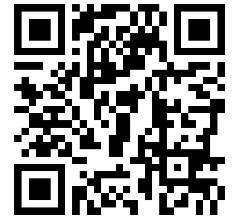# Currency Risk Exposure and Its Effect on the Performance of Import-Dependent Industries in Lusaka's Manufacturing Sector from 2019 to 2023.

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**ABSTRACT:** Currency risk which is also known as exchange rate risk, is a significant factor affecting businesses engaged in international trade. In Lusaka's manufacturing sector, many industries are heavily reliant on import of raw materials, technology, equipment, machinery, accessories, and components. Fluctuations in exchange rates can have profound implications on their cost structures, pricing strategies and overall financial performance. This study aimed to analyse the exposure to currency risk faced by import- dependent manufacturing industries in Lusaka and its effects on their performance from 2019 to 2023. The objectives of this study were to examine the key drivers of currency risk exposure on import dependent manufacturing industries, to analyse the effects of currency risk exposure on the financial performance of import dependent manufacturing industries in Lusaka, and to assess the effectiveness of risk management strategies in mitigating currency risk for import dependent manufacturing industries in Lusaka by the Bank of Zambia (BoZ). This research employed a mixed method approach. Quantitative data were collected from financial statements, exchange rate records, and economic reports. Key Performance Indicators (KPIs) such as profit margins and return on assets (ROA) were analysed in relation to exchange rate fluctuations. Additionally, qualitative data were gathered through interviews with industry experts and executives to understand their risk management strategies and operational challenges. The 10% rule was used to derive the sample size of 28 respondents from the 280-target population. Purposive and random sampling were used as techniques in which 28 were targeted for questionnaire administration on drop and pick basis. The preliminary findings indicate that significant exchange rate volatility between 2019 and 2023 has had a marked impact on manufacturing sector in Lusaka. Firms with robust hedging strategies and diversified sourcing were better able to mitigate negative effects, whereas those without measures experienced decreased profitability and increased financial strain. Also, this study reveals that external factors such as global economic conditions and domestic policy responses played a crucial role in shaping the extent of currency risk exposure. In conclusion, the analysis underscores the crucial need for effective currency risk management practices in import dependent industries. It also highlights the importance of policy interventions to stabilise macroeconomic environment and support the manufacturing sector's resilience against exchange rate fluctuations. Recommendations for industry stakeholders include enhancing financial risk management capabilities, exploring alternative supply chain industries and advocating for supportive economic policies.

**KEYWORDS**: Currency, Risk, Exposure, Effect, Performance, Import-Dependent Industries, Manufacturing Sector, 2019-2023, Lusaka.

## 1. INTRODUCTORY BACKGROUND

Modern industry contributes significantly to the accumulation of physical and human capital (although this is dependent on a number of factors). It provides relatively well-paid jobs for large numbers of unskilled or under-educated workers—particularly those who are not integrated in the formal economy—which increases household income and, hence, domestic demand ((Signe' & Johnson, 2018). This speaks to the importance of manufacturing industries which need a lot of attention by every nation. However, it must be observed that a lot of African nations are not in the narrative of booming manufacturing industries (Hapompwe, Banda, & Chalwe, 2024) and exposure to currency fluctuations is among the contributory factors to the phenomenon. It is, therefore, of paramount import that growth factors militating against the manufacturing sectors, which are largely import-dependent, are critically analysed for purpose of setting the record straight and legacy building.

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The Bank of Zambia (BOZ) is the central bank of Zambia and is responsible for the formulation and implementation of monetary policy, with the primary aim of achieving and maintaining price and financial system stability. The operations and activities of the Bank of Zambia are governed by a series of legislative and policy frameworks including the Bank of Zambia Act which is the primary legislation that outlines the functions, powers, and organisational structure of the Bank of Zambia. The Act specifies the Bank's role in issuing currency, managing the country's foreign reserves, acting as banker and financial advisor to the government, and regulating and supervising financial institutions. Banking and Financial Services Act provides the framework for the regulation and supervision of financial institutions in Zambia. It covers aspects such as licensing, operations, and the prudential requirements that banks and other financial service providers must adhere to. It also includes provisions for consumer protection and the prevention of financial crimes (Bank of Zambia, 2022).

Under the Financial Intelligence Centre Act No. 4 of 2016, the Financial Intelligence Centre (FIC) is tasked with identifying and curbing money laundering, terrorist financing, and other financial crimes. This involves monitoring financial transactions to detect suspicious activities and providing information to law enforcement agencies. Other relevant regulations and directives may include directives issued by the Bank of Zambia from time to time, guidelines on foreign exchange management, and regulations concerning financial technologies and innovations (World Bank, 2023).

