Chapter 1
CHAPTER 1

INTRODUCTION

1.1. The Research Problem

The international financial system has undergone different phases of change at the turn of the century. The end of 19th century witnessed the emergence of the flexible exchange rate system, as the existent system of adjustably pegged exchange rates broke down. The flexible exchange rate system brought forth with it the threat of currency exposure and risk caused by the unforeseen changes in the exchange rate. Today, the financial executives of any corporate, especially hotels with international subsidiaries, assets, liabilities and cash flows denominated in foreign currencies; or competition from abroad, face the serious problems of managing exchange rate risks. Many hotels of the premium segment find themselves caught up in the financial crises brought forth by the exchange rate risks. The exchange rate risks have caused premium segment hotels loss of their profitabilty and therefore their value. Thus exchange rate risk demands the serious attention of financial executives of hotels to minimize their losses and reduce their exposure to risk.

In 1973, the Bretton Woods System broke and Floating Exchange Rate System emerged, bringing along with it the new dimensions of foreign exchange risk management for financial executives to deal with. With regard to premium segment hotels, which cater to foreign tourists, the volatility of exchange rate applicable on substantial magnitude and in unpredictable directions represented
a new challenge with which they have to cope up. The rise of floating rate system has caused a drastic change in the international financial system, with special mention of proliferation of risks attached to the international financial transactions. The risks that evolved in the international financial system have been of two reasons: one, change in the value of the assets, liabilities, cash flows and the firm due to changes in exchange rates- this has been true even in domestic situations, and therefore doubly true in international situations; two, international investors, traders, bankers, financial institutions and the like have been highly motivated to minimize or eliminate their risks. The risks resultant of exchange rate volatility and the keen interests of market participants to ameliorate risks gave birth to numerous new financial instruments in the international financial system. Examples of these innovative instruments include currency futures, swaps, options, multi-currency bonds, international mutual funds, country funds and foreign stock index futures and options. These instruments and many others that keep evolving have broadened and extended the multinational nature of the global capital market by altering the exchange risks faced by creditors and debtors. These innovative instruments have proved their success at varying degrees in the international financial market as each instrument has its own advantages and disadvantages related to its particular formula for alleviating exchange risks.

Since 1975, when India entered into the basket link the rupee rates began to experience moderate variation. Effective from March 1, 1992 India adopted Liberalised Exchange Rate Management System (LERMS), which imparted stability to both the official rate and the market rate. The Unified Market
Determined Exchange Rate System replaced the Dual Exchange Rate System from March 1993. Since then, Rupee has been floating except for some RBI intervention at extreme situations. Thus, before March 1993, most of the Indian hotels have been untouched by exchange rate risk, as Indian rupee has been quite stable.

India has made rupee convertible on current account on August 19, 1994. Further it is working towards full convertibility of rupee with the rupee convertible on capital account in a phased manner. India has thus become a more open and liberal economy where market forces play a predominant role and the Central Bank’s intervention and artificial controls on the exchange rate have the least impact. The repeal of the Foreign Exchange Regulation Act, presents the liberal and open view of India on exchange rate. Market forces of supply and demand have really started to play a significant role in the determination of commodity prices, interest rates and exchange rates. Liberalisation and openness have caused fluctuations in the economy and financial system, as a more frequent phenomenon. Thus, all Indian industries especially hotel industry must take necessary precautionary measures to survive and thrive under challenging circumstances without the dual protection of high tariffs and foreign exchange controls. With more and more advancements towards full convertibility, Indian hotel firms have better opportunity to invest and borrow abroad. There are Indian hotels with investment on properties abroad, hotels that have raised capital abroad through Global Depository Receipts, and hotels that import heavily to provide the foreign guests the state of the art accommodation facilities. With the continually depreciating rupee, the liabilities and imports can prove a great threat.
of exchange rate risk. Of late, the rupee (early 2004) has been appreciating which would have a detrimental effect on assets and receivables denominated in foreign currencies. The economic environment of the nation, the domestic and international financial system, the latest instruments, tools and techniques of risk management and the like have aggravated the risk related to increased volatility of international exchange rates. As a result, Indian hotels need to provide ample attention to foreign exchange risk management. Managing foreign exchange risk is one of the greatest challenges of Indian hotels today.

