THE EFFECT OF RISK MANAGEMENT STRATEGIES ON THE SUSTAINABLE COMPETITIVE ADVANTAGE OF COMMERCIAL BANKS IN KENYA

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DECLARATION

This project is my original work and has not been presented before for the award of a degree in any other university.

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This research project has been presented for examination with my full approval as Supervisor.

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DEDICATION

This project is dedicated to my family; for their unwavering support and continuous encouragement throughout the course. To the younger ones may this be an inspiration to strive for greater achievements.

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ABBREVIATIONS AND ACRONYMS

B2B - Business to Business

CBK - Central Bank of Kenya

CRT - Credit Risk Transfer

KBV - Knowledge-Based View

KBVT - Knowledge-Based View Theory

RBV - Resource-Based View

RBVT - Resource-Based View Theory

ROA - Return on Assets

SCA - Sustainable Competitive Advantage

SME - Small & Medium Enterprises

ABSTRACT

Commercial banks are exposed to a variety of risks during the conduct of their business. This is a serious threat to their sustainable competitive advantage. Banks that intend to survive and thrive can use risk management as an opportunity towards sustainable competitive advantage. The objective of this study was to examine the effect of risk management strategies on the sustainable competitive advantage of commercial banks in Kenya. The study focused on how risk avoidance strategies, risk transferring strategies and risk absorption strategies impact on the sustainable competencies of commercial banks in Kenya. The study adopted a descriptive research design that employed survey methods. Data were collected using self-administered questionnaires. The target population was the risk managers of all the 43 commercial banks in Kenya, however, only 38 risk managers participated in the study. Data were analyzed using mean, standard deviation and regression analysis. The findings showed that risk avoidance strategies positively but insignificantly affected sustainable competitive advantage. The findings also showed that risk transferring strategies had a positive but insignificant effect on sustainable competitive advantage. Further, risk absorption strategies positively and significantly contribute to sustainable competitive advantage. The study recommends the strengthening of the use of risk avoidance strategies, risk transferring strategies and risk absorption strategies to sustainable competitive advantage. Commercial banks should strive to turn risk management into a source of sustainable competitive advantage.

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Risk taking is central to commercial bank's business, and risks are an unavoidable consequence of engaging in banking business. The commercial bank's aim is consequently to achieve an appropriate balance between return and risk and diminish potential adverse effects on its performance. Dim & Orzea (2010) view risk as unexpected and usually unpleasant variations in returns that threaten a business entity. In management of risk, Schroek (2002) suggest three approaches to mitigation of risk. A business entity can avoid the risk, it can transfer the risk or it can absorb the risk. Elimination involves strategic removal of investment projects that may not be consistent with the financial objectives of the firm. Risk transfer involves diversification of investment portfolio or through hedging or by insuring in another firm. Absorption of risk involves undertaking management policies such as process control, due diligence or any other similar methods to reduce or eliminate certain losses.

Management of risk is a very important aspect in the competitiveness of a business organization. According to the Resource Based View Theory (RBVT) a firm's success is based on how well it utilizes its resources to achieve its objectives (Mata, Fuerst & Barney, 1995). Consequently, a firm that smartly utilizes its resources will effectively mitigate risk. According to the Knowledge Based Theory (KBT), knowledge is essential in the management of risk. A firm should utilize its intangible assets to manage risk (Wiklund & Shepherd, 2003) and consequently attain sustainable competitive advantage. Portfolio theory suggests financial mechanisms that can be used to mitigate risk through

assessment of the risk-return relationship (Markowitz, Portfolio Selection, 1952). To mitigate risk, a weighted portfolio is created that yields the desired return while managing or eliminating risk.

One approach that has been put in place to manage risk is contained in the Basel agreement that governs management of risk in commercial banks. To control business operations by applying common standards of supervision, there was a need for the creation of a body that would oversee coordination and determining which standards were to be applied and to what extent. These tasks were assigned to the new supranational bodies: Commission of the European Communities and the Basel Committee (Županović, 2013).

Commercial banks in Kenya operate in an inherently risky banking environment which is a threat to the banking business. Not only are commercial banks faced with shrinking bottom lines, the bottom lines are subject to increased variability and some banks' solvency threatened (Omondi, 2015). To manage banking across the world, The Basel Accord put in place preliminary agreements on banking and capital standards that harmonized supervisory regulations. The Basel Accord also spelt out strategies that could help management of risk in the banking industry. Commercial banks also have their own strategic approaches to risk management that are meant to enable them to remain competitive and gain competitive advantage in the markets they conduct their business. However, commercial banks in Kenya still face high levels of risk and must grapple with shrinking profits and threats to their survival. This study therefore aims to establish how risk management strategies used by commercial banks contribute to their competitiveness in the Kenyan commercial banking industry.

1.1.1 Risk Management

A risk refers to an unexpected and usually unpleasant surprise that threatens to undercut or destroy a business. However, the essence of risk lies in the response the business gives to the risk. The banking industry faces risks classified into eight categories. These are: Market risk, Liquidity risk, Credit risk, Business risk, Operational risk, Systemic risk, Reputational risk, and Moral hazard. Commercial banks need to have effective strategies for managing these risks to remain competitive (Dima & Orzea, 2010).

Risk management as a concept was initially introduced by Henri Fayol in 1961. It was, however, formalized after Gallagher (1956). Modern risk management was conceptualized after the work of (Markowitz, Portfolio Selection, 1952). At this time, financial theorists formalized the explicit inclusion of risk in portfolio management and diversification discussion. The link between return and risk was formalized based on these studies. Risk management was then defined as the integrated and strategic process, and that incorporates both the measurement and the management of risk, with the overall goal of maximizing the value of a bank, while minimizing the risk of bankruptcy (Schroeck, 2002).

1.1.2 Risk Management Strategies

According to Dima & Orzea (2010) risk management refers to the procedures that an organization follows to protect itself against harm or loss. Practicing sound risk management is an ongoing process. Commercial banks that effectively manage their risks can attain competitive advantage. Such banks take risks deliberately, anticipate antagonistic changes and shield themselves from perilous changes. According to Moles

(2013) risk management is the discovery, assessment and decisions making regarding the treatment of risks faced by the organization.

Lapteva (2009) identifies three generic strategies of managing risk. These are hedging, diversification and insurance. Each of the strategies has two dimensions, namely, risk pooling and risk transfer. Hedging enables removal of risk through selling the risk in the market through financial instruments. It can also be done through forwards, futures or swaps where there is an arrangement to trade at some future date. The pooling dimension of hedging does not involve pooling per se, but transactions executed have the economic effect of selling or transferring the risk. The risk transfer dimension of hedging involves transfer of risk from one party to another.

Diversification strategy reduces risk by combining risks that are not seamlessly interrelated into portfolios. By example, though single borrowers each represent a significant risk, on average, the whole set of borrowers may not represent significant concerns about risk since their repayment behavior is diverse. In the pooling dimension of diversification, risks are placed together into portfolios whose aggregated risk is less than the sum of the individual risks. In the risk transfer dimension of diversification, no risks are transferred, but risk is reduced through portfolio effects (Guiso & Japelli, 2008).