These legislative frameworks ensure that the Bank of Zambia operates with a clear mandate and robust regulatory oversight, contributing to the stability and integrity of Zambia's financial system. Additionally, these laws are periodically reviewed and updated to align with international best practices and respond to emerging financial sector challenges. The Bank of Zambia (BOZ) plays a pivotal role in managing currency risk exposure for manufacturing companies in Zambia through several mechanisms. These are aimed at creating a stable economic environment that supports business operations, investment, and growth. The BOZ can influence the stability of the Zambian Kwacha (ZMW) by intervening in the foreign exchange market. For manufacturing companies that import raw materials or export goods, fluctuations in the exchange rate can significantly impact costs and revenues. By taking measures to stabilise the Kwacha, the BOZ helps manufacturers plan their finances with greater certainty (BOZ, 2023).

Additionally, according to Akuffo (2020), high inflation can erode purchasing power and lead to increased costs of production for manufacturers. The BOZ controls inflation partly through its monetary policy, for example adjusting interest rates, which directly affects manufacturing businesses by influencing the cost of borrowing and the overall economic environment. The BOZ manages the country's foreign exchange reserves to ensure there are sufficient funds to support the Kwacha in times of currency volatility. For manufacturers, having a stable currency is crucial for importing necessary materials and maintaining cost-effective production lines. The BOZ often works in conjunction with other government bodies to create policies that support manufacturing sector growth. This can include targeted incentives, financial products, or schemes that mitigate currency risks, such as forward contracts or swaps in the foreign exchange market.

By providing reliable and timely economic data, the BOZ helps manufacturing companies make informed decisions. Understanding economic trends, such as consumer demand, interest rates, and inflation, allows manufacturers to better manage their financial planning and currency exposure. By managing these areas effectively, the Bank of Zambia helps mitigate the adverse effects of currency fluctuations and other related financial risks for manufacturing companies, thereby supporting a conducive environment for industrial growth and economic stability in Zambia (BOZ, 2020).

Despite the above efforts by the Bank of Zambia, manufacturing industries are affected by macro-economic variables due to the rapid globalization of national economies, and foreign exchange rate is one of those variables. Unexpected fluctuations in foreign exchange rate may alter return, operating cash flows, financial decisions, investment and market value of a manufacturing industry. Even firms that have little or no discernible international transactions may also face indirect significant exchange rate exposure (Aggarwal and Harper, 2020). Therefore, exposure to currency movements is an important risk for manufacturing industries in Zambia.

The manufacturing sector, while contributing to GDP growth, has faced challenges related to currency risk exposure. In the 1960s and 1970s, Zambia witnessed an economic boom, primarily driven by its thriving copper industry. The country gained independence from British colonial rule in 1964, and soon after, Zambia's economy flourished, leading to a strong exchange rate against major currencies, including the British pound. Over the period from 2010 to 2018, Zambia experienced industrial growth, although the contribution of the manufacturing sector to GDP remained limited. The country aspired to climb the ladder of development, focusing on key strategic directions. Exchange rate fluctuations impact the competitiveness of Zambia's exports, including manufactured goods. A stronger Zambian kwacha (ZMW) relative to other currencies can make exports more expensive, affecting manufacturers' profitability. High inflation rates can erode the purchasing power of the ZMW. Currency depreciation increases the cost of imported inputs for manufacturers. Zambia's economy is susceptible to external shocks, such as fluctuations

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in global commodity prices (e.g., copper). These shocks can affect the exchange rate, trade balance, and overall economic stability (Lima, Crema and Verbano, 2020).

However, according to Sichoongwe, Thompson, & Hapompwe (2021), the country's annual real gross domestic product (GDP) growth rate averaged 6.8%, between 2000 and 2014 but between 2015 and 2019, the GDP growth rate slowed to 3.1% per annum, mainly attributed to declines in agricultural output, falling copper prices and hydro-electric power generation due to inadequate rains. These fluctuations in the GDP equally affect and/or are affected by the inflationary dynamics.

Managing currency risk remains crucial for Zambia's manufacturing industry. Policymakers and businesses need to consider exchange rate movements, inflation, and external factors to enhance resilience and sustainable growth. When Zambia introduced a floating exchange rate regime in 1994, it was one of the first countries in Sub-Saharan Africa to do so. While this has been welcomed as a critical step towards economic modernization and sound macroeconomic management, it has also created new challenges. Being a small, open, and rather undiversified economy (copper alone accounts for more than 70% of exports), the country is highly exposed to global shocks, potentially inducing large and unexpected fluctuations in the value of its currency (Masheta, 2019). In 2019 the Kwacha generally traded between ZMW 12 to ZMW 14 against the US dollar. It experienced relative stability during this period. In 2020 as the global pandemic impacted economies worldwide, the Kwacha weakened significantly, depreciating to around ZMW 20 against the US dollar by the end of the year, exacerbated by Zambia's default on its sovereign debt. In 2021 with political changes and the election of a new president, there was some optimism. Initial stabilization efforts saw improvements, with the Kwacha appreciating to about ZMW 16 against the dollar mid-year, but it faced renewed pressure later. In 2022 the year started with the Kwacha around ZMW 17 per US dollar. It fluctuated throughout the year, reacting to both domestic economic policies and global market conditions. In 2023 the currency faced ongoing challenges but displayed some signs of recovery and stability, trading around ZMW 18 to ZMW 25 against the US dollar, depending on the period and prevailing economic conditions. The Kwacha's value against the dollar is a good indicator of its international perception and domestic economic health, influenced by factors like inflation, political stability, and foreign investment (IMF, 2023).

This study titled 'An Analysis of Currency Risk Exposure and Its Effects on the Performance of Import-Dependent Industries in the Manufacturing Sector from 2019 to 2023' aimed to explore the intricate relationship between currency risk exposure and the performance of import-dependent industries within the manufacturing sector. According to Kairu (2016), exchange rate volatility refers to the fluctuation in currency exchange rates over time. For import-dependent industries, changes in exchange rates significantly impacted their financial performance. The study investigated how variations in exchange rates affect the cost of imported raw materials, production expenses, and overall profitability.

Banda and Haabazoka (2024), found that financial performance metrics such as revenue, profit margins, and return on investment play a crucial role in assessing the health of any industry. Import-dependent manufacturing sectors are particularly vulnerable to currency risk due to their reliance on foreign suppliers and global market dynamics. Effective management of exchange rate risk is essential for import-dependent industries. Hedging strategies, forward contracts, and other risk mitigation techniques do help stabilize financial performance. The study explored how companies in the manufacturing sector navigate currency risk exposure and its impact on their bottom line.

In an increasingly globalized economy, industries involved in manufacturing are not only pivotal to economic growth but are also highly dependent on imports for raw materials, components, and advanced technologies. This import dependency, according to Fadun and Oye (2020), inherently exposes such industries to currency risk, otherwise known as exchange rate risk, which occurs due to fluctuations in the value of the domestic currency relative to foreign currencies. For import-dependent industries in the manufacturing sector, these fluctuations can significantly impact costs, pricing strategies, profitability, and overall financial performance.

From 2019 to 2023, the global economic landscape has been marked by significant volatility, driven by factors such as geopolitical tensions, policy changes, and macroeconomic shifts, including the unprecedented impact of the COVID-19 pandemic. These events, according to Banda and Haabazoka (2024) have contributed to increased volatility in currency markets, thereby affecting exchange rates more dramatically than in previous years. For instance, sudden depreciations in a domestic currency can abruptly increase the cost of imported goods and materials, thereby squeezing profit margins unless adequately hedged.

The importance of understanding currency risk exposure lies in its direct correlation with strategic planning and risk management within the manufacturing sector. According to Chifwelu (2020), effective management of this risk can not only protect businesses from potential losses but also provide competitive advantages in pricing and resource allocation. This study aimed to analyse the extent of currency risk exposure and its effects on the performance of import-dependent industries in the manufacturing sector over the period from 2019 to 2023. By examining how these industries have managed their currency risks in the face of global economic instabilities and identifying trends in performance outcomes, valuable insights were drawn for industry stakeholders.

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This analysis is crucial for policymakers, investors, and business managers who may seek to understand the dynamics between currency risk exposure and industry performance, to better navigate the complexities of the international supply chains upon which these industries rely. Such understanding is also vital for crafting more resilient financial strategies that can withstand the shocks of unpredictable currency movements, thus ensuring sustainable growth and stability in the manufacturing sector.

### 1.1. Research Problem

According to Musonda (2020), the dynamic and volatile nature of global financial markets significantly impact economies with a high reliance on imports for their manufacturing sectors. This research was seeking to systematically analyse the effects of currency risk exposure on import-dependent manufacturing firms in Lusaka from 2019 to 2023. The study was aiming to quantify the extent to which fluctuations in foreign exchange rates have influenced the operational costs, pricing strategies, competitiveness, and overall financial performance of manufacturing firms in Lusaka. By focusing on a period marked by economic uncertainties, including the global pandemic and its aftermath, this research provided a comprehensive understanding of how currency risk has shaped the strategies and resilience of import-dependent manufacturing firms in Lusaka, setting a foundation for formulating more robust risk management and mitigation strategies in the face of global financial instabilities. With their heavy reliance on imports for their operations, manufacturing firms in Lusaka are greatly impacted by the dynamic and turbulent nature of the world financial markets. Banda and Haabazoka (2024) found that foreign exchange rates had an effect on the financial performance of CEC Plc. Whenever kwacha depreciated, financial performance of the company went down and vice versa. They suggested that there was a medium positive relationship between foreign exchange rates and key financial performance indicators. They recommended that CEC Plc should ensure that foreign exchange risk management techniques such as money market hedge, exposure netting and hedging with invoice currency are used to minimize foreign exchange risks. However, the findings of Banda and Haabazoka (2024) cannot be applied to import dependent manufacturing industries because these industries have a higher reliance on imports than industries in the energy sector, hence there was need for the research. The objective of this study was to methodically examine how exposure to exchange risk affected Lusaka's import-dependent manufacturing industry between 2019 and 2023. Due to exposure to currency risk, import-dependent companies encountered difficulties in operating between 2019 and 2023. As a result, several of these industries had to close, and many breadwinners lost their sources of income. This laid the groundwork for developing more resilient risk management and mitigation strategies in the face of global financial instabilities.

The increasing globalisation of markets has escalated the relevance of currency risk management for industries that rely heavily on imports. Import-dependent sectors in manufacturing are particularly susceptible to fluctuations in exchange rates, which can significantly affect their cost structures, pricing strategies, and overall financial performance. The period from 2019 to 2023 has witnessed unprecedented volatility in global financial markets, largely due to economic uncertainties, geopolitical tensions, and global crises such as the COVID-19 pandemic. This study aimed to analyse the extent of currency risk exposure and its subsequent effects on the performance of the import-dependent manufacturing industry within Lusaka during this turbulent period. By evaluating how these industries have managed and mitigated currency risks, the research shed light on effective strategies and potential areas for improvement in currency risk management practices. This is crucial for enhancing the resilience and sustainability of these industries in a globalised economic environment.

### 1.2. Study Objectives

**1.2.1.** To examine the key drivers of currency risk exposure on import dependent manufacturing industries in Lusaka.

**1.2.2.** To analyse the effects of currency risk exposure on the financial performance of import-dependant manufacturing industries in Lusaka.

**1.2.3.** To assess the effectiveness of risk management strategies in mitigating currency risk for import-dependent manufacturing industries in Lusaka by the Bank of Zambia.

## 2. LITERATURE REVIEW

### 2.1. Introduction

Currency risk exposure poses significant challenges for import-dependent industries, particularly in the context of emerging economies like Zambia. Import-dependent industries, which rely heavily on imported raw materials, components, and finished goods, are inherently vulnerable to fluctuations in exchange rates, as changes in currency values can directly impact their costs, profitability, and competitiveness in the global market. Understanding the nature and extent of currency risk exposure in import-dependent industries is essential for policymakers, businesses, and investors seeking to mitigate risks and promote sustainable economic development in Zambia.

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### 2.2. Empirical Review

### 2.2.1. Key Drivers of Currency Risk Exposure

Menkhoff and Sarno (2017), in their article titled Currency Momentum Strategies, they delved into the momentum strategies in the foreign exchange market. They identified that momentum, driven by medium-term currency movements, can be a critical factor in determining the risk and return in currency investments. The persistence of currency values over time can significantly affect the exposure of international investments to currency risk.

Pasquariello and Vega (2015) in their research on strategic Cross-Trading in Currency Markets, looked at how strategic cross-trading and currency arbitrage practices impact currency exposure. They argued that sophisticated trading strategies can mitigate but also sometimes increase exposure depending on market conditions and trader objectives.

As currency risk management continues to evolve, researchers and practitioners are delving deeper into the factors that influence it, often exploring the intersection of economics, finance, and technology (Lewis, 2021). The current environment characterized by rapid technological advancements, shifting geopolitical landscapes, and complex regulatory changes provides a fertile ground for further research. Recent research examines how blockchain technology and the rise of cryptocurrencies are reshaping currency risk. Decentralized finance (DeFi) systems potentially offer new ways to hedge currency risks but also introduce new types of exposure, including regulatory and technological risks. The impact of HFT on currency markets affects volatility and liquidity, thereby influencing currency risk exposure. Studies such as those by Melvin and Prins (2015) suggest that HFT can lead to greater efficiency and narrower spreads, which might reduce transaction costs but also increase systemic risk through rapid price movements.

The intricate network of global supply chains means that currency fluctuations can have a cascading effect on costs, pricing, and ultimately, the financial performance of companies. Research, such as that by Wagner and Bode (2022) discusses how firms can manage risks through strategic currency hedging aligned with their supply chain operations.

Changes in international trade agreements and sanctions can lead to significant volatility in currency markets. Authors like Frieden (2021) discuss how political risks, including elections and fiscal policies, can lead to abrupt changes in investor perceptions and currency stability. Researchers like Baker, Bloom, and Davis, who developed the Economic Policy Uncertainty Index, provide tools for measuring how uncertainty in economic policy affects markets. Their research shows that higher uncertainty can lead to greater currency risk for multinational corporations and requires more sophisticated hedging strategies.

These publications underscore that currency risk exposure is influenced by a complex interplay of economic, financial, and geopolitical factors. The evolution of financial strategies, coupled with international economic dynamics, means that currency risk management remains a dynamic and challenging field. In summary, currency risk management is being shaped by a variety of dynamic and interconnected factors. Understanding these influences requires a multidisciplinary approach that combines insights from finance, economics, technology, and international relations. As global markets continue to evolve, so too will the strategies to manage the associated risks. The above research however, does not adequately discuss the key drivers of currency risk exposure in the manufacturing industries which is the subject of this research.

### 2.2.2. Effects of Currency Risk Exposure on Financial Performance of Import-Dependent Industries

The impact of financial risk exposure on import-dependent industries within the manufacturing sector has been a significant topic, particularly in light of global economic volatilities, such as those caused by trade wars, pandemics, and geopolitical tensions. The researcher summarised some key insights and findings from recent research, highlighting the roles of currency risk, supply chain disruptions, and commodity price fluctuations.

Researchers like Sercu and Uppal (2022) have noted that currency volatility can disproportionately affect import-dependent manufacturers by increasing the cost of raw materials which are often priced in foreign currencies. In their analysis, companies without natural hedging mechanisms (i.e., matching revenue and costs in the same currency) or operational hedges face higher exposure.

A study by Sheffi (2021) illustrated how supply chain disruptions, especially in highly integrated international supply chains, significantly increase operational and financial risks for manufacturing firms. The COVID-19 pandemic, for example, exposed vulnerabilities in just-in-time production models, prompting firms to reevaluate and sometimes reshape their supply chain strategies. Li et al. (2023) analysed how such disruptions could lead to liquidity shortages, increased cost of capital, and more restrictive credit conditions for import-dependent firms, especially in industries like electronics and automotive manufacturing.

Fluctuations in commodity prices can affect the input costs for manufacturers. The work of Brown and Reilly (2022) highlighted how these fluctuations are influenced by global events and policy changes, impacting industries such as metal fabrication and chemical manufacturing. They suggest that companies can manage these risks through financial instruments like futures and options, though these tools also introduce complexity and potential for additional financial risk.

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As suggested by researchers like Tushman and Anderson (2021), technological innovations can mitigate some of the risks associated with global supply chains. The adoption of digital supply chain solutions, such as blockchain and IoT (Internet of Things), improves transparency and real-time data analysis, reducing uncertainties in supply chain management. These technologies can help predict disruptions, manage inventory more efficiently, and improve overall supply chain responsiveness. This aspect is particularly relevant in sectors where just-in-time production is prevalent and where delays or disruptions can lead to significant financial losses.

Import-dependent industries often face high risks from supplier concentration in specific geographic areas. The COVID-19 pandemic highlighted the dangers of this concentration, as regions heavily affected by the virus experienced shutdowns that rippled through global supply chains. According to authors like Choi and Krause (2023), strategic sourcing involves not just finding the lowest cost suppliers but also considering factors such as political stability, geographic risks, and logistical reliability. Diversifying suppliers across different regions can be a protective measure against regional disruptions and help manage currency and geopolitical risks.

Financial risk exposure also affects how companies report their financial performance. Fluctuations in exchange rates or raw material costs can lead to significant variability in reported earnings, affecting stock prices and investor perceptions. Researchers like Brealey, Myers, and Allen (2023) highlight that transparent reporting of risk management strategies and exposure is crucial for maintaining investor trust and can influence a company's credit ratings and borrowing costs.

### 2.2.3. Effectiveness of Risk Management Strategies

The Bank of Zambia in its role as the Central Bank of the republic has put in place various risk management strategies to mitigate the effects of currency risk exposure on various industries including the manufacturing industry.

In 2008, the Bank of Zambia sent the Risk Management Guide to all financial institutions, including banks, directing them to set up Risk Departments led by top management personnel. This strengthened Zambia's risk management framework. Even though most organizations benefited from this, Zambia has not yet reached a fully developed state of ERM maturity despite the implementation of Basel II not being fully realized. According to the 2018 AFI assessment, Zambia was determined to be operating on a pilot project and falling behind on all three of Basel II's pillar frameworks.

The Bank of Zambia realized in February 2022 that it needed to catch up with the rest of the world in implementing Basel II and III in its entirety.  The regulator notified all Heads of Financial Service providers via letter of the precise provisions of the Banking and Financial Services Act (also known as BFSA 2017 as amended) that had been activated. The Bank of Zambia's circulated information made clear that the institution was working to improve risk management standards by implementing the new Capital Adequacy Rules, which will operationalize the capital adequacy requirements under the new BFSA. Aspects of Basel III Capital Standards were implemented by these regulations, which meant that industrial financial institutions (FIs) would now transition from Basel II parallel run for some time by then to Basel III.

In 2020, Chifwelu carried out an investigation to ascertain the impact of risk management on the financial performance of insurance companies located in Zambia. She used a mixed-method approach to collect data on a sample size of forty-five employees of insurance companies, generating both quantitative and qualitative data methods through the use of interviews and a questionnaire. Interviews were conducted with key informants, comprising managers and other staff members, from multiple departments. While quantitative data was analysed using SPSS, qualitative data was examined and analysed on an individual basis. Regression analysis was also used in the study to show that most insurance companies in Zambia have implemented risk management strategies, which has significantly impacted their financial performance. The most important factor in assessing financial performance was risk identification, which was followed by risk mitigation, vulnerability analysis and measurement, and the implementation and oversight of risk assessment plans. He got to the conclusion that risk management strategies adoption and insurance firm financial performance in Zambia had a good link. The paper recommends that insurance companies in Zambia adopt a diverse strategy to risk management in order to maximize the effectiveness of their risk management initiatives. In order to keep up with contemporary global best practices, Zambian insurance companies should also implement enterprise risk management (ERM), which comprises a variety of insurance risk quantification techniques. The study found a strong correlation between risk management and financial success, but it did not look into the extent of RM use or the expected timing of repercussions. Additionally, in order to ascertain the relevant risk management levels, this research builds on earlier studies.

Ngala (2018) looked into the extent of inadequate and bad risk management in construction projects. The main objective was to try to combine current procedures so that modern enterprises in Zambia who deal with the planning and execution of building projects could use them, rather than to propose a totally new risk management methodology. The objective was to identify the main causes of a construction project's failure that resulted from inadequate risk management so that stakeholders may recognize

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the significance of risk management and, consequently, leave a legacy where risk management is handled more carefully and professionally.

### 2.3. Gaps in the Literature

There was a scarcity of empirical studies specifically focusing on currency risk exposure and its effect on the performance of import-dependent industries in Lusaka's manufacturing sector. Local studies such as for Ndhlovu & Hapompwe (2024) focused on investigating the extent of the application of entrepreneurial innovations in the food processing and manufacturing targeted firms in Lusaka from the year 2017 to 2021 and did not tackle matters of currency risk exposure and how it affects the performance of import-dependent manufacturing firms. Furthermore, while broader research on currency risk management and import dependence exists, there was a lack of detailed empirical analysis of the specific challenges and strategies employed by import-dependent industries in Lusaka to manage currency risk Hull (2024).

Another gap was sectoral analysis thus, the existing literature lacks comprehensive sectoral analysis, focusing primarily on aggregate trends or specific industries. Import-dependent industries in Lusaka span various sectors, including manufacturing, agriculture, mining, and retail. More in-depth sectoral analysis is needed to understand how currency risk exposure varies across industries and the sector-specific factors influencing vulnerability and resilience (Charambolis G. et al, (2008).

Also, longitudinal Studies was a gap in literature where many studies were cross-sectional or focus on short-term impacts, providing limited insights into the dynamics of currency risk exposure over time. Longitudinal studies tracking currency risk exposure and its effects on import-dependent industries in Lusaka over extended periods are needed to capture trends, patterns, and changes in response to evolving economic conditions and policy environments.

### 2.4. Theoretical Framework

Developing a theoretical framework for assessing currency risk exposure in import-dependent industries in Lusaka's manufacturing sector involves drawing on relevant theories from international finance, risk management, and international trade literature.

#### 2.4.1. Portfolio theory

This is a theory which posits that investors seek to optimise their portfolios by diversifying investments to reduce risk while maximising returns (Jack and Dongcheoi, 2013). Applied to import-dependent industries in Zambia, firms may adopt a similar approach to managing currency risk by diversifying their sourcing strategies, engaging in natural hedging, or using financial instruments to hedge against exchange rate fluctuations.

#### 2.4.2. The exchange rate pass-through theory

This theory examines the extent to which changes in exchange rates affect import prices and consequently, consumer prices (Charambolis G. et al, (2008). In the context of import-dependent industries in Zambia. This theory can help assess the degree to which currency fluctuations impact firms' input costs, pricing decisions, and profitability.

#### 2.4.3. Transaction exposure theory

This is another theory that focuses on the short-term impact of exchange rate movements on firms' cash flows and financial performance. Import-dependent industries in Zambia may face transaction exposure if they engage in foreign currency-denominated transactions for imports. This theory will help in assessing the immediate effects of currency fluctuations on firms' financial statements and cash flows.
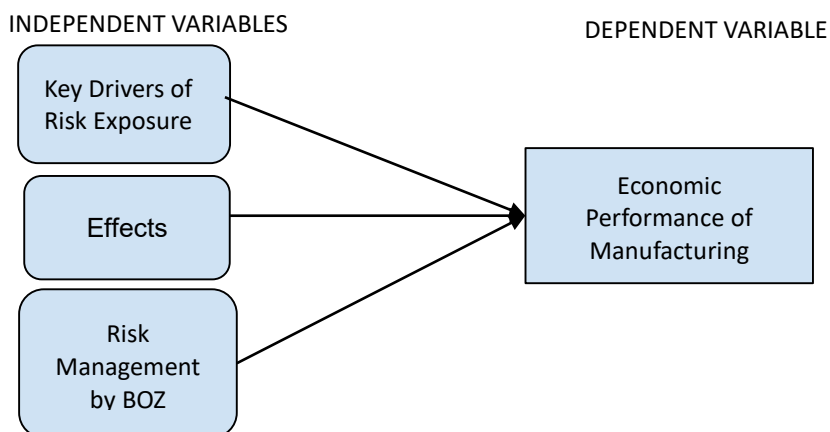
### 2.5. Conceptual Framework

INDEPENDENT VARIABLES                    DEPENDENT VARIABLE

Key Drivers of Risk Exposure

Effects

Risk Management by BOZ

Economic Performance of Manufacturing

**Figure 1: Study conceptual framework**
**Source:** Researcher's Design (2024)

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As shown above the dependent variable is economic performance of manufacturing industries which is affected by forex drivers, currency risk exposure, and risk management strategies of the Bank of Zambia which are the independent variables.

## 3. METHODOLOGY

This research employed a mixed method approach. Quantitative data were collected from financial statements, exchange rate records, and economic reports. Key Performance Indicators (KPIs) such as profit margins and return on assets (ROA) were analysed in relation to exchange rate fluctuations. Additionally, qualitative data were gathered through interviews with industry experts and executives to understand their risk management strategies and operational challenges. The 10% rule was used to derive the sample size of 28 respondents from the 280-target population of manufacturing firms from the Lusaka South Multi-Facility Economic Zone (LSMFEZ) and industrial parks. The population is according to ZDA (2023) manufacturing profile and Central Statistical Office (CSO) (2023). Purposive and random sampling were used as techniques in which 28 were targeted for questionnaire administration on drop and pick basis

## 4. FINDINGS

### 4.1. Key Drivers of Currency Risk Exposure on Import Dependent Manufacturing Industries in Lusaka

70% of the total respondent accentuated that indeed there were the key drivers of currency risk exposure on import dependent manufacturing industries in Lusaka. Conversely, 20% asserted that there was nothing like the key drivers of currency risk exposure on import dependent manufacturing industries in Lusaka. Lastly, 10% of the total respondents asserted that they were not sure about the key drivers of currency risk exposure on import dependent manufacturing industries in Lusaka.

### 4.2. Effects of currency risk exposure on financial performance of import dependent manufacturing industries in Lusaka

60% of the total respondent accentuated that indeed there were the effects of currency risk exposure on the financial performance of import-dependent manufacturing industries in Lusaka. Conversely, 23% asserted that there was nothing like the effects of currency risk exposure on the financial performance of import-dependent manufacturing industries in Lusaka. Lastly, 17% of the total respondents asserted that they were not sure about the effects of currency risk exposure on the financial performance of import-dependent manufacturing industries in Lusaka.

### 4.3. Effectiveness of risk management strategies in mitigating currency risk for import-dependent manufacturing industries in Lusaka by the Bank of Zambia.

54.2% asserted that indeed there are lots of effective risk management strategies for aforementioned industries, 29.2% of the total respondents accentuated that there no such strategies meant to mitigate the currency risk affecting the import dependent manufacturing industries in Lusaka. Conversely, 16.6% of the total respondents asserted that they were not so sure whether they could be such strategies or not. From the results obtained it can stress that, indeed there are effective risk management strategies that can be put in place so as to mitigate the currency risk affective the import dependent manufacturing industries in Lusaka.

## 5. DISCUSSION OF FINDINGS

### 5.1. Key Drivers of Currency Risk Exposure on Import Dependent Manufacturing Industries in Lusaka

Some of the respondents asserted that "differential interest rate between currencies and strategic cross trading and currency arbitrage practice were accentuated to be the major key drivers for currency risk exposure in that these affect the importers from one country to be able to import because the strength of one country's currency would determine their ability to import, for the importers using weaker currency would face lots of currency risk exposure because their ability to import more would deteriorated."

In line with the results obtained from this study, Menkhoff and Sarno (2017) conducted a study where they accentuated that driven by medium-term currency movements were major driver and critical factor in determining the risk and return in currency investments. On the other hand, another study conducted by Pasquariello and Vega (2015) was also in harmony with the results obtained by this study in that they pinpointed that research on strategic Cross-Trading in Currency Markets, looked at how strategic cross-trading and currency arbitrage practices impact currency exposure. They argued that sophisticated trading strategies can mitigate but also sometimes increase exposure depending on market conditions and trader objectives.

An identification of these key drivers of currency risk exposure should be one of the major factors influencing the productivity of the import dependent manufacturing industries in Lusaka in the sense that importation of raw materials and other products requires different currencies and so that on its own attracts so many fluctuations in the exchange rates which negatively influence the importation of these raw materials into the country by these manufacturing industries. Nonetheless, taking into accounts of

these drivers really helps the import dependent manufacturing industries to prepare themselves to curb and mitigate their adverse influence to these industries.

### 5.2. Effects of currency risk exposure in financial performance of import dependent manufacturing industries

In harmony with the results, Researchers like Sercu and Uppal (2022) did the study and found out that currency volatility can disproportionately affect import-dependent manufacturers by increasing the cost of raw materials which are often priced in foreign currencies. In their analysis, companies without natural hedging mechanisms (i.e., matching revenue and costs in the same currency) or operational hedges face higher exposure. Another study by Li et al. (2023) analysed how disruptions in currency could lead to liquidity shortages, increased cost of capital, and more restrictive credit conditions for import-dependent firms, especially in industries like electronics and automotive manufacturing.

### 5.3. Effectiveness of risk management strategies in mitigating currency risk for import-dependent manufacturing industries in Lusaka by the Bank of Zambia

In line with this study, in 2020, Chifwelu carried out an investigation to ascertain the impact of risk management on the financial performance of insurance companies located in Zambia. The most important factor in assessing financial performance was risk identification, which was followed by risk mitigation, vulnerability analysis and measurement, and the implementation and oversight of risk assessment plans. He got to the conclusion that risk management strategies adoption and insurance firm financial performance in Zambia had a good link. The paper recommends that insurance companies in Zambia adopt a diverse strategy to risk management in order to maximize the effectiveness of their risk management initiatives. In order to keep up with contemporary global best practices, Zambian insurance companies should also implement enterprise risk management (ERM), which comprises a variety of insurance risk quantification techniques. The study found a strong correlation between risk management and financial success, but it did not look into the extent of RM use or the expected timing of repercussions. Additionally, in order to ascertain the relevant risk management levels, this research builds on earlier studies.

## 6. CONCLUSION AND RECOMMENDATIONS

### 6.1. Conclusion

The study sought to analyse of currency risk exposure and its effect on the performance of import-dependent industries in Lusaka's manufacturing sector from 2019 to 2023. Based on the study findings, the study concluded that currency risk exposure has a great influence on the performance of import dependent industries as the results were supported by other studies conducted globally. The study also concluded that there are a number of key drivers that influence the performance of import dependent industries such as medium-term currency movement and interconnectivity of global markets and many drivers. It was accentuated that import dependent industries have been negatively affected by currency risk exposure such that it increases the cost of the imported raw materials as well as cost of capital. Lastly but not the least, the study also revealed some risk management strategies that include the use of forward contract, establishing risk management departments in these respective industries to curb the currency risk exposure befalling these industries.

### 6.2. Recommendations

Recommendations for this study are drawn from the responses to the survey by management of import dependent manufacturing industries in Lusaka. All factors highlighted as the possible drivers of currency risk exposure and its influence on the performance of import dependent industries in Lusaka and so forward contracts and setting up risk management department have been recommended as the major risk management strategies that must be employed by these industries so as to mitigate the said currency risk exposure. The following are some of the recommendations the researchers made at the end of the study:

**6.2.1.** Use econometric models to analyse the correlation between currency fluctuations and key performance indicators (KPIs) such as profitability, market share, and stock performance.

**6.2.2.** Study and apply different hedging techniques, such as forward contracts, options, and natural hedging, and their adoption across industries.

**6.2.3.** Analyse the role of government policies and international agreements in stabilizing currency fluctuations and supporting import-dependent industries.

### 6.3. Further research recommendations

The findings from this study can be used as the benchmark for the following further and future studies:

6.3.1. Monitor global economic indicators, geopolitical developments, and technological advancements that could affect currency markets.

6.3.2. Predict potential changes in trade policies, financial regulations, and market conditions that could alter the landscape of currency risk.

6.3.3. Explore the impact of digital currencies, blockchain technology, and fintech innovations on traditional currency risk management practices.

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