Exchange rates affect operating profits of companies in globally competitive industries, whether or not they export their products. In fact, changes in exchange rate can often affect the operating profit of companies that have no foreign operations or exports but that face important foreign competition in their domestic market\(^3\). This is true in the case of premium segment hotels that serve foreign tourists, despite they being placed domestically, face severe international competition on account of the exchange rate. The East Asian currency crisis of 1997-98, lead to deep devaluation, of the currencies of the East Asian region like the Thai Bhat, Malaysian Ringgit and the Korean Won. This made the East Asian countries competitive in terms of tourism and hotel industry on account of the weak currencies and posed a grave threat to Indian tourism and therefore to Indian hotel industry.

Foreign involvement introduces a clearly different set of risks from those faced by the purely domestic hotels. For many premium segment hotels, the most significant of the risks related to international operations is the risk of exchange
rate fluctuations, which in turn can alter the value of the transactions or can cause turbulent fluctuations in terms of assets and liabilities value which are positioned or located outside India.

1.2. Purpose of the study:

There has been some research concerning the behavior of firms under foreign exchange risk in the international context, but the researcher has been unable to identify any study relating to foreign exchange risk management practices of any specific industry in India. The study has been carried out with the purpose of identifying foreign exchange risk management practices in the Indian hotel industry. The research tried to address the following objectives:

a. To identify the factors that cause difficulties in dealing with foreign exchange risk faced by Indian hotels and to rank order them.

b. To analyse the risk management techniques available to Indian hotel industry for foreign exchange risk management.

c. To study the relationships between the extent in the use of the various foreign exchange risk management techniques and (i) form of organization of the hotel, (ii) type of the hotel (chain or stand-alone) and (iii) the extent of their international operations.

d. To bring to light the other significant and relevant relationships that are evident in the data.

1.3. Research Hypotheses

1) The size of hotel has no significant influence over the techniques adopted in foreign exchange risk management.

2) The form of organization has no significant influence over the techniques adopted in foreign exchange risk management.
3) The extent of international operations has no significant influence over the techniques adopted in foreign exchange risk management.

4) There is no difference between Chain and Stand-alone hotels in reported frequency of the use of twenty one techniques of foreign exchange risk management.

5) There is no difference among the four forms of organizations of hotels in the reported frequency of the use of twenty one techniques of foreign exchange risk management.

6) There is no significant relationship between extent of international operation and the reported frequency of the use of twenty one techniques of foreign exchange risk management.

7) There is no difference between the two types of hotel properties in the reported frequency of the difficulty factors while dealing with foreign exchange risk management.

8) There is no difference among the four forms of hotel organizations in the reported frequency of the difficulty factors while dealing with foreign exchange risk.

9) There is no significant correlation between the extent of international operation of hotels and the difficulty factors.

10) There are no significant differences between the two types of hotels in reported frequency of use of various information sources for exchange rate forecast.

11) There is no significant difference among the different forms of organization of hotel in the reported frequency of the use of the source of information utilized in foreign exchange rate forecast.
12) There is no significant correlation between the extent of international operations of hotels and the reported frequency of the use of the source of information utilized in foreign exchange rate forecast.

13) There is no significant difference between the chain and the stand-alone hotels in the reported frequency of objective of foreign exchange risk management.

14) There is no significant difference among the different forms of organization of hotels in the reported frequency of foreign exchange risk management.

15) There is no significant correlation between the extent of international operations of hotels in their reported frequency of objective of risk management.

16) There is no significant difference between the types of hotel properties in the reported frequency of the choice “most successful” technique of foreign exchange risk management.

17) There is no significant difference among the different form of organization of hotels and the reported frequency of the choice of “most successful” foreign exchange risk management technique.

18) There is no significant correlation between the extent of international operations of the hotels in the reported frequency of the choice of “most successful” technique of risk management.

19) There is no significant difference between hotels with 'defensive' or 'aggressive' objective of foreign exchange risk management and the reported mean frequently of the choice of technique as "most successful".
20) There is no significant difference between hotels with "defensive" or "aggressive" objective of foreign exchange management and the reported frequency of the 21 techniques of foreign exchange risk management.

21) There is no significant correlation between the rank ordering of the twenty-one techniques of foreign exchange risk management based on the frequency of use and frequency of most successful.

1.4. Research Method

This part of the study presents methods by which the research was conducted and the procedures used for the study. The research design, data source, preliminary administration, instrumentation, analysis of data, and research assumptions and delimitations are explained here.

