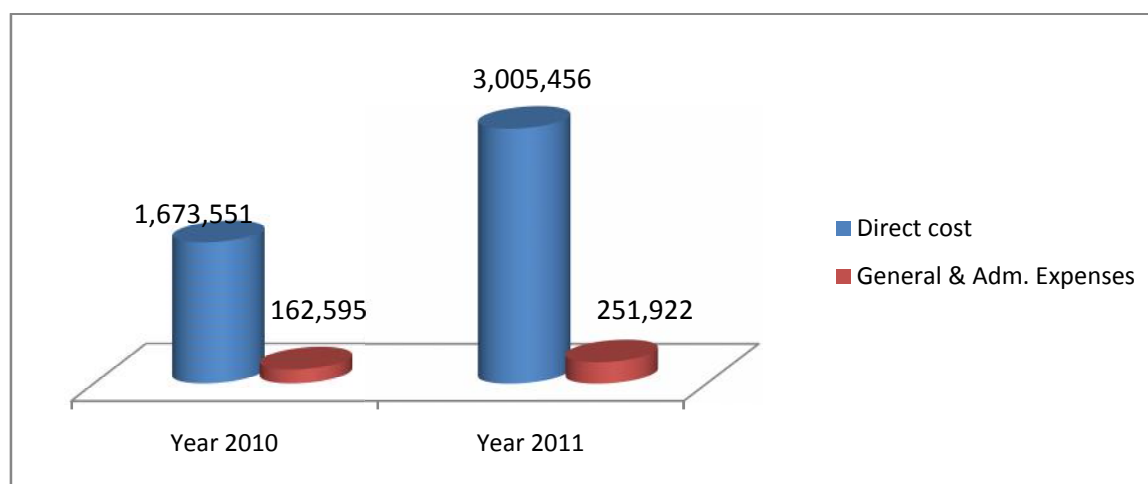
Figure 4.2 TIME SERIES OF EXCHANGE RATES



Source; Field Survey ,June 2012

Response from the questionnaire administered indicated that, it is difficult for the company to obtain the required foreign currency from the banks. In this regard, the firm often relies on the parallel market to supplement its foreign currency requirements. Figures 4.1 and 4.2 shows that the rates at which the firm obtained the US dollar from the parallel market for the period under study was higher than the quoted rates on the interbank market. Whilst figure 4.1 illustrates the average annual rates of the interbank and the parallel market, figure 4.2 on the other hand illustrate the monthly rates of the interbank market and the parallel market. On the average, in 2010, the firm was acquiring its foreign currency supplement from the parallel market at a rate of 4.2 percent higher than the prevailing rate on the interbank market. This trend was repeated in 2011 with the rates on the parallel market being 6.3percent higher than the interbank rate. This caused an upward increase in total cash outflows recorded during these periods. As a result, the direct cost and administrative cost increased in the year 2011 with regards to 2010 as depicted in figure 4.2

Table 4.3 CASH OUTFLOWS OF BUDGET CITY LIMITED



Source: Field survey, May 2012

The bar chart of outflows shows direct cost versus general administrative cost and indicates that in 2010, direct cost constituted 91.14% of total outflows. This increased to 92.27% in 2011.

Table 4.6 Effects of Foreign Exchange Fluctuations on Production

Response	Frequency	Percentages
Yes	7	87.5%
No	1	12.5%
Total	8	100%

Source: Field survey, May 2012

Table 4.6 indicates that 87.5% of the respondents said fluctuations of the exchange rates affect the cost of production of the organization and the remaining 12.5% of the respondents said that the fluctuations of the exchange rate has no bearing on the cost of production of the company.

Secondary data presented by the firm confirmed the responses, the cost of production as well as the administrative cost of the firm increased as shown in figure 4.2.

