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DEVELOPMENT OF FOREX BUREAUS IN KENYA AND THEIR IMPACT ON EXCHANGE RATE AGAINST THE US DOLLAR

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Abstract

This study examined the relationship between the development of Forex Bureaus and the exchange rate of the US dollar in Kenyan financial market. It was conducted in Nairobi from November 2005 to January 2006, and data was collected using questionnaires. The questionnaires were distributed to a number of foreign exchange bureaus in Nairobi with the purpose of analysing their development over the years since they were first incorporated in 1995 to date. The main purpose of the study was therefore to analyse the development of foreign exchange bureaus and determine their impact on exchange rates. From the study, the researchers were able to conclude that there is a weak positive relationship between the development of foreign exchange bureaus and the exchange rates in the economy. This was evidenced by the fact that 57.14% of the respondents agreed that there was a positive correlation while 42.86% of the respondents disagreed that there was any relationship.

Keywords: Forex Bureaus, Exchange Rates, US Dollar, Spot transaction, Kenya Shilling

INTRODUCTION

Foreign exchange has been around since 1927. It all started at the Barber shop of Gyllenspets at Central Station in Stockholm. Gyllenspet learnt that many of his customers were tourists, who also had a big need for currencies, especially local against foreign currency. With time, his Barber Shop turned into a small foreign exchange bureau that was run up until the 1960s by the Swedish State Rail Authority. The name of this foreign exchange was later changed to “FOREX”. In 1965, travel agent Rolf Friberg, the then FOREX’s CEO, was offered the opportunity to buy the foreign exchange bureau business to be able to provide a foreign exchange currency service to his travel agency’s clients. Until the beginning of the 1990s, FOREX was the only company besides the banks that was licensed by the Bank of Sweden to trade in currencies. Currently, FOREX is one of the biggest foreign exchange bureaus with a turnover of SEK 20 billion from its branches in Sweden, Denmark and Finland (FOREX, Business Concept and History).

Foreign exchange bureaus were introduced in Kenya via the Kenya Gazette Notice No. 150 of January 9, 1995 to make the foreign exchange market more competitive by serving the retail end of the market. Foreign Exchange bureaus were initially licensed under the Exchange Control Act but with the subsequent repeal of the Act, the institutions are now licensed under the Central Bank of Kenya (amendment) Act, 1995. Since 1995, Foreign exchange bureaus have been the medium for foreign exchange transactions.

Commercial banks offer services as foreign exchange bureaus in Kenya. These services are regulated for purposes of money laundering since the Central Bank of Kenya Regulation applies to all the services offered by commercial banks. Commercial banks are however, not the only providers of services as foreign exchange dealers. Since 1995, there has been a policy of licensing independent foreign exchange dealers. The licensing and, presumably, the control of these independent bureaus is the responsibility of the Central Bank of Kenya. According to the Central Bank of Kenya, the licensing of foreign exchange bureaus was meant to make the foreign exchange market more competitive (Central bank of Kenya, Forex Bureau Guidelines).

To regulate the non-bank Forex bureaus, the CBK issued the Forex Bureau Guidelines with which all such bureaus must comply. The Guidelines prohibit any person from engaging in business as a foreign exchange bureau without a license. They required the bureau to deposit US$ 5,000 with the CBK as security for compliance with the Guidelines and to open and maintain, with a commercial bank, an account or accounts, designated ‘Forex Bureau Foreign Currency Account’. A bureau is required to immediately pay into its account all foreign exchange remittances it receives. The Guidelines required bureaus to engage only in ‘spot transactions’ and ‘not in transactions involving forward cover’. Bureaus may buy and sell foreign exchange.

They may also buy traveller's cheques, personal cheques and bank drafts but may not engage in the sale of these instruments without specific approval from the Central Bank of Kenya (Kegoro, 2004).

As at October 2004, there were 96 foreign exchange bureaus in Kenya (Forex Bureaus Management Report).

The Guidelines of Forex Bureaus

These Guidelines are intended to provide guidance to Forex Bureau Management to ensure that the bureaus conduct foreign exchange business prudently in the liberalised foreign exchange market. These Guidelines also supersede any circulars or guidelines that have been issued to govern licensing and operation of Forex Bureaus following the repeal of the Exchange Control Act (Kitili, J p.6).

These Guidelines are issued by the Central Bank of Kenya with the aim of ensuring that Forex Bureaus conduct their foreign exchange business prudently and in complete compliance with the statutory requirements.

Some of these guidelines are as follows;

a) No person shall operate a Forex Bureau without a licence from the CBK. The license is not transferable or assignable and no person other than those approved by the CBK should manage a Forex Bureau.
b) A company intending to apply for a license to operate a Forex Bureau shall incorporate the words 'Forex Bureau' or 'Foreign Exchange Bureau' or 'Bureau De Change' in its name and have buying and selling foreign currency as its main objective.
c) A Bureau is required to pay an application fee of Kshs. 5,000 and, on approval, a license fee of Kshs. 50,000. Each additional branch approved, is subject to an additional fee of Kshs. 25,000.
d) There should be a satisfactory inspection report of the Bureau's premises made by the Central Bank of Kenya before a license is granted.
e) A bureau must present its proposed Principal Officer and his or her alternate for interview and registration by the Central Bank of Kenya before a license is granted.
f) A bureau is required to have a minimum paid up share capital of US$ 15,000 or its equivalent in Kenya Shillings to be built up to US$ 25,000 or its equivalent in Kenya Shillings within six months of commencement of operations.
g) A Forex Bureau that fails to commence operations within six months from the date of issuance of the license shall, if still intending to transact foreign exchange business in Kenya, apply for a license as though the first license had never been granted.

h) A Forex Bureau is required to deposit a sum of US$ 5,000 in a non-interest bearing account with the Central Bank of Kenya as a commitment to ensure compliance with the regulations under the Central Bank of Kenya Act. The deposit is subject to forfeiture in case of contravention of the regulations under which the license is issued.

i) A Forex Bureau shall open and maintain accounts designated 'Forex Bureau Foreign Currency Account' in not more than two authorised banks and maintain a minimum balance of US$2,000 in each account.

j) A Forex Bureau should only engage in spot transactions and not in transactions involving forward cover.

k) A licensed Forex Bureau should ensure that payments and receipts are not connected with illegal activities such as money laundering or tax evasion.

l) A Forex Bureau shall be free to competitively set exchange rates in all transactions with customers and between themselves and should conspicuously display the foreign exchange buying and selling rates in its premises. Such rates should be net of any commission.

A Comment on the Guidelines

The Guidelines specifically require dealers to only engage in spot transactions. There is no requirement to keep records other than such as will enable the conduct of a proper audit of accounts of a dealer. Such audits as may be conducted by the Central Bank of Kenya are from the perspective of monitoring the movement of foreign exchange, rather for controlling money laundering.

Although the guidelines mention the need to ensure that such records leave a paper trail, there is no specific requirement to identify the persons with whom forex bureaus may deal .It is thus impossible, under existing arrangements, for dealers to be in a position to know their customers in the event of a need to do so.

Dealers are required to open and maintain bank accounts with commercial banks. This enables banks to receive money from persons whom neither they nor the dealers can identify. The possibilities of mischief are numerous. According to a bank manager in Nairobi, some commercial banks have been expressing concern over banking, by their bureau customers, of large sums of money whose sources cannot be explained. Such banks have, as a result, been reluctant to keep bureaus as customers.

Trade and Financial Reforms

For a successful reform process, Mirakhor and Villanueva (1993), Edwards (1989) and Monteil (1995) observe that an optimal sequencing of the reforms should be adopted. For example, financial reforms should be preceded by macro-economic and financial stability; otherwise this may result to high interest rates, bankruptcy and loss of monetary control.

Sequencing of the reforms in Kenya show some consistency with what was proposed. Interest rates were liberalised in 1991. The government embarked on a phased tariff reductions and rationalisation of the tariff bands in 1990. There were initial attempts to liberalise imports during 1980-84 and 1988-91 but these, particularly the first attempt were unsuccessful (Swamy 1994). By 1991, quantitative restrictions affected only 5% of imports compared with 12% in 1987 (Swamy 1994). Simultaneously, foreign exchange controls were gradually relaxed, starting with the introduction of Foreign Exchange Bearer Certificates (FOREX-C's), which could be used for automatic import licensing in 1991(Were et al., 2001). During the same year, currency declaration forms were abolished. In 1992, foreign exchange retention accounts were introduced and a further secondary market for FOREX-C's was established. Significant changes were witnessed in 1993 following the resumption of aid after two years suspension. The government adopted a tight monetary and fiscal policy and also made significant steps in liberalising the external sector. For example, in March 1993, FOREX-C's were made redeemable at market rate instead of official exchange. In May 1993, import licensing was abolished and retention accounts reintroduced, while in October, the official exchange rate was abolished, paving way for a freely floating exchange rate. Complete liberalisation of offshore borrowing was implemented in May 1994, while some restrictions on inward portfolio were lifted in January 1995. By 1995, virtually all the foreign exchange restrictions had been eliminated; foreign exchange bureaus were permitted and the exchange control Act was repealed.

Regulations

Regulations of foreign exchange dealings in Kenya are contained in Part VI A of the Central Bank of Kenya Act and Legal Notice no.23 of 28th February 1996.

Foreign Exchange Dealers

These are authorized banks and foreign exchange bureaus licensed by the Central Bank under section 33B of the Act.

Authorized Banks

Authorized banks are licensed to buy, sell, borrow or lend in foreign currency or transact any other business involving foreign currency. Authorized dealers are also free to facilitate payments between Kenyan residents and non-residents and engage in spot money market derivative foreign exchange dealers.

Foreign Exchange Bureaus

Forex Bureaus may engage in buying and selling foreign currency cash; buying traveler's cheques; personal cheques; banker's drafts and bank transfers. A Forex bureau may also sell travelers' cheques but must seek and obtain prior approval from the central Bank of Kenya.

Forex Bureaus are only allowed to engage in spot foreign exchange transactions and should not engage in derivative foreign exchange deals.

Persons Permitted to Transact Foreign Exchange Business

According to Legal Notice No.23 of 28th February 1996, any legal person permitted by the Central Bank of Kenya under Section 33A(3) of the Central Bank of Kenya Act to accept foreign exchange receipts should not deal in (buy and sell) foreign currency. The permission is granted to any person who is licensed under the Tourist Licensing act to carry on any registered tourist enterprise; or owns or operates a Duty Free Shop; or by the nature of his\her business requires to transact regularly in foreign currency. The foreign currency should be dealt with as follows;

- Credited to a foreign currency account
- Sold to an authorized dealer
- Used to settle external obligations through authorized banks
- Settle local debts billed in foreign currency

Currency Sales and Purchases

Buying and selling of foreign currency is prohibited unless one of the parties to the transaction is an authorized dealer under Section 33(B) of the Central Bank of Kenya Act (Cap.491).

Counterfeits/Forged Currency Notes

All foreign exchange dealers should have the necessary equipment to detect counterfeit currencies. The counterfeits presented by customers should be sized, the customer issued with evidencing receipt and counterfeit currencies delivered to the Central Bank of Kenya for investigation in consultation with the relevant authorities.

Exchange Rate Display Board

Foreign exchange dealers must display their counter exchange rates prominently and in locations within their premises convenient to the public. Each foreign exchange dealer must have an Exchange Rate Display Board and issue a receipt in respect of each foreign exchange transaction.

Market Manipulation

All foreign exchange dealers must avoid engaging in speculative transactions that tend to mislead the other participants in the market and must also avoid misuse of any privileged information.

Problems Faced

The role of forex bureaus in Kenya as channels through which money is laundered has been noted. One report claimed that Pakistani-run bureaus in Nairobi are linked to the laundering of money through the hundi system (A. Odera, p.3). The hundi system is a system of money transfer that leaves no paper trail for investigators to follow. In a typical transaction, an individual receives money from those who want to send it abroad, for example to their relatives. After taking a small commission, the dealer calls or e-mails another dealer in the customer's hometown who delivers the money or makes it available for pick up by family members (Cox, J 2001). In 1999 a couple was arrested at the Jomo Kenyatta International Airport while trying to smuggle Ksh 50 million in foreign currency out of the country. The couple had been illegally running a foreign exchange business in Nairobi. The connection between foreign exchange dealers and money laundering is made clear by this case.

Other than the formal foreign exchange dealers, a number of underground foreign exchange outlets exist in the big cities especially Nairobi, Mombasa and Kisumu. These arose during the time when exchange controls existed in Kenya and they managed to undercut formal sources of foreign exchange, because of their relatively low costs, including through tax invasion. Even after the liberalization of the foreign exchange, they have stubbornly remained in business, although they have now lost their competitive advantage. However they try to make up for this by opening for longer hours (Kegoro, p8).

Clearly, these dealers also pose risks from a money laundering point of view. The volumes with which they deal are impossible to ascertain, given the informality of their business. Strictly speaking, these dealers operate illegally since a license from the Central Bank of Kenya is required to handle foreign exchange (Central Bank of Kenya, op cit, paragraph 1.2).

Problem Statement

Other than the formal foreign exchange dealers, a number of underground foreign exchange outlets exist in the big cities especially Nairobi, Mombasa and Kisumu. These arose during the time when exchange controls existed in Kenya and they managed to undercut formal sources of foreign exchange, because of their relatively low costs, including through tax invasion. Even after the liberalization of the foreign exchange, they have remained in business, although they have now lost their competitive advantage and they try to make up for this by opening for longer hours. Hence this study aimed at investigating the impact of the development of exchange rate bureaus on the exchange rate of the Kenya shilling against the U.S dollar.

General Objective of the Study

To investigate the development of foreign exchange bureaus and their impact on exchange rate on the US dollar

Specific Objectives

The study was guided by specific objectives which were to:

1) To find out the main transactions handled by the foreign exchange bureaus in Kenya.
2) To examine the impact of foreign exchange bureaus on exchange rates in Kenya.
3) To determine the political atmosphere as a factor influencing exchange rates in Kenya.
4) To find out balance of payments position of foreign exchange bureaus in Kenya.

Table 1: Annual Average Exchange Rate for the Period 2000-2004

Currency / Year	2000	2001	2002	2003	2004
U.S Dollar	76.18	78.56	78.73	75.94	79.17
Percentage changed		3%	0.22%	-3.7%	4.1%

Source: Central Bank of Kenya Foreign Exchange Department

From Table 1, it can be seen that the exchange rate of the Kenya Shilling against the US dollar increased by 3% between the year 2000 and the year 2001. Between 2001 and 2002, there was a further increase of 0.22%. However, between the years 2002 and 2003, there was a decrease in the exchange rate of –3.7%. This rate increased by 4.1% however between the year 2003 and 2004. These fluctuations are however not very excessive and so the exchange rate of the Kenya shilling to the US dollar can be said to be relatively stable.

Foreign Exchange Controls Affecting Trading

In conjunction with the removal of import licensing requirements in 1993, Kenya has moved to a market-determined exchange rate. The Exchange Control Act has been repealed. The repeal frees all the existing controls on foreign exchange. This policy measure has attracted short-term capital inflows. The Central Bank of Kenya licenses foreign exchange bureaus, which were introduced in 1995 to enhance efficiency in the Forex market. These bureaus are open longer hours than banks and have increased competition in the foreign exchange market. Currently, only the following capital transactions have foreign exchange restrictions:

a) Investment by foreigners in shares (set in May 2002 at not more than 75 percent for both companies and individuals on shares traded on the NSE); and

b) Investments by Kenya residents outside Kenya exceeding $500,000 must be approved by the Central Bank through the facilitating bank.

Residents and non-residents are now permitted to buy or sell foreign exchange from/to authorized dealers up to the equivalent of $5,000. Amounts exceeding this will require the necessary documentation to show the purpose for the transaction. This is mainly for record purposes that are provided to the Central Bank of Kenya.

There is currently no anti-money laundering legislation. Exporters are authorized to retain all their export proceeds in foreign currency accounts with local banks or sell such proceeds to obtain local currency.

Residents may borrow abroad with no limit on the amount. However, the government will not guarantee any borrowing by the private sector. Although payments under technical, management, royalty and patent fees are freely remittable, the relevant agreements and renewals will be subject to approval.

Persons leaving or entering Kenya are permitted to take or bring into the country Kenyan currency up to a maximum of Ksh500, 000 and foreign currency equivalent to a maximum of $5,000. Amounts beyond these limits may be taken out or brought into the country, provided they are declared at the point of departure or entry.

Factors That Influence Forex Rates

Foreign exchange rates are extremely volatile and it is incumbent on those involved with foreign exchange - either as a purchaser, seller, speculator or institution - to know what causes rates to move. There are a variety of factors-market sentiment, the state of the economy, government policy, demand and supply and a host of others. The more important factors that influence exchange rates are discussed below:

Strength of the Economy

The strength of the economy affects the demand and supply of foreign currency. If an economy is growing fast and is strong it will attract foreign currency thereby strengthening its own. On the other hand, weaknesses result in an outflow of foreign exchange.

If a country is a net exporter (as were Japan and Germany), the inflow of foreign currency far outstrips the outflow of their own currency. The result is usually a strengthening in its value.

Political and Psychological Factors

Political or psychological factors are believed to have an influence on exchange rates. Many currencies have a tradition of behaving in a particular way such as Swiss francs which are known as a refuge or safe haven currency while the dollar moves (either up or down) whenever there is a political crisis anywhere in the world. Exchange rates can also fluctuate if there is a change in government. Some time back, India's foreign exchange rating was downgraded because of political instability and consequently, the external value of the rupee fell.

Wars and other external factors also affect the exchange rate. For example, when Bill Clinton was impeached, the US dollar weakened. During the Indo-Pak war the rupee weakened. After the 1999 coup in Pakistan (October/November 1999), the Pakistani rupee weakened.

Economic Expectations

Exchange rates move on economic expectations. For example after the 1999 budget in India there was an expectation that the rupee would fall by 7% to 9%. Since such expectations affect the external value of the rupee, all economic data-the balance of payments, export growth, inflation rates and the likes-are analyzed\and its likely effect on exchange rates is examined. If the economic downturn is not as bad as anticipated the rate can even appreciate. The movement really depends on the 'market sentiment'-the mood of the market-and how much the market has reacted or discounted the anticipated/expected information.