The insurance strategy involves limiting risk in exchange for the payment of a premium. For instance, banks consider the benefits they expect from assets and agree to pay a fixed premium to an insurer in order protect the bank from damages or losses arising from the ownership and/or damage to or loss of the asset. This is done in the traditional insurance contract. Risk of uncertain future losses is taken by the insurer. In the risk pooling

dimension of insurance strategy, assumed risks may be pooled at the consolidated level and hence risk taker may get benefits of diversification. Risks are transferred from the buyer to the seller who assumes all future uncertainties about value under the risk transfer dimension, (Lapteva, 2009).

1.1.3 Sustainable Competitive Advantage

Day (1984) when elucidating strategies of maintaining competitive advantage came up with the concept of Sustainable competitive advantage (SCA). Porter (1985) comprehensively expanded this concept in terms of using a couple of competitive strategies such as differentiation, focus and cost leadership to achieve long-term competitive advantage.

Sustainable competitive advantage is concerned with the entity making efforts towards setting up and retaining realized benefits permanently. Sustainable competitive advantage is affected by the scale and extent of the captive market, restrictions on the powers of the competitors and greater access to customers and resources. A firm can create sustainable competitive advantage when executives use a strategy that is based on features that are difficult to be assimilated by competitors (Coyne, 1986).

Peteraf (1993) suggest four factors he considers necessary for achievement of sustainable competitive advantage. These are heterogeneity of resources, imperfect resource agility, ex post limits and restrictions to competition. According to Matthews & Shulman (2005) sustainable competitive advantage can be attained through a positive brand reputation, innovation, a relational structure and strategic assets.

Competitive advantage is a matter of position in which firms occupy a competitive space, build a market around that position and jealously defend it. Stable competitive environments allow competitive advantage to be successful, particularly for large and dominant organizations operating in mature industries. Competitive advantage can be sustained for so long as the services the organization delivers and the way it does the delivery is characterized with unique characteristics that match to the key buying criteria of a significant proportion of customers. The attributes should not be spread across competitors and they should be hard to imitate (Duncan, Gintei, & Swayne, 1998). According to Denison (1990) sustainable competitive advantage comes about due to a perpetual value differential characteristic that separates the services or product offerings of one organization from those of competitors in the minds of customers.

1.1.4 Commercial Banking Sector in Kenya

Commercial banks in Kenya are governed by the Companies Act (Cap, 486) the Banking Act, (Cap, 488) the Central Bank of Kenya Act (Cap, 491) and the various prudential regulations issued by the Central Bank of Kenya (CBK). The 2016 Annual Supervision Report by CBK indicates that as at 31 December 2016, the sector comprised of 43 commercial banks, 13 Microfinance Banks (MFBs), 1 mortgage finance company, 3 credit reference bureaus (CRBs), 8 representative offices of foreign banks and 77 foreign exchange (forex) bureaus. Improved earnings were reported in 2016 within the banking sector with profit before tax increasing by 10 percent. Further, the 2016 CBK report notes that the financial services industry in Kenya was facing increased complexity which includes innovative financial products, ever-changing consumer needs, technological advancement and the use of multiple delivery channels. To surmount these challenges

and be competitive in the new operating environment, banks need to launch new products, expand current offerings and deploy exciting and innovative delivery channels. Banks also must strive to enhance access to customers as well as differentiating their products and services by use of alternative delivery channels such as e-banking and m-banking.

The current 43 commercial banks in Kenya are operating under condition of high levels of risk. As they play their key role of financial intermediation that ensure the country grows economically towards the realization of Vision 2030 strategic development goals, the banks have to grapple with various types of risks (Kithinji, 2010). This has made the core business of banking which is lending to be of material concern and an issue that affects the strategy of the banks if they have to remain solvent, profitable and competitive.

The liberalization of the market coupled with these types of risk has made commercial banking in Kenya a risky business. The liberalization has effectively changed the banking landscape by lowering the barriers to entry. Other sources of financing (such as SACCOs's, small & medium enterprise (SME's) banks, mobile banking etc) have become easily accessible making the traditional commercial banking in Kenya not attractive to a large segment of Kenyans. Banks have responded by tailoring products to fit the new market dispensation. However, this has come with high levels of risk in addition to the risk faced in the regular banking (Mulwa & Kosgei, 2016). Consequently, this study investigated the strategic implication of risk management to the competitive advantage of commercial banks in Kenya.

1.2 Research Problem

The post liberalization era has ushered in a new market dispensation full of pressure as evidenced by the distress signals which have become more frequent than before (Arunkuma, 2005). Based on the 2016 CBK Annual Supervision report, twelve banks were in violation of the Banking Act and CBK Prudential Guidelines as compared to four banks in 2016. The increase in the number of banks in violation was mainly in respect to non-compliance with liquidity ratio after Chase Bank Ltd was placed into receivership due to deposit movement.

With liberalization, exposure to various types of risks has increased. Commercial banks need to look at risk strategically since risk management is a significant part of the banking business and has become a key determinant of competitive advantage. Robust management of risk is a crucial ingredient of sustainable competitive advantage (Dima & Orzea, 2010). Banks that are unable to manage risk effectively have their competitive advantage threatened (Županović, 2013).

Kenya's liberalized commercial banking sector is dynamic and the intensity of competition has been heightened. Consequently, the level and nature of risks have evolved. Commercial banks management has had to reassess their activities and implement decisions that will not only reduce risk, but will make their banks achieve sustainable competitive advantage. If they do not use the right strategies to position themselves competitively, they will lose to local or international financial organizations that have superior risk management strategies (Ngalawa & Ngare, 2014). Policy makers and researchers have been forced to examine the failures in the global banking system

following the financial crisis. In doing so, effective risk management has come out as one factor that needs to be addressed by banks to guarantee their sustenance (Muteti, 2014).

Analysis of the studies below indicate that little has been done to ascertain the risk management strategies deployed by commercial banks in Kenya to gain competitive advantage and how the strategies contribute to sustainable competitive advantage of the banks. For instance, the study conducted by Muteti (2014) did not address how risk management contributed to competitiveness but concentrated on the link between the banks performance and risk management. Another study that was conducted by Kithinji (2010) focused on how credit risk management contributed to the profitability of commercial banks but failed to address how risk management strategy affected the sustainable competitiveness of commercial banks. The study by Omondi (2015) did not describe how risk management contributed to sustainable competitive advantage. Clearly, none of the studies focused on how risk management strategies affected the sustainable competitive advantage gained by commercial banks.

1.3 Objective of the Study

To examine the effect of risk management strategies on the sustainable competitive advantage of commercial banks in Kenya

1.4 Research Question

How do risk management strategies affect the sustainable competitive advantage of commercial banks in Kenya?

1.5 Value of the Study

To scholars and researchers of strategic management, this study may provide a basis for future research concerning how risk management strategies contribute to sustainable competitive advantage of commercial banks in emerging markets such as Kenya. The study will contribute to the body of empirical literature on how risk management strategies contribute to competitive advantage. Scholars may then find the contents and findings of this research necessary in furthering related research and arguments.

To commercial banks, the study will provide useful insights into how to utilize risk management strategies to gain competitive advantage. Given their role as drivers of economic growth and reduction of poverty, financial institutions have found themselves in positions where they need to manage risk as a strategic issue if they want to maintain competitive advantage. This research will provide the necessary insight into this approach in commercial banks.