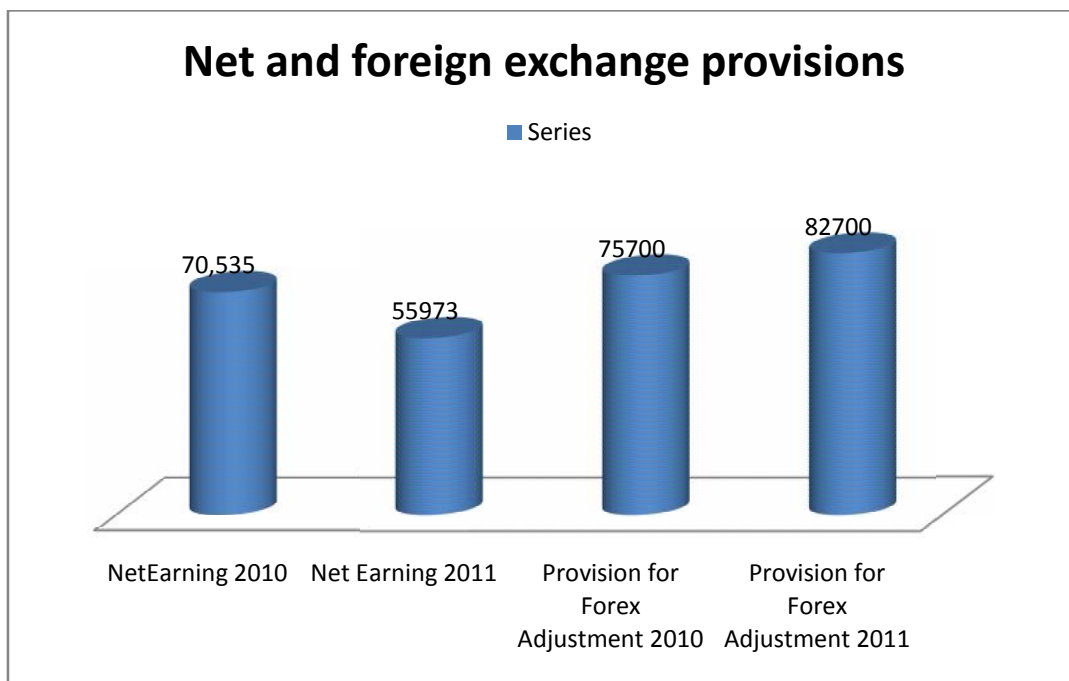
Table 4.7 Price Adjustment during Exchange Rate Changes

Responses	Frequency	Percentages
Yes	1	12.5%
No	7	87.5%
Total	8	100%

Source: Field survey, May 2012

The researcher wanted to know whether or not the company adjust their price (up or down) in the event of exchange rate fluctuation, 87.5% affirmed that the company does not adjust the prices especially upwards and only 12.5% do not attest to that.

They operate in a market where customers are sensitive to prices, so an upwards adjustment will lead to a loss of customers to competitors. The inability of the company to pass on cost, lead to the increase in cost of both direct and indirect cost of operation in figure 4.2 and decreased the net earnings of the company illustrated in figure 4.3.



Source: Field survey, May 2012

The bar chart of the net earnings in figure 4.4 indicated high earnings in 2010, and experience a decline in earnings in 2011. Also, there was a high provision for foreign exchange adjustment in 2011 than 2010. This explains why the firm respondents in the questionnaires that they are unable to price their product on a full cost recovery basis. The management further explains that there is an intense competition in the market within which they operate, where consumers are sensitive to prices to the extent that the marginal

increases in prices will lead to a switch of consumers to suitable products on the market. This also explains why there is a drop in the net-earnings of the firm as depicted in the diagram above. It could be realized that though the provision for forex adjustment increased during the period, the cost could however be passed onto consumers, this led to a drop in net earnings.

Table 4.8 Respondents Knowledge to the financial Information of the Company

Respondents	Frequency	Percentages
Yes	5	62.5%
No	-	-
Not Aware	3	37.5%
Total	8	100%

Source: Field survey, May 2012

The table indicates that 62.5% of the respondents are privy to all financial information of the company whereas the remaining 37.5% said they were not aware to all the financial information of the company.