Inflation Rates

It is widely held that exchange rates move in the direction required to compensate for relative inflation rates. For instance, if a currency is already overvalued, i.e. stronger than what is warranted by relative inflation rates, depreciation sufficient enough to correct that position can be expected and vice versa. It is necessary to note that an exchange rate is a relative price and hence the market weighs all the relative factors in relative terms (in relation to the counterpart countries). The underlying reasoning behind this conviction is that a relatively high rate of inflation reduces a country's competitiveness and weakens its ability to sell in international markets. This situation, in turn, will weaken the domestic currency by reducing the demand or expected demand for it and increasing the demand or expected demand for the foreign currency (increase in the supply of domestic currency and decrease in the supply of foreign currency).

Capital Movements

Capital movements are one of the most important reasons for changes in exchange rates. Capital movements of foreign currency are usually more than connected with international trade.

This occurs due to a variety of reasons - both positive and negative. For example, when India began its economic liberalization and invited Foreign Institutional Investors (FIIs) to purchase equity shares in Indian companies, billions of US dollars went into the country strengthening the currency. In 1996 and 1997, FIIs took several billion US dollars out of the country weakening the currency. These were capital outflows. One of the reasons popularly believed for the rupee not depreciating in the manner other South-east Asian currencies did in 1997-98 was because the rupee was not convertible on the 'capital account'.

Speculation

Speculation in a currency raises or lowers the exchange rate. For instance, the foreign exchange market in Kenya is very shallow. If a speculator enters and buys US $1 million, it will raise the value of the US dollar significantly. If a few others do so too, the price of the US dollar will rise even further against the Kenya shilling.

Balance of Payments

As mentioned earlier, a net inflow of foreign currency tends to strengthen the home currency vis-à-vis other currencies. This is because the supply of the foreign currency will be in excess of demand. A good way of ascertaining this would be to check the balance of payments. If the balance of payments is positive and foreign exchange reserves are increasing, the home currency will become stronger.

Government's Monetary and Fiscal Policies

Governments, through their monetary and fiscal policies affect international trade, the trade balance and the supply and demand for a currency. Increasing the supply of money raises prices and makes imports attractive. Fiscal surpluses will slow economic growth and this will reduce demand for imports and encourage exports. The effectiveness of the policy depends on the price and income elasticity's of demand for the particular goods. High price elasticity of demand means the volume of a good is sensitive to a change in price.

Monetary and fiscal policies support the currency through a reduction in inflation. These also affect exchange rate through the capital account. Net capital inflows supply direct support for the exchange rate.

Central governments control monetary supply and they are expected to ensure that the government's monetary policy is followed. To this extent they could increase or decrease money supply. For example, the Reserve Bank of India, to curb inflation, restricted and cut money supply. In Kenya, the Central Bank in order to attract foreign money into the country is offering very high rates on its treasury bills.

In order to maintain exchange rates at a certain price the Central Bank will also intervene either by buying foreign currency (when there is an excess in the supply of foreign exchange) or selling foreign currency (when demand for foreign exchange exceeds supply). This is known as ‘Central Bank Intervention’.

It must be noted that the objective of monetary policy is to maintain stability and economic growth and central banks are expected to- by increasing or decreasing money supply, raising or lowering interest rates or by open market operations - maintain stability.

Exchange Rate Policy and Intervention

Exchange rates are also influenced, in no small measure, by expectation of change in regulations relating to exchange markets and official intervention. Official intervention can smoothen an otherwise disorderly market. As explained before, intervention is the buying or selling of foreign currency to increase or decrease its supply. Central banks often intervene to maintain stability. It has also been experienced that if the authorities attempt to half-heartedly counter the market sentiments through intervention in the market, ultimately more steep and sudden exchange rate swings can occur.

Interest Rates

An important factor for movement in exchange rates in recent years is interest rates, i.e. interest differential between major currencies. In this respect the growing integration of financial markets of major countries, the revolution in telecommunication facilities, the growth of specialized asset managing agencies, the deregulation of financial markets by major countries, the emergence of foreign trading as profit centres, per se, and the tremendous scope for bandwagon and squaring effects on the rates, etc. have accelerated the potential for exchange rate volatility.

Kenya intrinsically has a very weak economy but the rates offered within the country have always been very high. To illustrate this point the treasury bill rate in September 1998 was as high as 23%. High interest rates attract speculative capital moves so the announcements made by the Federal Reserve on interest rates are usually eagerly awaited - an increase in the same will cause an inflow of foreign currency and the strengthening of the US dollar.

Tariffs and Quotas

Tariffs and quotas exist to protect a country’s foreign exchange by reducing demand. Till before liberalization, India followed a policy of tariffs and restrictions on imports. Very few items were permitted to be freely imported. Additionally, high customs duties were imposed to discourage imports and to protect the domestic industry. Tariffs and quotas are not popular internationally as they tend to close markets. When India lifted its barriers, several industries such as the mini steel and the scrap metal industries collapsed (imported scrap became cheaper than the domestic one). Quotas are not restricted to developing countries. The United States imposes quotas on readymade garments and Japan has severe quotas on non-Japanese goods.

Exchange Control

The purpose of exchange control is to manage the supply and demand balance of the home currency by the government using direct controls basically to protect it. Currency control is the restriction of using or availing of foreign currency at home/abroad.

In India, up to liberalization in the nineties there was very severe exchange control. Access to foreign currency was tightly controlled and the same was released only for permitted purposes. This was because Indian exports had not taken off and there were still large imports. There are several countries that maintain their rates at artificial levels such as Bangladesh.

India is now fully, convertible on the current account but not as yet on the capital account. This, to an extent, possibly saved India when the run on currencies took place in Asia in 1997. If the Indian rupee was fully convertible and there were no exchange control restrictions, the rupee would have been open for speculation. There would have been large outflows at a time of concern resulting in a snowballing plunge in its value.

As long as the par value system prevailed, the rates could not go beyond the upper and lower intervention points. The only real question under the fixed rate system was whether the balance of payments and foreign exchange reserves had deteriorated to such an extent that devaluation was imminent or possible. Countries with strong balance of payments and reserve positions were hardly called upon to revalue their currencies. Hence, a watch had to be kept only on deficit countries.

However, under a generalized floating regime, exchange rates are influenced by a multitude of economic, financial, political and psychological factors. But the relative significance of any of these factors can vary from time to time making it difficult to predict precisely how any single factor will influence the rates and by how much.

It is further assumed that the rate is also well influenced by the presence of Foreign exchange bureaus, and this is the main issue of this study.