The study is empirical, uni-dimensional and descriptive. The empirical nature of the study has been determined due to the objective: the orderly and systematic investigation of current exchange risk management practices of Indian hotel industry. The study is said to be uni-dimensional as it is concerned with exchange risk management alone of empirically derived factual information. "In descriptive research the business researcher seeks to deduce patterns which explain why, how, or when. He may gather such data for the purpose of generalization or specific prediction." The research approaches used in this study have been descriptive elemental and descriptive correlational. These approaches have been deemed appropriate as the study sought to collect data to determine not only frequencies of occurrence, but also associations of elements with one another. The first two objectives have used descriptive-elemental
research approach, while third and fourth research objectives have adopted a descriptive-correlational research approach. The data obtained by the examination of documents have been tabulated and the results analyzed and interpreted according to the specifications of the research questions. The research effort has been designed to examine a few research questions pertaining to Indian hotel industry and its financial activities, which have been created to deal with foreign exchange risk. The research questions have been presented in Appendix A. (Please see Appendix A)

1.4.1. Collection of Data

The collection of data involved elements of selection of data sources, instrumentation and preliminary administration. Each of these has been considered in detail in the forthcoming pages:

1.4.1.1. Data Sources:

Data for identifying eligible hotels has been obtained from The Handbook of Federation of Hotels and Restaurants Association of India 1999, to develop the study sample. Data sources have to meet the following criteria in order to be included in the sample:

a. All hotels were listed in the FHRAI Handbook 1999, which is published by Federation of Hotels and Restaurants association of India.

b. All hotels selected for the sample have been either wholly owned or partially owned by Indians living in India.

c. All hotels had their geographical presence in India.

d. All respondents have been required to be financial executives of the hotels concerned.

e. All hotels were of the premium segment.
1.4.1.2. Instrumentation and Preliminary Administration:

Mail survey method has been used as the principal technique in the acquisition of the data. For the purpose of mail survey the questionnaire has been designed. (Please see Appendix B) Apart from mail-survey, the researcher had to visit hotels in order to meet the financial executives.

The questionnaire consists of two parts: the first part on the general details and the second part on the seven questions pertaining to the objectives of the study. The hotel company's annual turnover has been accounted for from the secondary data available. A variety of questions have been specifically developed for collection of data related to foreign exchange risk management practices of Indian hoteliers. At the outset respondents have been required to present five factors that proved difficult and detrimental in managing foreign exchange risk. They have been requested to provide the sources of information they used for their exchange rate forecast. Further they have been asked of the purpose of the hotel for involving in foreign exchange risk management – whether it has been to avoid loss or to acquire profits? The instrument has requested the respondents to rate the frequency of use of twenty-one foreign exchange risk management techniques on a five-point Likert scale. In order to indicate the frequency of the use of each technique the procedure has been to assign a weight of 1 to "Never or almost never," a weight of 2 to "Less than half the time," a weight of 3 to "About half the time," a weight of 4 to "More than half the time," and a weight of 5 to "Always or almost always." At the final part the instrument has required the respondents to identify the three techniques that have been
most successful in achieving the hotel's foreign exchange risk management objectives.

The questionnaire has been originally designed with seven questions and has been given a preliminary administration. The purpose has been to assure that the terminology and format selected for the collection of the required data have been clear and unambiguous to the respondents. The questionnaire has been screened and scrutinized by a panel of experts from a cross section of academics and financial executives.

The original questionnaire has been made available to five financial executives of premium segment Indian hotels and their comments and suggestions requested. It has been made clear to the executives that their evaluation of the instrument will be of paramount significance both in terms of its organization and in terms of its content and clarity.

After receiving the suggestions and comments from the five financial executives, the questionnaire has been modified and finally approved by two professors in the areas of Commerce and Economics respectively.

Further the questionnaire has been given to five post-graduate students of the business administration faculty to check its clarity and thereby the researcher has established the clarity of the questionnaire. Finally the questionnaire has been distributed to two financial executives for their final comments and the two hotels have been removed from the list of hotels, so that they would not participate in the regular research. The comments and suggestions on organization, content and clarity have been solicited from the
executives and incorporated. The final approval of the guide has been sought and received.

Table No.1.1.

Number of hotels chosen for the study classified by size and type of organization

<table>
<thead>
<tr>
<th>Type of hotel property</th>
<th>Types of organisation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Private Ltd</td>
</tr>
<tr>
<td>Chain</td>
<td>5</td>
</tr>
<tr>
<td>Stand-alone</td>
<td>40</td>
</tr>
</tbody>
</table>