Table 4.9 Percentage of Foreign Exchange in Production Cost

Responses	Frequency	Percentage
1-20%	Nil	-
21-40%	1	12.5%
41-60%	2	25%
61-80%	5	62.5%
81-100%	Nil	-
Total	8	100%

Source: Field survey, May 2012

In response to this question, 12.5% of the respondents were of the view that foreign exchange rate constitutes between 21-40% of the production cost of the company. 25% were of the view that foreign exchange range between 40-50% of the production cost. 62.5% of the respondents said foreign exchange constitutes 61-80% of the production cost of the company. It is explained that the firm is highly exposed to foreign exchange risk. Furthermore, the inability to price products at a full cost of recovery explains the reason why their net earnings in 2011 dropped significantly as shown in figure 4.4.

Table 4.10 Raw Material Agreement

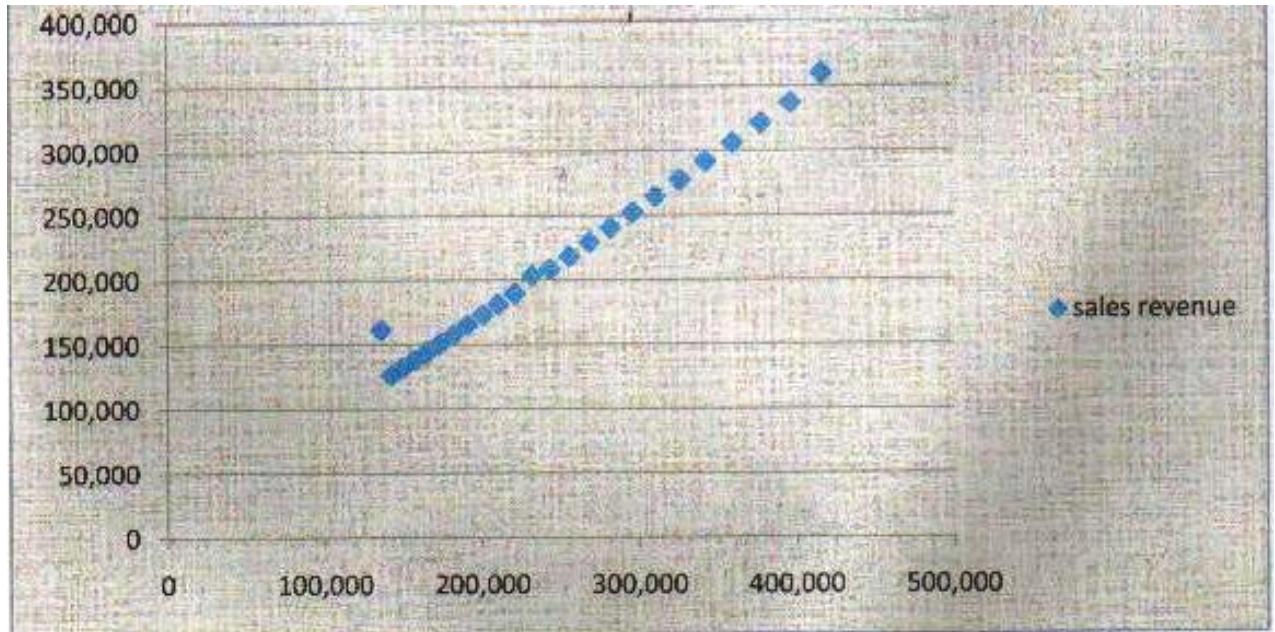
Response	Frequency	Percentage
Yes	-	-
No	8	100%
Total	8	100%

Source: Field survey, May 2012

From the above table, it is obvious that all respondents of the company does not in any way concerned with other suppliers with regards to the prices of raw materials. The respondents were of the view that few suppliers are in the business of importing the raw materials so it is difficult to establish an agreement in prices to be paid for the raw materials regardless of the prevailing exchange rates. It can be realized from this response that the company has no currency management techniques available for dealing with the currency fluctuations.

Scatter plot of sale revenue and total out flow

Fig. 4.5



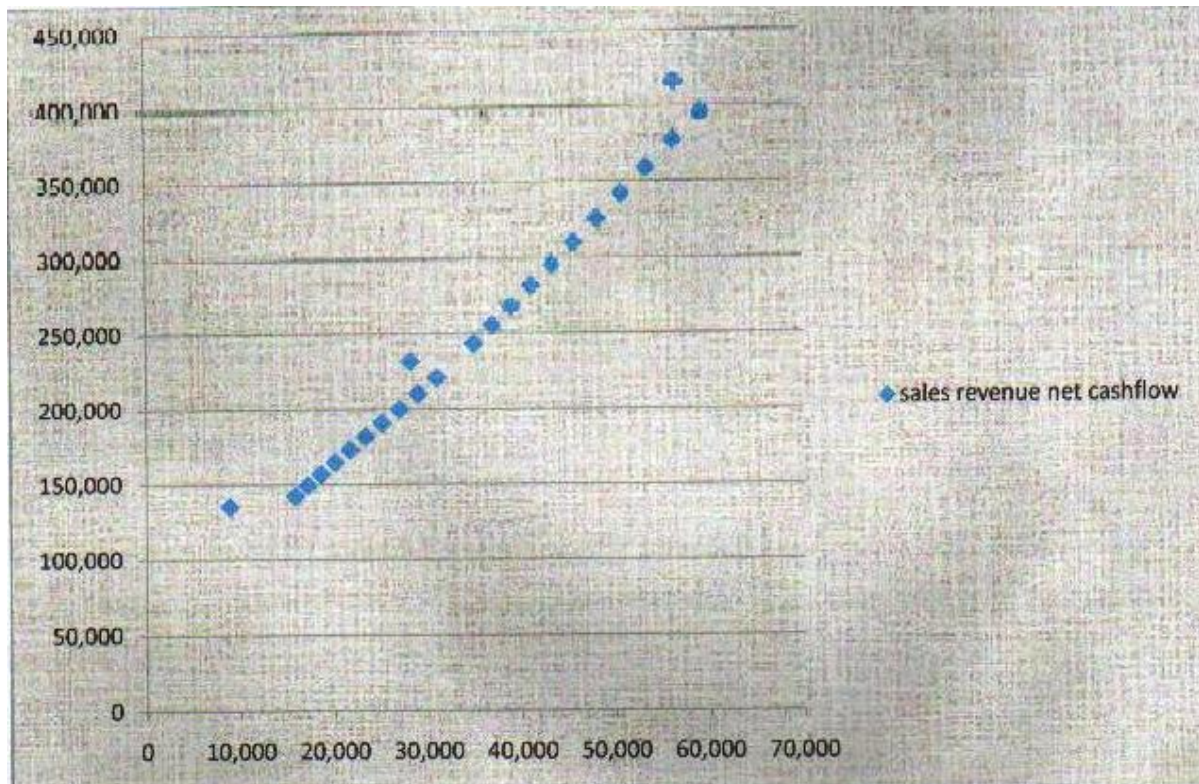
Source: Field Survey, June, 2012

Figure 4.1, a scatter plot of sale revenue against total outflow, shows a strong correlation between sales revenue and total outflow. It indicates that sales revenue increased constantly with increases in total outflow from January 2009 to December, 2010.

There is a direct relationship between sales revenue, total outflow and net cash flow. As sales revenue goes up, net cash flow and total outflow might also go up as depicted in figure 4.2. Even though there has been a decline in the inflation rate since the third quarter of 2009 as shown in figure 4.4, the exchange rate increased on the average. This explains why the cost of operations of Golden Share Limited increased within the period under review; illustrated on the bar chart of outflows in figure 4.3

Scatter plot of net cash flow against sales revenue

Fig 4.6

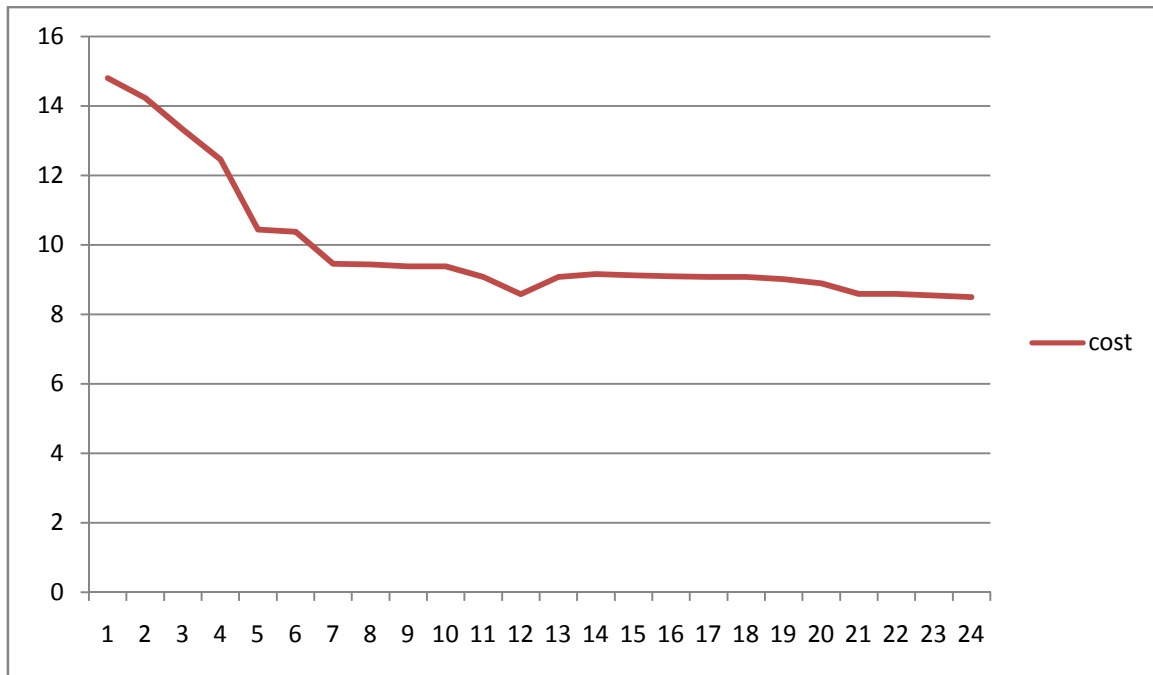


Source: Field Survey, June 2012

Figure 4.6 also shows a positive correlation between net cash flow and sales revenue for the period. Net cash flow increased for the period alongside sales revenue. This however may not imply increase in profit. Although the net cash flow increased, analysis of net earnings in figure 4.4 shows a decline in 2011.

TIME SERIES PLOT OF INFLATION RATES FROM 2010-2011

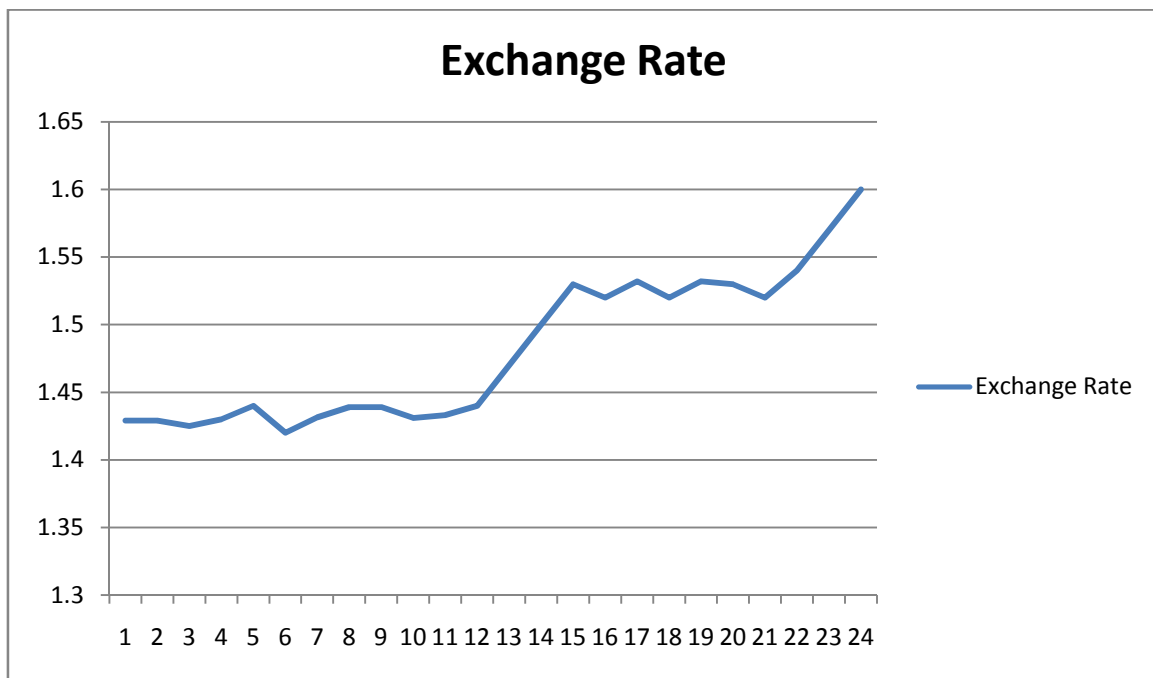
Fig 4.7



Source; Field Survey, June2012

The time series plot of the inflation rate in fig 4.7 showed a decreasing trend from January 2010 through to December 2011. This may have contributed to trend observed in net cash flows for the period.

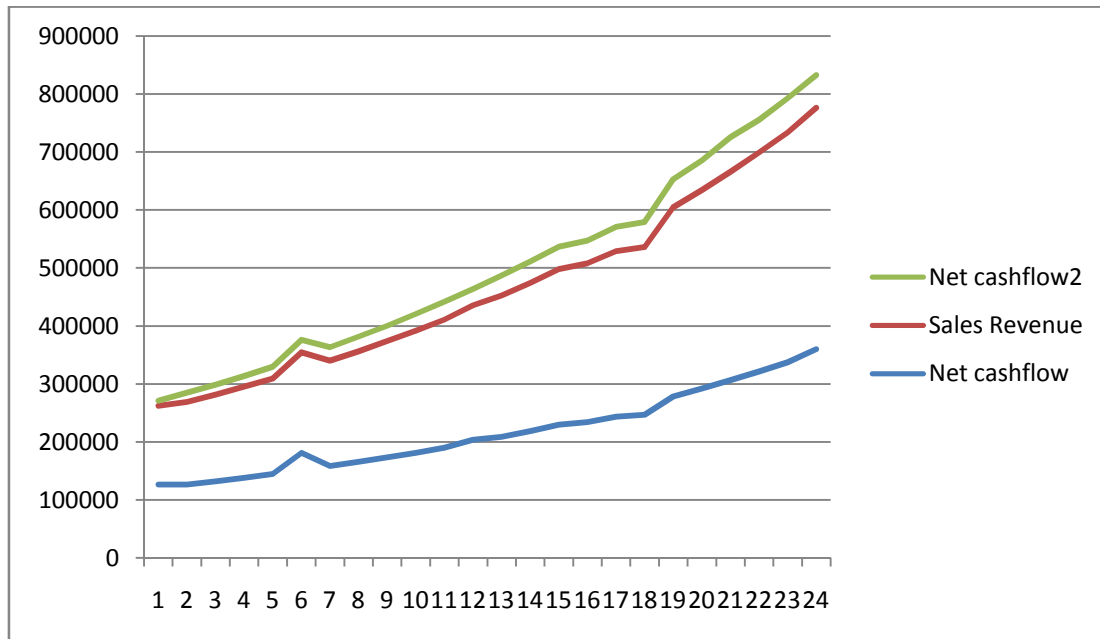
Figure 4.8 TIME SERIES OF EXCHANGE RATE



Source: Field Survey, June 2012.

Figure 4.8 shows the time series plot of exchange rates for the period January 2010 to December 2011. The trend depicts a high rate of depreciation of the cedi against the US Dollar from January 2010 to December 2011. This implies that exchange rate for 2011 increased.

Fig 4.9 LINE GRAPH TOTAL OUTFLOW, SALES REVENUE AND NET CASH FLOW.



Source; Field Survey, June 2012

The line graphs in the fig 4.9 also indicate the time series trend in total outflow, sale revenue and net cash flow. They all indicated an increase. The rate of increase for the net cash flow is however lower.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATION

5.1 INTRODUCTION

To ensure Budget City Limited remains profitable and contribute its quota to the country's economic growth, this final stage of the study is made to dwell on the conclusion and summary of the findings made through the use of the data collection instruments in the study. It also presents the recommendations made by the researchers based on the findings to enhance future research into this problem.

5.2 SUMMARY OF FINDINGS

The aim of the entire research has been to establish the relationship between the cedi depreciation against the major foreign currencies especially the US dollar and the profitability of SME's in Ghana focusing on Budget City Limited. All the activities in this research study, including literature review, data collection, analysis and discussions were geared toward realizing this goal.

The research work succeeded in coming out with the following findings.

1. The depreciation of the cedi against the US Dollar affected the cost of operations of Budget City Limited.
2. The relationship between total out flow, sales revenue and net cash flow was investigated using the line graph indicates an increased and the rate of the cash flows was however lower.
3. The depreciation of the cedi also influences management to sacrifice profitability in order to be competitive. Management couldn't pass on additional cost to consumers.
4. Budget City Limited has no strategies in place to deal with the cedi depreciation against the US Dollar in order to remain competitive and profitable. (Miller and Reuer, 1998) suggest that companies should have foreign exchange management strategies in place in order to be profitable.

5.3 CONCLUSION

- This research study has established that exchange rate fluctuations has a negative impact on the profitability of Small and Medium scale Enterprises in Ghana, with Budget City Limited not being an exception.
- The research study also established that exchange rate fluctuation has a negative impact on the profitability of Budget City Ltd due to their inability to push price increase to consumers because of high competitive market.
- The study also established that the small and medium enterprises finds it difficult to acquire the required foreign currency due to high demand which increased cost of production.

5.4 RECOMMENDATIONS

From the research study undertaken, as well as the analysis of the data gathered, the following recommendation was made;

- ❖ The managers of Budget City Limited should adopt a variety of risk management techniques like currency swaps, diversification, future contracts and hedging to remain competitive in its industry.
- ❖ The managers of Budget City Limited should also find a way to source some of their raw materials from the local market to reduced cost of production.
- ❖ Union formation should be encouraged by companies using the same raw materials for production. Therefore as factors of production increased due to exchange rate fluctuation these companies can push price increased to consumers without affecting individual company.

5.4.1 SUGGESTIONS FOR FUTURE RESEARCH

The analysis of the findings, achievements and limitations of this research study indicate that the following measures must be taken into consideration in any future development of this problem.

- ✓ The research scope must span across more SME's in order to obtain detailed information of the effects of currency depreciation on their businesses.
- ✓ Student Researchers must be made to pick research topics at the beginning of the final academic year to give them ample time to do a thorough work.
- ✓ Sponsorship could be solicited from companies for a research work like this so that could use the findings and recommendations to improve their business performance.

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