To the policy makers in the government's Ministry of Finance this study will provide a deeper understanding of how risk management is affecting the competitive advantage of commercial banks. The study will assess how banks are currently mitigating the various types of risk and how the approaches are affecting the competitive advantage of the commercial banks. The policy makers may then use the findings of this research as input for change of policy in the commercial banking sector.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

Literature relating to the effect of risk management strategies on sustainable competitive advantage of commercial banks is analyzed in this chapter. It examines the theoretical foundation of the study, discusses the concept of sustainable competitive advantage, discusses risk management strategies and reviews past research on the relationship between strategy and sustainable competitive advantage.

2.2 Theoretical Foundation of the Study

A review of the theoretical literature regarding effect of risk management strategies on the sustainable competitive advantage is covered as part of this section. Three theories are discussed. The three theories are: Resource Based Theory of Competitive Advantage, Knowledge Based Theory of Competitive Advantage and the Portfolio Theory.

2.2.1 Resource Based View Theory

The Resource Based View (RBV) Theory of sustainable competitive advantage posits that the basis for competitive advantage lies primarily in how a firm applies its bundle of valuable resources. In a deeper analysis of the resources firms have, the theory asserts that competitive advantage is realizable if the competences and resources controlled by competing firms vary, that is, resource heterogeneity and when the variances in the resources are long lasting (or are immobile) (Mata, Fuerst, & Barney, 1995).

The first concern is whether a resource or capability is valuable. If not, the firm has a competitive disadvantage with regard to that resource. If yes, a higher concern arises

which is whether the competency and resource is heterogeneously distributed across entities or not. If not, then the firm has competitive parity for it has no advantage over competitors as regards that resource. If yes, the firm has sustainable competitive advantage. Competencies and resources that ensure sustainable competitive advantage should be valuable, heterogeneously distributed among competitors and imperfectly mobile (Mata, Fuerst, & Barney, 1995).

2.2.2 Knowledge Based Theory

The knowledge-based view (KBV) is a recent extension of the RBV. The theory views knowledge as a critical strategic resource (DeCarolis & Deeds, 2002). In this context, the focus shifts to intangible assets. In KBV, organizations are diverse entities loaded with knowledge-based assets. Knowledge resources are vital as they are difficult to copy between firms and therefore enable sustainability of the competitive advantages. are sustainable, as these resources are difficult to imitate. They therefore underpin and provide effective basis for differentiation that is long lasting. (Wiklund & Shepherd, 2003).

The knowledge-based view has some particularly appealing features. First, the view incorporates a lot of the key principles encapsulated in the socially oriented firm theories, such as the interaction between cognition, action and a shared identity of firm members (Kogut & Zander, 1996). It also draws from the resource-based view the nature of assets and competencies that support sustainable competitive advantage (Barney, 1996). Second, the view adds knowledge at the group and the firm levels of analysis as opposed to what was only the individual business level of analysis. Third, the view reflects an appreciation among managers and academics that the new frontier of competitive

advantage is based on the precious asset of knowledge (Teece, 1996). Finally, the knowledge-based view of the firm corresponds well with knowledge management in practice. Managers are increasingly becoming aware that effective supervision and oversight on the knowledge attributes of their employees, their skills, and various techniques and instruments are of immense value to their organizations (Tiwana, 1999).

The resource based view of sustainable competitive advantage is of strong relevance to this research. It points out the use of the firm's knowledge capacities as the driver of sustainable competitive advantage. Management of risk can be turned into a skill that can provide the commercial banks with the strength to gain sustainable competitive advantage especially if the skill is valuable, imperfectly mobile and heterogeneously distributed across commercial banks. The theory advocates for the use of knowledge, skills, techniques and information that turns risk management into bases of sustainable competitive advantage in commercial banking.

2.2.3 Portfolio Theory

The portfolio theory is the formalization of risk management from a modernistic empirical approach. The theory was put forth by the pioneering work of Markowitz (1952). The theory mathematically modeled the relationship between risk and return asserting that, rational investors compared risk and return so that the greaterr the risk, the greater the expected return. In the theory, return is estimated by the percentage of gains above the amounts invested while risk is the standard deviation of the streams of returns on an investment. In a portfolio of investments, return is measured by the weighted average of the returns of each investment weighted on amounts invested in each asset.

The key feature of the portfolio theory is its strategy of diversification of risk. Though the benefits of diversification have a limit, the theory posits that choosing investments that are not perfectly correlated to make a portfolio can have a risk reducing effect exposure to risk (Markowitz, 1952). The actual tactics used to mitigate risk can form a strategy that can be used to position the firm and become the competitive position of the firm. If the positioning is valuable, non-imitable and rare, it forms the sustainable competitive advantage of the business organization.

2.3 Empirical Literature Review

This section presents the review empirical studies conducted regarding the relationship between risk management strategies and sustainable competitive advantage. In the review, the section focuses on how Risk Avoiding Strategies, Risk Transferring Strategies and Risk Absorption Strategies contribute to sustainable competitive advantage.

2.3.1 Risk Avoidance Strategies and Sustainable Competitive Advantage

According to Tuncel & Alpan (2010) risk avoidance provides a very effective mechanism of managing risk in any organization. This is because by avoiding an activity, the chances of loss with regard to that activity are totally eliminated. There are two types of risk avoidance strategies. These are Type 1 and Type 2 (Manuj & Mentzer, 2008). A firm can apply the Type 1 avoidance strategy if the risk associated with conducting business in a geographical market, with a particular supplier or with a given customer is unacceptable to the firm. Exiting such type of risk can be done through delayed entry into the market, deploying of specialized assets, or focusing on certain low risk geographies. The aim is

to eliminate the risk completely. Type 2 risk avoidance strategies focus on preempting adverse events and then reducing their frequency and probability of occurrence.

A study that was conducted by Manuj & Mentzer (2008) focused on the relationship between risk management and risk management strategies in supply chains. The study was a review of empirical literature supplemented with a focus group discussion and detailed interviews. The risk management strategies that the study focused on included speculation, security, hedging, postponement, control, and avoidance. The study established that risk avoidance was widely used and was highly effective. The methods of risk avoidance were delay of entry into markets deemed as high risk, divestiture of specialized assets, participating only in low risk markets and forestalling adverse events.

2.3.2 Risk Transferring Strategies and Sustainable Competitive Advantage

In discussing the relationship between risk transfer strategies and sustainable competitive advantage, this subsection will focus on securitization hedging which are ways of risk transfer. In a study conducted by Sarkisyan, Casu, Clare, & Thomas (2009) the aim was to evaluate whether banks improve their performance when they securitize their debt. The study was conducted on commercial banks in the USA using data from 2001 to 2008. The study used a propensity score matching approach. The study established that securitization did not improve the performance of commercial banks.

Another study conducted by Chang, Ho, & Hsiao (2010) sought to determine how hedging affected risk exposure of commercial banks and how hedging affected financial performance. The study was conducted on European banks operating in 25 countries. The study established that banks that used more hedging were more exposed to risk. Data

were obtained from banks' balance sheet and income statements retrieved from the Bankscope database. Analysis was conducted by linear regression. The study established that banks with high risk exposure and higher value used derivatives. This indicates that risk management through hedging affected performance as measured by firm value.

2.3.3 Risk Absorption Strategies and Sustainable Competitive Advantage

According to Guiso & Japelli (2008) risk absorption can be achieved by diversification. A study conducted by Mercieca, Schaeck, & Wolfe (2006) investigated how diversification affected the creditworthiness and earnings of low level European credit companies. The study was conducted using data from 755 small banks in 15 countries. The study covered the time between 1997 and 2003. The Herfindahl Hirschman Index was used as a measure of diversification. Earnings were measured by Return on Assets (ROA) and Return on Equity (ROE). Z scores were used to conduct the analysis. The results suggested that diversification did not affect the profitability of small banks.

In a study by Berger, Hasan, & Zhou (2010) the goal was to evaluate the effect of broadening risk profile through diversification on the performance of Chinese commercial banks. The study was conducted on 88 Chinese banks for the ten years between 1996 and 2006. The study was a comparison between banks with concentration strategies against those with diversification strategies. This risk management strategy of diversification was classified into: location within the country, nature and type of deposits, loans and assets. Diversification indicators were regressed upon bank specific factors such as performance, risk, cost efficiency, size, conglomerate affiliation and ownership. Results suggested that diversification negatively affected bank performance.

Muteti (2014) focused on the relationship between financial risk administration and financial performance of Kenyan business banks. The population for this study was Commercial banks in Kenya. Analysis was performed using SPSS whereby a multiple regression model was employed. The ratio ROA was used to measure financial performance while the independent variables were: interest rate, credit risk, liquidity, management of capital, forex exposure, bank deposits, and size of the bank. The study found that the following risks: forex exposure. interest rate, credit, capital management, liquidity, bank size, and bank deposits had a significant influence on the financial performance of Kenyan commercial banks. This study will focus on risk management impact on the sustainable competitive advantage.

2.4 Summary of Literature and Knowledge gaps

Table 3.1 below presents a summary of the empirical literature review focused on by this chapter. As shown in the table, the studies reviewed did not focus on operational risk and indeed did not show how operational risk can be used a s strategy to gain competitive advantage in commercial banks.

Table 3. 1: Summary of Empirical Literature and Research Gap

Author	Year	Objective	Findings	Research Gap
Muteti	2014	The relationship between financial performance and financial risk administration of commercial banks in Kenya.	Interest rate risk, forex risk, credit management, liquidity, capital management, bank size, and bank deposits significantly influenced financial performance	Did not look at operational risk and did not focus on sustainable competitive advantage
Berger, Hasan, & Zhou	2010	The effect of broadening risk profile through diversification on the performance of Chinese commercial banks	Diversification negatively affected bank performance	The study did not focus on operational risk and did nothing regarding sustainable competitive advantage
Chang, Ho, & Hsiao	2010	How hedging affected financial performance	Risk management through hedging affected performance as measured by firm value	Did not relate operational risk to sustainable competitive advantage

Author	Year	Objective	Findings	Research Gap
Sarkisyan, Casu, Clare, & Thomas	2009	Evaluate whether banks improve their performance when they securitize their debt	Securitization did not improve the performance of commercial banks	Did not relate operational risk to sustainable competitive advantage
Manuj and Mentzer	2008	The relationship between risk management and risk management strategies in supply chains	The study established that risk avoidance strategies were widely used and was highly effective	Did not relate operational risk to sustainable competitive advantage
Mercieca, Schaeck, & Wolfe	2006	Effect of risk diversification the creditworthiness and earnings of low level European credit companies	Profitability of small banks were not affected by diversification.	The study did not focus on operational risk as a strategy for sustainable competitive advantage

The literature review has focused on theories and the empirical literature forming the basis of this study. The three theories, namely, knowledge-based theory, resource-based view theory, and portfolio theory indicated a close connection between strategy and performance indicating that risk management strategy can affect performance. However, findings from empirical review provide varying findings. For instance, while the study by Manuj & Mentzer (2008) found that risk avoidance strategies contributed to performance, other studied such as that by Sarkisyan, Casu, Clare, & Thomas (2009) established that risk management by securitization did not affect the performance of commercial banks.

The study has three research gaps to address. First, no known study has assessed how the use of risk avoidance by commercial banks in Kenya can be a basis for long-lasting competitive advantage. Secondly, no known study has assessed the use of risk transfer strategy as a source of sustainable competitive advantage. Thirdly, no known study has focused on the use of risk absorption as a strategy of gaining sustainable competitive advantage.

2.5 Conceptual Framework

According to Creswell (2003) a conceptual framework is a pictorial representation of the variables in a study that suggests the relation between them. Figure 2.1 below shows the conceptual framework of the study. The independent variable is risk management. Risk management strategies are broken into three: Risk Avoiding Strategies, Risk Transferring Strategies and Risk Absorption Strategies. Risk Avoiding Strategies variable was measured by focusing on credit signaling, credit monitoring, strong partnerships, carefully spelt contracts and portfolio risk assessment. Risk transferring strategies was measured by focusing on loan trading, credit derivatives, asset-backed securities,

insurance and collateralized debt. Risk absorption strategies will be measured by focusing on collateral, interest rate instruments, investment protection, special capital allocation and loan loss reserves. The dependent variable is Sustainable Competitive Advantage. This variable was measured by focusing on the uniqueness of products, the demand, positive response by consumers, new ways of operation, improved returns and costs.

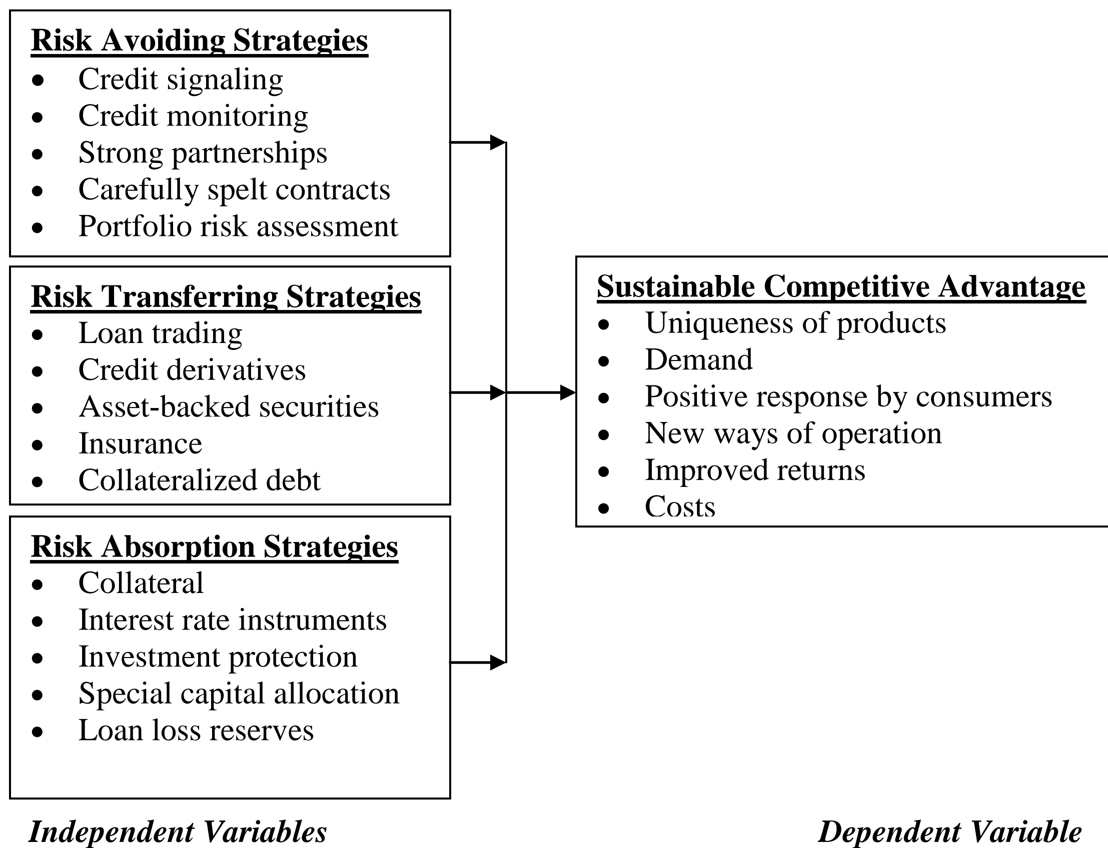

Figure 2. 1: Conceptual Framework of Variables

Source: Researcher, 2017

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

The chapter focusses on the methodology adopted for this study. The chapter defines the research design that was adopted, the population and the sample, which data is needed and how the data were collected. Further, the chapter describes how the collected data was analyzed to realize the objectives of the study.

3.2 Research Design

This research adopted a descriptive research design that employed survey methods. The research incorporated quantitative methods in collecting and analyzing data (Creswell, 2003). The researcher collected and analyzed numerical data from commercial banks in Kenya. To collect the data, the researcher used survey questionnaires that contained both open-ended and closed-ended questions (Kothari, 2004).

The descriptive research design was the most apt for this study since the information required was about strategic management of risk which is a concept with both qualitative and quantitative characteristics. The researcher used closed ended questions to attach numerical measures to responses. However, the researcher allowed respondents to give narrations of how they use risk management as strategy to gain sustainable competitive advantage in the commercial banking industry in Kenya. According to Creswell (2003) this can only be achieved through the mixed research design.

3.3 Population of the Study

Commercial banks in Kenya form the population of this study. The CBK 2016 Annual Supervision Report indicates that as at end of 2016, the Kenyan banking sector comprised

of 43 commercial banks. These 43 commercial banks (see Appendix II) formed the population of this study. According to Mugenda & Mugenda, (2003), the target population should have observable characteristics, to which the researcher intends to generalize the results of the study.

Only officers in charge of risk management in the commercial banks provided the information required by this study. Officers in charge of risk management have the information and experience required to provide the necessary responses. Further, the number of the officers was 43 which was small and manageable enough to warrant a census study. Also, all commercial banks are involved in risk management.

3.4 Data Collection

Primary data required for this study was obtained by means of a self-administered questionnaire completed by risk managers in each of the 43 commercial banks in Kenya. The questionnaire was delivered in person by the researcher and collected immediately after being completed by the risk managers.

The questionnaire collected data by requiring the officers to fill in blank spaces and ticking on options. The spaces required both closed ended and open-ended responses. The first part of the questionnaire focused on general demographic data about the bank and risk managers. The second segment captured data on the strategy of eliminating or avoiding risk. The third section focused on the strategy of transferring risk while the fourth section focused on the strategy of absorbing or managing risk. The final section of the questionnaire required information on sustainable competitive advantage. The Likert-scaled questions used for each of sections two to five involved circling or ticking from an

option of numbers from 1 to 5. On each section, an open-ended question required the respondent to give a narration.

3.5 Data Analysis

The quantitative data collected in the questionnaires was digitized by coding them and storing in the SPSS version 2.0. Quantitative data were evaluated using descriptive statistics which included: standard deviation and the mean. For example, the mean was used to assess responses to given items on variables in the questionnaire. The data were presented using graphical presentations such as tables.

The relationship between sustainable competitive advantage and risk management strategies was determined by regression analysis. The conceptual model showing the relationship between sustainable competitive advantage and risk management strategies is as shown below:

$$Y = f(X_1, X_2, X_3)$$

Where Y is Sustainable Competitive Advantage, X_1 is Risk Avoiding Strategies, X_2 is Risk Transferring Strategies while X_3 is Risk Absorption Strategies. In the establishment of the relationship between Sustainable Competitive Advantage and risk management strategies, the analytical model below will be applied.

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + e$$

In the analytical model, α is the constant term while β_1, β_2 and β_3 are the sensitivities of Sustainable Competitive Advantage (Y) to X_1, X_2 and X_3 respectively. The term e represents the error term of the regression. The significance of α, β_1, β_2 and β_3 were

tested using the t-statistic at 95% confidence level. The strength of the relationship was assessed using the F-test. Before the use of the regression model the data were assessed collinearity and correlation. Variance inflation factors (VIF) was used to test collinearity while correlation was tested using correlation coefficient.

CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

An analysis of the data is presented in this chapter. The chapter analyzes the effects of Risk Avoidance Strategies, Risk Transferring Strategies and Risk Absorption Strategies on Sustainable Competitive Advantage. It also discusses the findings arising from the research results.

4.2 Response Rate

The researcher targeted risk managers of 43 commercial banks in Kenya. However, only 38 completed and submitted the duly filled questionnaires that were used in data collection. This led to a response rate of 88.4% indicating the finding are representative of the population.

4.3 Reliability Analysis

In reliability assessment, the researcher employed the Cronbach's Alpha to measure how reliable responses to the questionnaire items were on each of the variables being tested. The values of Cronbach's Alpha are presented in Table 4.1. The lowest level of reliability was 0.689 which was the reliability of the responses on Sustainable Competitive Advantage. The rest of the variables had reliability of more than 0.7 indicating meaningful inference.

Table 4. 1: Reliability Analysis

Variable	Cronbach's Alpha	Reliability
Risk Avoidance Strategies	0.724	Acceptable
Risk Transferring Strategies	0.789	Acceptable
Risk Absorption Strategies	0.857	Good
Sustainable Competitive Advantage	0.689	Questionable

4.4 Descriptive Analysis

4.4.1 Risk Avoidance Strategies

This sub-section addresses the issue of how Risk Avoidance Strategy is used in commercial banks and how the use of the strategy affects Sustainable Competitive Advantage. To address the effect of Risk Avoidance Strategy on Sustainable Competitive Advantage, the risk managers of the commercial banks responded to various items about risk avoidance in a Likert scale. In the Likert, the managers were to respond by ticking on options that best explained their position regarding the use of Risk Avoidance Strategy and how it affected Sustainable Competitive Advantage. In the scale, 1=Strongly Disagree; 2=Disagree; 3=Not Sure; 4=Agree; while 5=Strongly Agree. The mean response of the risk managers with the corresponding standard deviations for every item is as presented in Table 4.2 below. The mean responses are ranked according to the mean in descending order.

Table 4. 2: Effect of Risk Avoidance Strategies

Risk Avoidance Strategies (X_1)	**Mean**	**Std. Deviation**
You have strict documentation policies in the bank	4.21	.704
You frequently conduct portfolio risk assessment	4.03	.854
You have strong partnerships with credit rating agencies	3.82	.801
You conduct credit monitoring while issuing credit	3.76	.751
You have carefully spelt contracts design strategy	3.71	.867
There are strong credit signaling policies	3.66	.745
The bank has deliberate risk diversification strategies	3.58	.976
Your pricing of credit depends on CRT instruments	3.47	1.033
You have a reliable risk profiling method	3.39	1.001
Workers are trained to avoid risky contracts	3.34	1.072
Grand Mean	3.70	

As shown in the table, risk managers most strongly indicated that they have strict documentation policies in their banks (M = 4.21, σ = 0.704); that they frequently conduct portfolio risk assessment (M = 4.03, σ = 0.854); and that they have strong partnerships with credit rating agencies (M = 3.82, σ = 0.801). However, they least strongly indicated that their pricing of credit depends on credit risk transfer (CRT) instruments (M = 3.47, σ = 1.033); that they have a reliable risk profiling method (M = 3.39, σ = 1.001); and that workers are trained to avoid risky contracts (M = 3.34, σ = 1.072). The grand mean of the variable was 3.70 indicating mild agreement that Risk Avoidance Strategies contributed positively to Sustainable Competitive Advantage of commercial banks. The position is also indicated by the results of the regression analysis in which the coefficient of Risk Avoidance Strategies was 0.282 showing a positive relationship.

4.4.2 Risk Transferring Strategies

This subsection addresses how Risk Transferring Strategies affect Sustainable Competitive Advantage. To provide information about how Risk Transferring Strategies contributed to Sustainable Competitive Advantage, risk managers were required to rate items regarding Risk Transferring Strategies in a Likert scale. The Likert scale had 10 items about Risk Transferring Strategies. Risk managers responded by ticking the option that best represented their position. Mean response for each item and the standard deviation were calculated and the items ranked according to the mean as shown in Table 4.3.

Table 4. 3: Risk Transferring Strategies

Risk Transferring Strategies (X_2)	**Mean**	**Std. Deviation**
All credit products are insured	3.82	1.010
You have increased the use of total return swap	3.76	.786
Your use of credit derivatives has increased recently	3.66	.938
Number of insurance linked credit products has grown	3.66	1.097
The bank is comprehensively self-insured	3.50	.893
Loan trading is a significant part of your strategy	3.37	1.217
You strictly insist on guarantees for all credit	3.37	1.195
You use more of credit default swaps	3.18	1.159
Collateralized debt obligations	3.00	1.040
You have increased the use of asset-backed securities	2.21	1.119
Grand Mean	3.35	

As shown in the table, risk managers indicated most strongly that all credit products are insured (M = 3.82, σ = 1.010); that they have increased the use of total return swaps (M = 3.76, σ = 0.786); that the use of credit derivatives has increased recently (M = 3.66, σ = 0.938); and that the number of insurance linked credit products has grown (M = 3.66, σ = 1.097). The risk managers least strongly indicated that they use more of credit default

swaps (M = 3.18, σ = 1.159); that they collateralized debt obligations (M = 3.00, σ = 1.040); and that they have increased the use of asset-backed securities (M = 2.21, σ = 1.119). The grand mean of 3.35 indicates weak contribution of Risk Transferring Strategies on sustainable competitive advantage. Regression analysis confirms that Risk Transferring Strategies had a coefficient of 0.015 which was positive but not statistically significant.

4.4.3 Risk Absorption Strategies

This sub-section focuses on the effect of Risk Absorption Strategies on Sustainable Competitive Advantage of commercial banks. To assess the effect of Risk Absorption Strategies on Sustainable Competitive Advantage, the researcher required that risk managers respond to a Likert scale of seven items relating to Risk Absorption Strategies. The managers responded by way of selecting an option on the scale of 1 to 5 that estimated their position regarding its effect on Sustainable Competitive Advantage. For each of the items, the mean and the standard deviation were calculated and presented in Table 4.4. The items are ranked in descending order according to the mean.

Table 4. 4: Risk Absorption Strategies

Risk Absorption Strategies (X_3)	**Mean**	**Std. Deviation**
Your loan loss reserves are growing	4.00	.658
You insist on collateral when providing credit	3.97	.677
Interest Rate Instruments	3.87	.875
You charge special risk premium for risky borrowers	3.87	.844
You have in place investment protection reserves	3.74	1.032
Risk financing	3.68	.904
You have special capital allocation to cover risk	3.61	.679
Grand Mean	3.82	

As shown in the table, risk managers most strongly indicated that loan loss reserves are growing (M = 4.00, σ = 0.658) and that they insist on collateral when providing credit (M = 3.97, σ = 0.677). However, they least strongly indicated that they used Risk financing (M = 3.68, σ = 0.904) and that that have special capital allocation to cover risk (M = 3.61, σ = 0.679). The grand mean was 3.82 which indicated that the managers generally agreed that Risk Absorption Strategies contributed to Sustainable Competitive Advantage. The regression analysis shows that the coefficient of Risk Absorption Strategies was 0.310 indicating that Risk Absorption Strategies positively contribute to Sustainable Competitive Advantage and the contribution is significant.

4.4.4 Sustainable Competitive Advantage

Risk Managers in commercial banks were required to assess the sustainable competitive advantage of their commercial banks. To do this, they responded to items in a Likert scale. They indicated their position by ticking on an option for every item. The choices were summarized using the mean and standard deviation and presented as shown in Table 4.5 below. The items are ranked according to the mean.

Table 4. 5: Sustainable Competitive Advantage

Sustainable Competitiveness Advantage (*Y*)	**Mean**	**Std. Deviation**
Your strategies have overcome key organizational hurdles	4.39	.595
The services you provide are unique	4.13	1.212
You experience reduced costs due to risk management strategies	3.97	.716
The services you provide have no close substitutes	3.92	.850
Your market share grows due to risk management strategies	3.92	.997
Your banking products are very difficult to imitate	3.89	.689
Consumers more positively respond to your products	3.84	1.001
Your bank always comes up with new ways of operation	3.84	.916
Your products reach beyond existing demand	3.76	1.076
Your risk management strategies have led to improved returns	3.58	.758
Grand Mean	3.92	

As shown in the table the Risk Managers in commercial banks indicated most strongly that their strategies had overcome key organizational hurdles (M = 4.39, σ = 0.595); that the services they provide are unique (M = 4.13, σ = 1.212) and that they experience reduced costs due to their risk management strategies (M = 3.97, σ = 0.716). However, they least strongly believe that their products reach beyond existing demand (M = 3.76, σ = 1.076) and that their risk management strategies have led to improved returns (M = 3.58, σ = 0.758). The grand mean of 3.92 indicates agreement that generally the banks have sustainable competitive advantage.

4.5 Effect of Risk Management Strategies and Competitive Advantage

Regression analysis was conducted to establish the relationship between risk management strategies and Sustainable Competitive Advantage of the commercial banks. Responses from Risk Managers on each of the four variables in the study were summarized using

the mean in order to come up with distributions for each of the variables. The summary of the resulting distribution of the four variables is as presented in Table 4.3.