Source: Compiled from sample source- FHRAI Handbook 1999

1.5. Procedures

After necessary alterations and field validation of the questionnaire, it has been mailed to 100 hotel financial executives. The questionnaire package consisted of the Guide's authentication letter that the data has been required for a bona fide academic research purpose, a letter from the scholar seeking the earnest cooperation of the respondents and the assurance of confidentiality and the questionnaire along with a self-addressed stamped envelope. Of the 100 questionnaires only 32 have been returned of which 28 fully complete and 4 have been partially complete. Only the fully complete questionnaires have been considered for the study.
<table>
<thead>
<tr>
<th>Category</th>
<th>Questionnaires distributed</th>
<th>Questionnaires returned</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chain</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Private</td>
<td>5</td>
<td>2</td>
</tr>
<tr>
<td>Public</td>
<td>11</td>
<td>5</td>
</tr>
<tr>
<td>PSU</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>MNC</td>
<td>5</td>
<td>2</td>
</tr>
<tr>
<td>Stand alone</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Private</td>
<td>40</td>
<td>12</td>
</tr>
<tr>
<td>Public</td>
<td>27</td>
<td>6</td>
</tr>
<tr>
<td>PSU</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>MNC</td>
<td>10</td>
<td>0</td>
</tr>
</tbody>
</table>

Source: Compiled from sample source- FHRAI Handbook and questionnaires returned.

1.6. Analysis of Data

Each questionnaire received from the respondents has been checked to know the completeness of the responses and for the conformity with the established criteria.

General data have been then tabulated to determine the composition of the sample. Responses for the questions have been tabulated, categorized and analyzed in terms of numbers and percentages per item in order to achieve each of the first two research objectives. Chi-square has been used to determine the
significance of the bias detected in the reported main purposes of foreign exchange risk management and the influence of hotel characteristics on the techniques used by them.

Apart from the mean used to check the simple frequency distribution of each variable, an investigation of the possible relationships between the variables has been carried out.

With regard to research objectives three and four several analytical techniques have been utilized. Analysis using t-test has been conducted to find out the mean differences in order to determine significant differences between hotel chains and stand-alone hotels.

One-way analysis of variance has been applied to know if there existed any significant mean difference among hotels in terms of the form of organization and of other variables.

The Pearson Product-Moment Correlation has been used to determine the strengths and directions of relationships between the percentage of the hotel's turnover devoted to international operations, and the dependent variables of difficulty factors, use or non-use of various information sources, category of main objective of foreign exchange risk management, the usefulness of various risk management techniques and the success of these techniques. The level of significance at 0.05 has been chosen as appropriate. In addition Spearman's Rank Order Coefficient of Correlation (Rho) has been used to identify the relationship between the perceived rank orders for the usefulness of techniques and for success of techniques.

SPSS Version 9.0 was used to generate the statistical analysis results.
1.7. Research Assumptions and Delimitations

1.7.1. Research Assumptions:

The assumptions made by the scholar, in the course of research are as follows:

a. The subjects have been sufficient in number and have been suitable for the study.

b. The descriptive elemental and descriptive correlational research approaches have been suitable for the nature of the research problem and have been valid for the purpose of the study.

c. The questions have been answered honestly by the respondents, despite the fact that the data sought by the researcher has been of financial nature.

d. The questionnaire provided appropriate information to achieve the research objectives.

e. The research instrument used for the study has been appropriate, valid and reliable.

f. The procedures employed for gathering and analyzing data have been adequate and accurate.

1.7.2. Research Delimitations:

The study has been limited to hotel industry and therefore no other corporate has been considered. Further, the study has been restricted to the study of foreign exchange risk management in the premium segment hotels of India. Hence, other financial environmental concepts, which the financial officers must cope up with has not been considered for the study.
1.8. Chapter Scheme

The report of the research study is presented in six chapters. The first chapter gives a detail introduction to the study covering the research problem, the objectives, significance of the study, methodology adopted for the study, the research assumptions and delimitations. An extensive review of related literature has been presented in Chapter two, which is organized as three parts- part one covering theoretical studies, part two encompassing empirical studies and part three on Indian foreign exchange market.

Hotel industry’s significance has been elaborated under chapter three. The chapter gives a clear picture of the origin and growth of hotel industry, its significant linkage to tourism industry and its characteristics.

Chapters four presents the Foreign exchange exposure and risk management practices of Indian hotel industry. The factors causing foreign exchange risk management difficulty, the sources of information available for exchange rate forecast, the objective of hotels in foreign exchange risk management, foreign exchange risk management techniques used and their success in achieving the hotels’ foreign exchange risk management have been analysed there under.

Chapter five has been focused on the relationships between the techniques of foreign exchange risk management and the hotel characteristics. The chapter has tried to identify other relationships and differences too. The conclusion and summary of the study, along with the recommendations have been presented in Chapter six. The chapter presents a comprehensive view of the research carried out.
References:


