

# **The relationship between financial risk management practices and profitability of airlines in Kenya**

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## **Abstract:**

This paper reviews the use of financial derivative instruments by airlines in Kenya to manage financial risk exposure and its relationship to profitability. It provides the main objectives of an airline to enter into derivative contracts with counterparty and the scope of usage of these instruments. It is evident that most companies use derivative instruments to preserve cash flows and increase profitability as opposed to taking positions in contracts for speculative purposes. The paper focused on the risk management practices of airlines operating in Kenya. The airline industry employs derivative instruments primarily to manage volatility in jet fuel prices, interest rates and foreign exchange rates. In spite of the lack of consistent information provided in the annual reports, there is strong evidence to support the effective use of derivative instruments to manage operating costs and thereby maximize profitability. A review of the risk management practices in the airline industry is done. To this end, a sample of 14 airlines' risk exposures and usage of derivatives to mitigate these risk exposures specifically volatility in the jet fuel price were examined. While most of the airlines in Kenya do not have policies in place to pursue an aggressive hedging strategy, there exist general concurrences that financial risk management will help the airlines achieve high profitability once implemented as per the feedback I have received from the respondents.