Table 4. 6: Summary Statistics

Variable	Min	Max	Mean	Std. Deviation
Risk Avoidance Strategies	2.40	4.30	3.70	.4762
Risk Transferring Strategies	1.70	4.30	3.35	.6190
Risk Absorption Strategies	2.57	4.86	3.82	.6022
Sustainable Competitive Advantage	2.90	4.60	3.93	.4619

As shown in Table 4.6 the highest value of Risk Avoidance Strategies was 3.70 while the minimum was 2.40. Its mean was 3.70 ($\sigma = 0.4762$). The highest value for Risk Transferring Strategies was 4.30 with the minimum as 1.70. Risk Transferring Strategies had a mean of 3.35 ($\sigma = 0.6190$). The highest value for Risk Absorption Strategies was 4.86 while its minimum was 2.57. The mean for Risk Absorption Strategies was 3.82 ($\sigma = 0.6022$). Regarding Sustainable Competitive Advantage, the maximum was 4.60 and the minimum was 2.90. The mean for Sustainable Competitive Advantage was 3.93 ($\sigma = 0.4619$)

Correlation analysis was conducted to ensure the independence of the independent variables of the study. The figures presented in Table 4.7 are the correlations between the variables.

Table 4. 7: Correlation Analysis

Coefficient Correlations[a]			
	Risk Avoidance Strategies	**Risk Transferring Strategies**	**Risk Absorption Strategies**
Risk Avoidance Strategies	1.000	-.217	-.340
Risk Transferring Strategies		1.000	.100
Risk Absorption Strategies			1.000
a. Dependent Variable: Sustainable Competitive Advantage			

As shown in the table, the correlation coefficient between Risk Avoidance Strategies and Risk Transferring Strategies was -0.217 which was not significant indicating the two variables were independent. The correlation coefficient between Risk Avoidance Strategies and Risk Absorption Strategies was -0.340 which was not statistically significant indicating the two variables were independent. The correlation coefficient between Risk Transferring Strategies and Risk Absorption Strategies was 0.100 which was not statistically significant indicating the variables were independent. The independence of the three variables allowed for regression analysis. The values of the Variance Inflation Factor (VIF) were about 1.0 indicating the variables were independent.

Table 4. 8: Regression Analysis

Coefficients[a]							
	Unstandardized Coefficients		**Standardized Coefficients**	**t**	**Sig.**	**Collinearity Statistics**	
	B	Std. Error	Beta			Tolerance	VIF
(Constant)	1.652	.674		2.451	.020		
Risk Avoidance Strategies	.282	.143	.290	1.972	.057	.952	1.050
Risk Transferring Strategies	.015	.114	.020	.132	.895	.884	1.131
Risk Absorption Strategies	.310	.119	.404	2.592	.014	.850	1.176
a. Dependent Variable: Sustainable Competitive Advantage							

Model Specification:

$$Y = 1.652 + 0.282X_1 + 0.015X_2 + 0.310X_3$$

As shown in Table 4.8, the constant of regression was $1.652\ (t = 2.451, p = 0.020)$ which was significant. The coefficient of Risk Avoidance Strategies was $0.282(t = 1.972, p = 0.057)$ which was positive, but not statistically significant. The coefficient of Risk Transferring Strategies was $0.015(t = 0.132, p = 0.895)$ which was positive, but not significant. The coefficient of Risk Absorption Strategies was 0.310(t=2.592, p=0.014) which was positive and statistically significant.

Table 4.9 presents the results of the Analysis of Variance (ANOVA) and the coefficient of determination. As shown in the table $F = 4.827(p = .007)$ which is statistically significant. The coefficient of determination, $R^2 = 0.299$, indicating that only 29.9% of variation in Sustainable Competitive Advantage is explained by the independent variables.

Table 4. 9: Analysis of Variance

ANOVA[a]					
	Sum of Squares	**d.f**	**Mean Square**	**F**	**Sig.**
Regression	2.358	3	.786	4.827	.007[b]
Residual	5.536	34	.163		
Total	7.894	37			
a. Dependent Variable: Sustainable Competitive Advantage					
b. Predictors: (Constant), Risk Avoidance Strategies, Risk Transferring Strategies, Risk Absorption Strategies					
$R^2 = 0.299$					

4.6 Discussion of Findings

The study established that risk avoidance strategies contributed positively to sustainable competitive advantage. The findings support those of Manuj & Mentzer (2008) who established that risk avoidance methods benefitted by realized sustainable performance demonstrated in their sustainable competitive advantage. The findings also echo the findings of Tuncel & Alpan (2010) who posited that risk avoidance is an effective mechanism of managing risk in any organization and can be a source of sustainable competitive advantage.

The study finds that risk transfer had a positive but not significant effect on sustainable competitive advantage. The findings support those of Sarkisyan, Casu, Clare, & Thomas (2009) who also established that risk transferring strategies such as securitization did not improve the commercial banks performance in the USA. The findings do not seem to agree with those of Chang, Ho, & Hsiao (2010) who established that risk management

strategies such as hedging affected the performance as measured by firm value and therefore its sustainable competitive advantage.

This study established that risk absorption had a positive and significant effect on sustainable competitive advantage. The findings disagree with those of Berger, Hasan, & Zhou (2010) who established that risk absorption strategies such as diversification in Chinese commercial banks negatively affected their performance. The findings also disagree with those of Mercieca, Schaeck, & Wolfe (2006) who studied European credit companies and established that diversification did not affect their profitability.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter begins with a summary of the findings by focusing on the three independent variables and how they affect sustainable competitive advantage in commercial banks. The chapter then presents the conclusions and recommendation.

5.2 Summary of Findings

Regarding the relationship between risk avoidance strategies and sustainable competitive advantage risk managers indicated that they have strict documentation policies in their banks, they frequently conduct portfolio risk assessment and they have strong partnerships with credit rating agencies. However, they had weakness in factoring credit risk transfer (CRT) instruments in pricing of credit, risk profiling methods and training of workers to avoid risky contracts. Generally, risk avoidance strategies had a weak positive effect on Sustainable Competitive Advantage of commercial banks. Regression analysis showed a positive relationship between Risk Avoidance Strategies and Sustainable Competitive Advantage but the relationship was not significant.

As regards the effect of transferring strategies on sustainable competitive advantage the study found that in commercial banks all credit products are insured, the use of total return swaps is on the rise, the use of credit derivatives is also on the rise and the number of insurance linked credit products has grown. Further, commercial banks do not to a large extent use collateralized debt obligations (CDO's), credit default swaps and asset

backed securities as a drive of sustainable competitive advantage. Risk Transferring Strategies had a positive but insignificant effect on sustainable competitive advantage.

About the relationship between risk absorption strategies and sustainable competitive advantage the study established that loan loss reserves are growing and they insist on collateral when providing credit. However, the use of risk financing and special capital allocation to cover risk are limited. The regression analysis indicates risk absorption strategies positively and significantly contribute to sustainable competitive advantage.

5.3 Conclusions

Basing on the findings, the study makes the following conclusions. Risk avoidance strategies do not significantly contribute to the sustainable competitive advantage of commercial banks in Kenya. While commercial banks use strict documentation policies, frequently conduct portfolio risk assessment and bank on strong partnerships with credit rating agencies, they do not show enthusiasm in using CRT instruments in pricing of credit. They also do not effectively use risk profiling methods. Their staff is not properly trained to avoid risky contracts.

Risk Transferring Strategies have a positive but insignificant effect on sustainable competitive advantage of commercial banks. Specifically, all credit products are insured, banks use more of total return swaps and credit derivatives. Banks are also selling more insurance linked credit products. Further, commercial banks do not use asset-backed securities, collateralized debt obligations (CDO’s) and credit default swaps as key drivers of sustainable competitive advantage.

Risk absorption strategies positively and significantly contribute to sustainable competitive advantage. While loan loss reserves are growing, commercial banks strictly insist on collateral when providing credit. However, there is limited use of risk financing and special capital allocation to cover risk.

5.4 Recommendations

Based on a review of the above conclusions, the study makes the following recommendations. Risk avoidance strategies should be strengthened as a way of improving on attainment of sustainable competitive advantage by Kenyan commercial banks. While commercial banks use strict documentation policies, frequently conduct portfolio risk assessment and bank on strong partnerships with credit rating agencies is commendable, banks should exploit the use of CRT instruments in pricing of credit. They should also use risk profiling methods more effectively. Further, they should train their staff on how to detect and avoid risky contracts.

Banks should also strengthen the use of risk transferring strategies to make them have a strong effect on sustainable competitive advantage of commercial banks. While much is done to ensure all credit products are insured, more of total return swaps and credit derivatives are used and that more insurance linked credit products are sold, the banks should be encouraged to use collateralized debt obligations (CDO's), asset backed securities and credit default swaps to gain sustainable competitive advantage.

The study recommends commercial banks capitalize on Risk absorption strategies to gain competitive advantage since currently this strategy has the strongest effect on sustainable competitive advantage. While maintaining strict collateral requirement when providing

credit banks can improve on the use of risk financing and special capital allocation to cover risk.

5.5 Suggestions for Further Research

This study suggests that further research can be conducted to cover the whole of the financial sector in Kenya given the interconnectedness of the players in the industry. Such players include micro-finance institutions, sacco's and telecommunication companies which are partnering with banks to provide credit. Such players may benefit from such research to determine factors that may impact their sustainable competitive advantage. Further, the study can be expanded to cover the East African region given the drive towards a more integrated East Africa Community as part of a regional trading bloc.

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APPENDICES

Appendix I: Questionnaire

Please provide the information indicated below as carefully and truthfully as possible. Fill in the blank spaces or tick the option that best captures your opinion. The information obtained will be treated confidentially and will not be used in any manner to reveal your identity, harm you or the organization you work for. The information obtained is strictly for academic purposes. Do not write your name on this questionnaire.

SECTION I: GENERAL INFORMATION

1. Indicate your gender ___________________
2. Indicate your age? ___________________ Years
3. How long has the bank operated in the country? ______________________ Years
4. What is the estimate of your work force? ______________________ Workers
5. How many branches do you have in Kenya? ______________________
6. How long have you been in risk management for the bank?____________ Years

SECTION II: RISK AVOIDING

Indicate by ticking (✓) one of the options from 1 to 5 the extent to which you agree the following contribute to your bank's sustainable competitive advantage.

1-Strongly Disagree 2-Disagree 3-Not Sure 4-Agree 5-Strongly Agree

RISK AVOIDING STRATEGIES	1	2	3	4	5
There are strong credit signaling policies					
You conduct credit monitoring while issuing credit					
You have strong partnerships with credit rating agencies					
You have carefully spelt contracts design strategy					
You frequently conduct portfolio risk assessment					
You have strict documentation policies in the bank					
You have a reliable risk profiling method					
Your pricing of credit depends on CRT instruments					
Workers are trained to avoid risky contracts					
The bank has deliberate risk diversification strategies					

What other risk avoiding strategies do you use?

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Comment on how the strategies have contributed to the sustainable competitive advantage of your bank.

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SECTION III: RISK TRANSFERRING STRATEGIES

Indicate by ticking (✓) one of the options from 1 to 5 the extent to which you agree the following contribute to your sustainable competitive advantage.

1-Strongly Disagree 2-Disagree 3-Not Sure 4-Agree 5-Strongly Agree

RISK TRANSFERRING STRATEGIES	1	2	3	4	5
Loan trading is a significant part of your strategy					
Your use of credit derivatives has increased recently					
You have increased the use of asset-backed securities					
Collateralized debt obligations					
Number of insurance linked credit products has grown					
All credit products are insured					
You use more of credit default swaps					
The bank is comprehensively self-insured					
You have increased the use of total return swap					
You strictly insist on guarantees for all credit					

What other risk transferring strategies do you use?

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Comment on how the strategies have contributed to the sustainable competitive advantage of your bank.

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SECTION IV: RISK ABSORPTION STRATEGIES

Indicate by ticking (✓) one of the options from 1 to 5 the extent to which you agree the following contribute to your sustainable competitive advantage.

1-Strongly Disagree 2-Disagree 3-Not Sure 4-Agree 5-Strongly Agree

RISK ABSORPTION STRATEGIES	1	2	3	4	5
You insist on collateral when providing credit					
Interest Rate Instruments					
Your loan loss reserves are growing					
You have special capital allocation to cover risk					
You have in place investment protection reserves					
You charge special risk premium for risky borrowers					
Risk financing					

What other risk absorption strategies do you use?

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Please provide a commentary on how these strategies have aided to the sustainable competitive advantage of your bank.

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SECTION V: SUSTAINABLE COMPETITIVE ADVANTAGE

Indicate by ticking (✓) one of the options from 1 to 5 the extent to which you agree the following about to your sustainable competitive advantage.

1-Strongly Disagree 2-Disagree 3-Not Sure 4-Agree 5-Strongly Agree

SUSTAINABLE COMPETITIVE ADVANTAGE	1	2	3	4	5
The services you provide are unique					
Your banking products are very difficult to imitate					
The services you provide have no close substitutes					
Your products reach beyond existing demand					
Your strategies have overcome key organizational hurdles					
Consumers more positively respond to your products					
Your bank always comes up with new ways of operation					
Your risk management strategies have led to improved returns					
You experience reduced costs due to risk management strategies					
Your market share grows due to risk management strategies					

How ELSE have your risk management strategies contributed to sustainable competitive advantage in your bank?

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Appendix II: List of Licensed Commercial Banks in Kenya

1. Victoria Commercial Bank
2. United Bank of Africa
3. TransNational Bank Kenya
4. Standard Chartered Bank Kenya
5. Spire Bank (former Equatorial Commercial Bank Limited)
6. Sidian Bank (former K-Rep Bank)
7. Prime Bank (Kenya)
8. Paramount Universal Bank
9. Oriental Commercial Bank
10. NIC Bank
11. National Bank of Kenya
12. Middle East Bank Kenya
13. Kenya Commercial Bank
14. Jamii Bora Bank
15. Imperial Bank of Kenya (In receivership)
16. I&M Bank
17. Housing Finance Company of Kenya
18. Habib Bank AG Zurich
19. Habib Bank
20. Gulf African Bank
21. Guardian Bank
22. Guaranty Trust Bank Kenya
23. Giro Commercial Bank
24. First Community Bank
25. Fidelity Commercial Bank Limited
26. Family Bank
27. Equity Bank
28. Ecobank Kenya
29. Diamond Trust Bank
30. Development Bank of Kenya

31. Credit Bank
32. Cooperative Bank of Kenya
33. Consolidated Bank of Kenya
34. Commercial Bank of Africa
35. Citibank
36. Chase Bank Kenya (In Receivership)
37. Charterhouse Bank Ltd (under Statutory management)
38. CfC Stanbic Holdings
39. Barclays Bank of Kenya
40. Bank of India
41. Bank of Baroda
42. Bank of Africa
43. ABC Bank (Kenya)

Source: CBK 2016 Bank Supervision Annual Report (www.centralbank.go.ke)