Table 2: Annual Average Trend of Foreign Exchange Bureaus in Kenya between 2000-2004

Year	2000	2001	2002	2003	2004
Number of Bureaus	46	47	48	81	89
Percentage changed		2.2%	2.13%	40.7%	8.98%

Source: Central Bank of Kenya, Bank Supervision Annual Report 2000-2004

Table 3: An Analysis of the Relationship between Average Rate of Exchange and the Trend of the Forex Bureaus in 2000 – 2004

Currency / Year	2000	2001	2002	2003	2004
U.S Dollar	76.12	78.56	78.73	75.94	79.17
Number of Bureaus	46	47	48	81	89

Source: Central Bank of Kenya

In Table 3, there was an increase in the number of foreign exchange bureaus from 46 to 89 in the period 2000 to 2004. There was a weakening of the Kenya Shilling against the dollar from 2000 to 2002 before it strengthened in 2003 and then further weakened in 2004.

METHODOLOGY

Research Design

The design of this study was correlational because it involved finding out if there was any relationship between the trends of foreign exchange bureaus and the price of the Kenyan Shilling against the US dollar. This design permitted the researcher to obtain information concerning the degree of relationship between the variables being studied.

Target Population and Sample

The target population in this research was all foreign exchange bureaus in Kenya, which are 96. Therefore in this study, a survey method was applied.

The sample was foreign exchange bureaus located in Nairobi which are a total of 79. This was because most of the bureaus are located in Nairobi and therefore the selected sample was representative of the population. The bureaus are also not very far from each other and were therefore easily accessible to the researcher.

Research Instruments

This refers to the instruments that the researcher uses to collect the necessary information from the respondents. The research instrument that was used in this study is the questionnaire. A questionnaire consists of a number of questions printed or typed in a definite order on a form.

Questionnaires are used to obtain important information about the population and as such they were sent to all the subjects included in the sample. Each of the questions in the questionnaire was be formulated in such a way as to address the specific objectives and research questions of the study. The questionnaire therefore had questions asking the respondents to briefly describe the impacts of foreign exchange bureaus on the exchange rates and also if these bureaus played any role in helping to stabilize exchange rates in the country.

Piloting the Instruments

This is also referred to as 'pre-testing' the questionnaire. It involves trying out the questionnaire in the field once it has been finalised. The questionnaire was thus pre-tested on a sample of foreign exchange bureaus which were not been included in the original sample but which closely represented the actual sample. The purpose of pre-testing was to allow the researcher to make meaningful observations and to also establish how practical the questionnaire was. The researcher therefore visited each of the foreign exchange bureaus in the pre-testing sample selected and used the questionnaire to obtain the relevant information. Thereafter, the researcher made the necessary adjustments to the questionnaire using the results of the pilot study and this adjusted questionnaire was used in the actual research.

Procedure for Data collection

The use of self-administered questionnaires was be employed in this research study. This is because the sample selected was considered to be literate and were therefore be able to understand and answer the questions accordingly. The researcher personally delivered the questionnaires to each of the foreign exchange bureaus identified in the sample because they are easily accessible and it was more cost efficient to hand deliver them as opposed to sending them. The questionnaire employed the use of both open and close-ended questions.

Data Analysis

Once the questionnaires had been collected from the respondents, the researcher systematically organized the raw data collected in a manner that facilitated analysis. First of all the questionnaires were field edited to check for completeness. The data was then edited in order to detect errors and omissions and these were corrected where possible. Thereafter, the researcher checked that the questionnaires were well arranged to facilitate coding and tabulation.

After editing, the data was coded and the quantitative data was put into a number of categories. Coding was done by assigning numerical values to the answers so that the responses could be put in a limited number of categories. Each category of questions was assigned a different code. The closed-ended questions were assigned a numerical value on the margin of the questionnaire. The open-ended questions were coded as well and categorized into their various groupings.

Descriptive statistics was also used in analysing the data. A measure of central tendency, the mean, was used to enable the researcher to describe the distribution of scores concerning the data collected. Inferential statistics was also used to analyse the open-ended questions in order to come up with the final results. The summarized data was then represented diagrammatically using tables and pie charts in order to show a more general picture of the data collected.

ANALYSIS AND FINDINGS

The purpose of the study was to investigate the development of foreign exchange bureaus and their impact on exchange rate on the US dollar. The questionnaires were distributed to 50 foreign exchange bureaus out of a sample size of 79. From these companies, the response rate was 84%, that is, 42 out of the 50 foreign exchange bureaus.

The number of foreign exchange bureaus has grown steadily over the years since they were first incorporated in 1995. According to the respondents, there was a total of 14 foreign exchange bureaus in 1995. There was an increase in the number of bureaus between 1996 to 1998 from 14 to 22, an overall increase of 57.14%. Between 1999 to 2001, the number increased to 27, an increase of 22.27%. Between 2002 to 2004, the number further increased from 27 to 42, an increase of 55.56%. No foreign exchange bureaus were set up during the year 2005. This information can be illustrated in a table as follows:

Table 4: Trend of the Development of Foreign Exchange Bureaus in Kenya

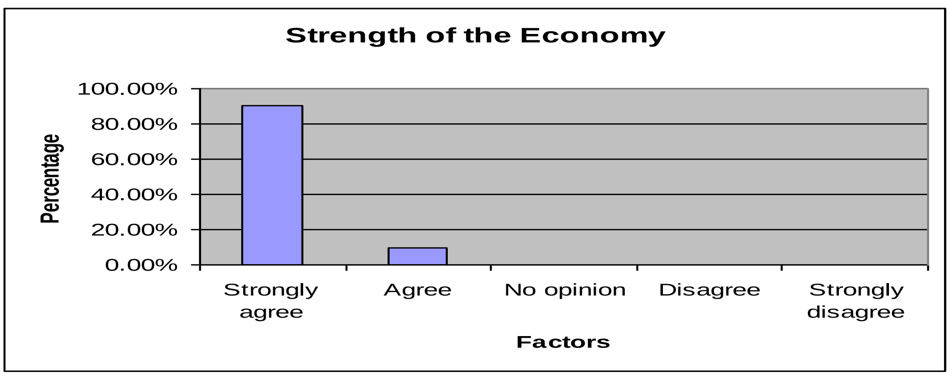
YEAR	NUMBER OF BUREAUS	PERCENTAGE CHANGED
1995	14	
Between 1996-1998	22	57.14%
Between 1999-2001	27	22.27%
Between 2002-2004	42	55.60%
2005	42	0%

Concerning the bureaus major transactions, 31 respondents, which is 73.8% of the group said they were involved in over-the-counter retail transactions, while 11 respondents, 26.2%, stated that they were involved mainly in commercial transactions.

When respondents were asked about what impact foreign exchange bureaus had on exchange rates, 9 respondents, 21.4%, stated that they helped to stabilize exchange rates due to competition with commercial banks. 11 respondents, 26.2%, further stated that they had no impact since the rates were already set by Reuters. A further 11 respondents, 26.2%, stated that the rates were set using the inter-bank rates and they therefore had no impact on the exchange rates. The remaining 11 respondents, 26.2%, also stated that they had no impact on the exchange rates since they were set by the market forces of demand and supply.

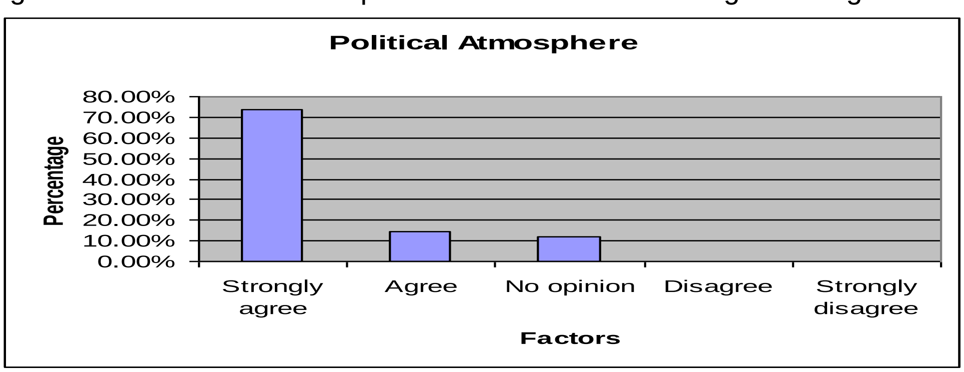
Concerning the level of agreement on the factors that influence exchange rates, majority of the respondents which is 90.5% indicated that they strongly agreed that the strength of the economy is a factor that influences exchange rates, while 9.5% agreed. The mean was 4.9 indicating that majority of the respondents strongly agreed.

Figure 1: Strength of the Economy as a Factor Influencing Exchange Rates



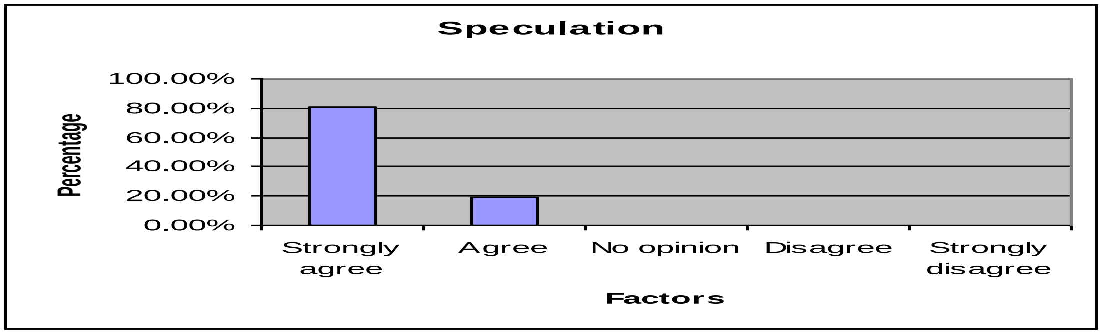
Concerning the effect of the political atmosphere on exchange rates, majority of the respondents, 73.8%, indicated that they strongly agreed, 14.3% indicated that they agreed while the remaining 11.9% had no opinion. The mean was 4.62 indicating that a majority of the respondents strongly agreed.

Figure 2: The Political Atmosphere as a Factor Influencing Exchange Rates



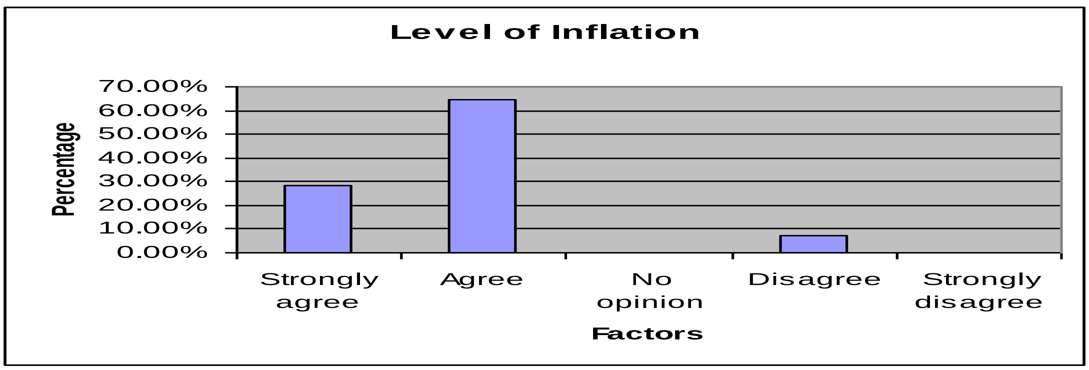
When asked about their levels of agreement on speculation, 81% of the respondents strongly agreed while 19% of the respondents agreed. The mean was 4.81indicating that a majority of the respondents strongly agreed.

Figure 3: Speculation as a Factor Influencing Exchange Rates



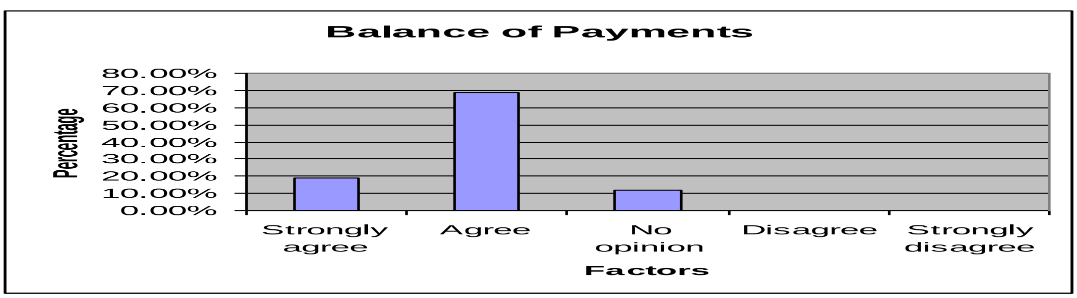
Concerning the levels of agreement on inflation, 28.6% of the respondents strongly agreed, 64.3% of the respondents agreed while 7.14% disagreed. The mean was 4.14 indicating that a majority of the respondents agreed.

Figure 4: The Level of Inflation as a Factor Influencing Exchange Rate



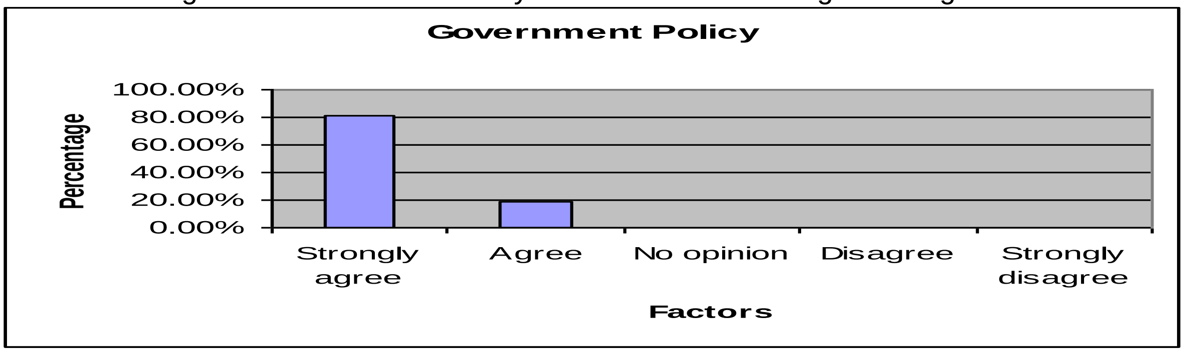
On the question concerning the balance of payments position, 19% of the respondents strongly agreed, and 69% agreed while 11.9% had no opinion .The mean was 4.07 indicating that a majority of the respondents agreed.

Figure 5: The Balance of Payments as a Factor Influencing Exchange Rates



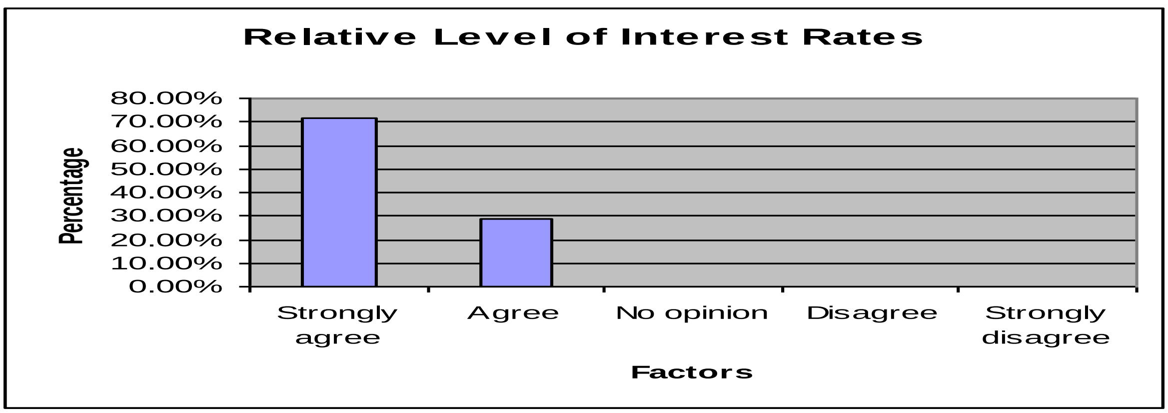
Concerning the government policy, majority of the respondents, that is, 81 % agreed while 19% disagreed. The mean was 3.62 indicating that a majority of the respondents agreed.

Figure 6: Government Policy as a Factor Influencing Exchange Rate



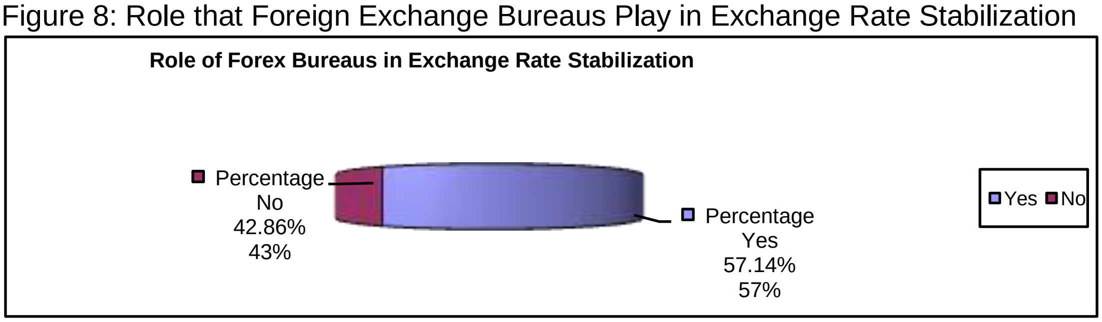
Concerning the relative level of interest rates, 71.4% strongly agreed, while 28.6% agreed. The mean was 4.71 indicating that a majority of the respondents strongly agreed.

Figure 7: Relative Level of Interest Rates as a Factor Influencing Exchange Rates



When respondents were asked if they thought that their foreign exchange bureaus played a role in the stabilization of exchange rates, 57.14% of the respondents indicated that their bureaus did play a role in the stabilization of exchange rates, while 42.86% indicated that they did not.

Figure 8: Role that Foreign Exchange Bureaus Play in Exchange Rate Stabilization



When asked how foreign exchange bureaus aid to stabilize the exchange rates, 27.3% of the respondents stated that the rates were stable since they were able to control them through the market forces of demand and supply. 45.5 % of the respondents however stated that their bureaus were competing with commercial banks and the competition therefore led to stable exchange rates. Another 36.3% of the total respondents indicated that they aided in price stability since the Central bank of Kenya analyzes the different rates between bureaus and the exchange rates are therefore within a given margin. A further 9.1% of the respondents stated that they were able to aid in the stabilization of exchange rates through the comparison of their exchange rates with other foreign exchange bureaus.

DISCUSSION OF FINDINGS

The research study was carried out to investigate the development of foreign exchange bureaus and their impact on exchange rate of a US dollar. The response rate was 84%, that is, 42 out of 50 foreign exchange bureaus. The objective of this study was to determine the relationship between the trend of foreign exchange bureaus and the price of the Kenya shilling against a U.S dollar, which is the exchange rate.

According to the questionnaires received from the respondents, there has been a steady increase in the number of foreign exchange bureaus since they were first incorporated. This indicates that there is a positive trend in the development of foreign exchange bureaus and an increasingly steady market for the services they offer that are related to the buying and selling of the currency. This trend is illustrated in detail in Table 2.

Concerning the question of the main transactions handled by the foreign exchange bureaus, 73.8% of the respondents indicated that they mainly dealt in over-the-counter transactions as opposed to 26.2% of the respondents who dealt in commercial transactions. This therefore implies that a majority of foreign exchange bureaus in Kenya cater for the retail end of the market, which refers to common individuals who may use the foreign exchange bureaus to purchase or sell small amounts of foreign currency.

On the impact of foreign exchange bureaus on exchange rates, 21.4% stated that their bureaus had a positive impact on the exchange rates since they were able to aid in the stabilization of these rates through stiff competition with commercial banks and other foreign exchange bureaus. The remaining 78.6% of the respondents indicated that they had no impact on the exchange rates. Of this, 26.2% of the respondents stated that Reuters provided the exchange rates and they therefore had no impact on these rates. A further 26.2% stated that they used the inter-bank exchange rates while the remaining 26.2% stated that the market forces of demand and supply set the rates. This therefore implies that foreign exchange bureaus have no impact on the exchange rates since a majority of them use pre-determined rates of exchange that have already been set by other variables. However it can be argued that they may have an impact on the exchange rates through the promotion of stiff with commercial banks and other foreign exchange bureaus.

Given that 90.5% of the respondents strongly agreed that the strength of the economy is a factor that influences exchange rates and a further 9.5% agreed, it is fair to say that the strength of the economy is in itself a strong factor that influences the exchange rates of an economy. Concerning the political atmosphere as a factor influencing exchange rates, a majority of the respondents, 73.8% strongly agreed indicating that this was also a strong factor affecting the exchange rates since political upheavals may lead to the loss of confidence of a country's currency. A further 81% of the respondents strongly agreed that speculation is a factor that influences exchange rates. This therefore indicates that a belief by spectators that a particular currency is going to depreciate will lead to the holders of that currency attempting to convert it into other currencies that they believe will maintain or increase their value. 64.3% of the respondents also agreed that the level of inflation was a factor influencing the exchange rates. This implies that it affects exchange rates through the fact that inflation rapidly increases the general price level in a country causing the currency to depreciate and therefore a higher rate of exchange. Concerning the balance of payments position, 69% agreed indicating that it influences exchange rates through deficits and surpluses. A deficit in the balance of payments exerts a downward pressure on the country's currency whereas a surplus will exert an upward pressure on the currency. As far as government policy was concerned, 81% of the respondents agreed, implying that the monetary and fiscal policies of the government actually play a great role in determining the exchange rates of an economy. 71.4% of the respondents strongly agreed that the relative level of interest rates in an economy affected the exchange rates indicating that the interest rates prevailing in the country at any given time directly determine the exchange rates of the Kenya shilling against other currencies.

Given that 57.14% of the respondents stated that their foreign exchange bureaus did play a role in helping to stabilize the exchange rates and 42.86% of the respondents stated that their bureaus did not help to stabilize exchange rates, it is fair to say that the presence of foreign exchange bureaus does aid in price stabilization although only to a certain extent. Out of the 57.14%, 27.3% of the respondents stated that they were able to control the rates through the market forces of demand and supply. 45.5% of the respondents indicated that competition with commercial banks helped to stabilize the rates. 36.3% of the respondents stated that the stability was brought about by Central Bank analyzing their rates and thereafter setting them within a given margin. And lastly 9.1% of the respondents stated that the stability in the exchange rates came about as a result of comparing their rates with those of other foreign exchange bureaus. This implies that the presence of foreign exchange bureaus has helped to keep the exchange rates stable within a desired margin.

CONCLUSION

The development of foreign exchange bureaus has had a positive impact on the exchange rates in Kenya. However, these impacts are not very pronounced as can be evidenced by the fact that some of the respondents stated that they had not noticed them.

In the foreign exchange market, a floating exchange rate system is used to value the shilling and has remained market determined with the Central Bank of Kenya only intervening in the foreign exchange market to smoothen out excessive fluctuations in the exchange rate. These fluctuations however do not occur very often as the presence of foreign exchange bureaus in the foreign exchange market has gone a long way towards ensuring that the exchange rate remains stable.

It can therefore be concluded that there is a positive relationship between the presence of foreign exchange bureaus and the exchange rates although the degree of correlation is weak.

LIMITATIONS OF THE STUDY

One limitation faced by the researcher was that most of the respondents were uncooperative. Some of the respondents totally refused to answer the questionnaires due to privacy issues or company policy. Some of the respondents also refused to answer certain questions which led to the collection of incomplete questionnaires.

Another limitation faced by the researcher was that the physical addresses of some of the foreign exchange bureaus was wrong since some bureaus had changed location and it therefore took a lot of time to locate some of them. The third limitation faced by the researcher is that of time and financial resources. The research involved moving to different locations constantly on limited time and finances.

SUGGESTION FOR FURTHER STUDY

This research study was carried out on 42 foreign exchange bureaus situated in Nairobi although there are a total of 96 foreign exchange bureaus in the country at present. Therefore an area of further study would be to carry out the same research on the whole population in order to get a clearer view on results of the study.

The degree of correlation, although positive, is still not very clear because an almost equal number of foreign exchange bureaus seem to disagree. A suggestion for further study thus would be to carry out the research again this time including those foreign exchange bureaus that were not approached and also those that declined to participate in this particular study in order to get their opinions on the issue.

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