

**RESPONSE STRATEGIES ADOPTED BY COMMERCIAL BANKS IN KENYA
TO CHANGES IN ECONOMIC ENVIRONMENT**

BY:

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**A RESEACH PROJECT SUBMITTED IN PARTIAL
FULFILLMENT OF THE REQUIREMENT FOR THE AWARD OF DEGREE
OF MASTER OF BUSINESS ADMINISTRATION, SCHOOL OF BUSINESS,
UNIVERSITY OF NAIROBI**

November, 2012

DECLARATION

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

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DEDICATION

To my late dad, George Ndung'u for the upbringing, believing in that girl child education is important. I miss you great and wish you were around to witness my dreams being fulfilled.

Special thanks to Mum, Mrs Laura Wambui and also my in-laws especially my father in-law, Mr. Jeremiah Inanga for their encouragement. Special thanks to my hubby, Isaac for even the sacrifice and support and To all who supported me in whatever way to accomplish my MBA Programme.

ACKNOWLEDGMENT

I wish to express appreciation and gratitude to all the people that have contributed to the completion of this study.

I had a great fortune to study under supervision of Dr. Vincent Machuki and Professor Ogutu and I am very grateful for their guidance and encouragement. Their profound knowledge provided me with opportunity to broaden my knowledge and take significant progress.

Special thanks to my husband Isaac Thurania and my family as a whole for their ever present love and support ever. Without them none of this would have happened. To my dear friends who always had interesting reasons why I had to keep rolling. Your support propelled me forward.

I finally thank God for providing me with determination and resources both moral and material to accompany my studies.

ABSTRACT

The objective of this study was to identify which response strategies commercial banks in Kenya have adopted due to changes in the economic environment. Dynamic environment changes impact on organizations goals and objectives. This makes it difficult for an organization to remain viable. To be able therefore to stay ahead of competition, it's imperative for organizations to continually scan the environment. This enables the organization to adjust their strategic responses to accommodate the demands of the environment. The appropriate response strategies will guarantee a competitive edge. For the last 10 years Kenya's economy has experienced tremendous changes and they have impacted a lot in all industries in the country. The nature of competition for example has changed. The banking industry has not been spared either. This research project was a survey on all commercial banks. In an effort to meet these objectives the primary data was collected. Primary data was obtained through a questionnaire administered to managers have been involved or responsible for developing strategy. Secondary data was obtained from existing bank publications and annual reports. The study found out that Kenya commercial banks have been able to respond to the changes in their environment through Retrenchment strategies which involved cutting operating costs and divestment of non-core assets. They have also responded to the environment by use of investment strategies which contrast with retrenchment and as such firms perceive these changes as opportunities to invest, innovate and expand into new markets in order to achieve or extend a competitive advantage also noted is the use of Ambidextrous strategies where organizations combine incremental change with discontinuous change, or the exploitation of existing resources to improve efficiency, with exploration of new sources of competitive advantage and innovation. The researcher recommends that in order to stay ahead of competition banks should continuously scan the environment aggressively and also speed up implementation of its strategies.

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CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The environment that organizations exist encapsulates many different influences. The world is facing the severest economic crisis in decades, affecting businesses and communities across the planet. According to Johnson and Scholes (2002) the future environment is likely to be different from the past. These changes in the environment present businesses with a dilemma: whether to cut costs to conserve resource, or to invest in new products and processes to exploit competitor weakness. Having scenarios of possible future would in turn help managers to consider the different ways in which strategies might need to change depending on how the business environment behaves. The external environments influence an organization strategic development by creating both opportunities and threats. In assessing the external environment (Thompson, 1998) look at the remote environment as a set of forces that originated beyond and usually irrespective of any single firm operating situation i.e. political, economical, social and technological factors. Economic considerations include nature and direction of economy in which the business operates.

Despite the fragile global economic environment, slowdown in capital investments and private sector credit, the services sector remains buoyant in Kenya. Regional diversification following East African Community harmonization as well as cross-border investments presents an opportunity for business growth. Developments within the banking sector are strongly guided by the medium-term objectives of the financial sector

reform and development strategy embedded in the economic development blueprint, Vision 2030. In the year 2011, access to financial services continued to be enhanced, spurred by increased innovation in the delivery of financial products and services throughout the country. These developments have been a catalyst to fulfilling the goals of building an all-inclusive and efficient financial system. In Kenya, despite 2011 being a year of accelerated inflation arising from high food and fuel costs, the total population with access to financial services, which is a key indicator of financial sector growth and development, increased. This is attributable to cost effective and efficient innovations within the banking sector, particularly through the mobile money revolution. Commercial banks in Kenya are business companies; however, due to their specifics they must be conservative in their decisions, but dynamic in customer service. These two preconditions are vital for surviving in the competitive environment of business. (Musyoka, 2011) in her article, challenges of strategy implementation in Jomo Kenyatta foundation in the current turbulent economic times, said that firms in Kenya operate under increasing competitive and ever-changing environment. This puts them under pressure to continually review their strategic plans or formulate new ones to suit the existing trends.

All firms therefore need to have a clear understanding of both the external economic trends that directly or indirectly affect their industry because ultimately they will affect consumption patterns. They include interest rates, rates of inflation and trends in the gross Domestic product (Johnson and Scholes, 2002). As the environment changes firms must change their strategies so as to survive. In turbulent environment, strategic thinking

enables organizations to be flexible enough to change accordingly. Rowe et al (1994) describes strategic thinking as ‘an on-going process in which significant events are dealt with in a comprehensive manner’. Strategic thinking is a part of strategic management. Organizations rely on the environment for their inputs and rely on the environment to consume its services or products as outputs. The success of any organization is manifested in attaining a competitive position or series of competitive positions that lead to superior and sustainable performance, (Jauch, 1988). This paper endeavored to look at response strategies commercial banks have adopted due to the changing economic environment in Kenya.

1.1.1 Response Strategies

Response strategies are ways an organization ensures a fit into the changing environment. Pearce and Robinson (2010) defined strategic response as the set of decisions and actions that results in the formalization and implementation of plans designed to achieve a firm’s objectives. Strategic management literature suggests that a successful firm’s strategy must be favorably aligned with the external environment. Jauch (1988) argued that decisions and actions taken will lead to the development of an effective strategy which will help to achieve organizational objectives. Changing business environments alter the way organizations fundamentally conduct business. Such adaptations made to suit the firm may be referred to as strategic response.

For effective strategic responses continuous scanning of both internal and external environment is a prerequisite so as it keeps abreast of all environmental variables underpinning current and future business operations of the firm (Thompson and Strickland, 2003). What is more, firms have adapted to being a ‘learning organization’ in

order to cope effectively with the environment turbulence as failure to do so may jeopardize future success of these organizations (Aosa, 1992). Response strategies may include: response which are beneficial for reasons other than environmental change and justifiable in their own right; economically efficient and cost effective, in particular those that use market-based mechanisms; able to serve multiple social, economic, and environmental purposes; flexible and phased, so that they can be easily modified to respond to increased understanding of business, technological, and economic aspects of businesses environmental change, compatible with economic growth and the concept of sustainable development; administratively practical and effective in terms of application, monitoring, and enforcement; and , reflecting obligations of the areas of financing and technology (Schendel and Hoffer, 1977).

Strategic responses require organizations to change their strategy to match the environment and to redesign their internal capability to match this strategy (Grant, 2011). If an organization's strategy is not matched to its environment, then a strategy gap arises. The degrees to which response are viable will also vary considerably depending on the region or country involved. The implications of specific response will depend on its social, environmental, and economic context (Grant, 2011).

1.1.2 Kenya's Economic Environment

Kenya sustained the momentum of economic recovery through 2010 with real GDP growth of 5.6 percent compared with growth of 1.5 and 2.6 percent in 2008 and 2009, respectively. The favorable economic outcome in 2010 is attributed to several factors including: favorable weather conditions that supported the dominant agricultural sector; increased credit to the private sector, enhanced public investment in infrastructure and a

relatively stable domestic macroeconomic environment all of which supported private consumption and investment demand. The growth enabling environment in 2010 reversed in 2011 with adverse supply side shocks that manifested in higher domestic food and fuel inflation. (Central Bank of Kenya, 2011).

The domestic economy's Gross Domestic Growth (GDP) is estimated to have expanded by 4.4 percent in 2011. High oil and food prices as well as unfavorable weather conditions in some parts of the country were the major causes that restrained growth during the year. Instability in the foreign exchange market experienced during the second half of 2011 further exacerbated the situation by suppressing economic activities. Agriculture and forestry continued to be the main driver of the economy with its share contribution increasing from 21.4 percent in 2010 to 24.0 percent in 2011. Other key sectors whose share increased include wholesale and retail trade and financial intermediation (Central Bank of Kenya, 2011).

The persistence of high interest rates and inadequate long rains are likely to impact negatively on the economic performance in 2012. Government expenditure is likely to rise more rapidly on account of the implementation of the new constitution, particularly the setting up of the county governments and sustained infrastructure projects being undertaken currently (Central Bank of Kenya, 2011).

1.1.3 Banking Industry in Kenya

The banking industry in Kenya is governed by the Companies Act, the Banking Act, the Central Bank of Kenya Act and the various prudential guidelines issued by the Central Bank of Kenya (CBK). The banking sector was liberalized in 1995 and exchange controls lifted. The CBK, which falls under the Minister for Finance docket, is responsible for formulating and implementing monetary policy and fostering the liquidity, solvency and proper functioning of the financial system (PWC, 2012).

As at December 2011, there were forty three banking and non bank institutions, fifteen micro finance institutions and one hundred and nine foreign exchange bureaus. The banks have come together under the Kenya Bankers Association (KBA), which serves as a lobby for the banking sector's interests. The KBA serves a forum to address issues affecting members. The Kenyan banking sector remained resilient in 2011 despite a challenging macro-economic environment. The sector registered a 20.4 percent increase in the total net assets from Ksh. 1.68 trillion in December 2010 to Ksh. 2.02 trillion in December 2011. Similarly gross non-performing loans declined by 8.0 percent from Ksh. 57.6 billion in December 2010 to Ksh. 53.0 billion in December 2011 (Central Bank of Kenya, 2011).

The sector faced challenges in 2011 from increasing levels of inflation, interest rates and exchange rate volatility. The inflation rate which increased from 3.97 per cent in March 2010 to 12.05 per cent in April 2011 stood at 18.93 per cent in December 2011. This was mainly attributed to steep increases in food and fuel prices. The depreciation of the Kenya Shilling against most traded world currencies in the year was attributed to the

Euro sovereign debt crisis that led to increased demand for US dollars and a widening current account deficit. Due to the persistent inflationary pressures and weakening of the shilling, the Monetary Policy Committee adopted a tight monetary stance to tame their effects on the economy. Towards the end of 2011, the Central Bank in collaboration with the Ministry of Finance and Kenya Bankers Association developed a package of measures to be implemented by banks as part of initiatives to mitigate the impact of the sharp increase in interest rates on the borrowers and ensure stability of the banking sector (Central Bank of Kenya, 2011). Players in this sector have experienced increased competition over the last few years resulting from increased innovations among the players and new entrants into the market. The dynamism in Kenyan Banking is expected to continue as banks seek new opportunities in the face of an anticipated subdued risk appetite. The evidence indicates that there is significantly and economically important, negative relationship between both banking sector development and equity market activity, further the relationship is non-linear (Philip, 2001).

Developments within the banking sector are strongly guided by the medium-term objectives of the financial sector reform and development strategy embedded in the economic development blueprint, Vision 2030. Despite 2011 being a year of accelerated inflation arising from high food and fuel costs, the total population with access to financial services, which is a key indicator of financial sector growth and development, increased. This is attributable to cost effective and efficient innovations within the banking sector, particularly through the mobile money revolution and the adoption of branchless banking models like the agency banking model (Central Bank of Kenya, 2011).

1.1.4 Commercial Banks in Kenya

Commercial banks in Kenya are either privately-owned or public-owned institutions that accept monetary deposits, process loans, and provide other financial services, such as international banking, documentary collection, and trade financing (Central Bank of Kenya, 2011). Commercial banks are licensed and regulated by the Central Banks of the jurisdictions (countries) in which they operate (Charlotte, 1999). In Kenya, the Central Bank of Kenya (CBK) licenses, supervises and regulates commercial banks, as mandated under the Banking Act (Cap 488). Kenya currently has 43 licensed commercial banks and one mortgage finance company. Of these 43 licensed commercial banks and one mortgage finance company. Of these 43 institutions, 31 are locally owned and 12 are foreign owned. The Government of Kenya has a substantial stake in three of Kenya's commercial banks. The remaining local commercial banks are largely family owned. Commercial banks in Kenya accept deposits from individuals and turn a profit by using the deposits to offer loans to businesses with a high interest rate (Bank Supervision Annual Report , 2011)

Commercial banks are an important part of the Kenya financial landscape they also offer a wide variety of services. Commercial banks are responsible for adding customer deposits in a safe and liquid form and lending the proceeds to worthy commercial, industrial, governmental and nonprofit institutions. Commercial banks also provide market-making activities in municipal, government and corporate bonds.

Banks provide consulting and advisory services to customers as well as safekeeping and trust. Kenya's commercial banks play a crucial role in ensuring Kenya's economic progress. Kenya's commercial banks like any other organization are open systems operating in a turbulent environment. Their continued survival depends on the ability to secure a "fit" with the environment (Central Bank of Kenya, 2010).

The commercial banks in Kenya are liable to many forms of risk which have triggered occasional systemic crises. These include liquidity risk (where many depositors may request withdrawals in excess of available funds), credit risk (the chance that those who owe money to the bank will not repay it), and interest rate risk (the possibility that the bank will become unprofitable, if rising interest rates force it to pay relatively more on its deposits than it receives on its loan (Central Bank of Kenya, 2011).

The pressures for the currencies to weaken result mainly from the widening of the current account deficit originating from rapid expansion of the oil import bill and imports for infrastructure development. In addition, the exchange rate volatility has been due to the effects of the Euro sovereign debt crisis and currency speculation activities. Given these challenges, the government has agreed to co-ordinate such actions as: Tightening monetary policy, stemming volatility in the foreign exchange markets, and curbing currency speculation activities (Central Bank of Kenya, 2011).

1.2 Research Problem

The dynamism of the environment implies that organization have to constantly redesigned their strategies in order to remain competitive or to survive. Failure to effectively adapt the organization leads to a strategic problem (Ansoff and McDonnel,

1990). Such a problem will be evidenced by a mismatch between what the organization offers and what is in the market. Robinson (2003) states that for such organizations to achieve their goals and objectives it is necessary for them to adjust to their environment by responding strategically to the conditions in the market.

Kenya's ability to achieve its Vision 2030 objectives is not wholly subject to its own making. The global financial crisis which commenced in 2008 has adversely impacted Kenya, and highlighted the importance of external factors in influencing the growth of an economy. Kenya is vitally integrated within the global economy, being dependent on external commodity markets for its exports and critical energy imports, sensitive to the state of global tourism markets, significantly reliant on remittances, a recipient of aid flows, and ambitious in its pursuit of both direct foreign investment flows and possible external credits. There is, thus, an important argument for seeking a policy program that is robust to potential downside risks and the possibility of very different external environments (World Bank, 2006).

The commercial banks in Kenya face challenges which include declining interest margins, global financial crisis which affect the banking industry in Kenya especially in regard to deposits mobilization, reduction in trade volumes and the performance of assets and new regulations; for instance, the Finance Act 2008, which took effect on 1 January 2009 requires banks and mortgage firms to build a minimum core capital of Kshs. 1 billion by December 2012 (CBK Annual Report, 2011). This requirement, help transform small banks into more stable organizations. The implementation of this requirement poses a challenge to some of the existing banks. As such the effects of

dynamic environment require the commercial banks to respond strategically to ensure their survival in the industry. They must therefore look ahead for the various strategies to be able to survive in this dynamic environment since they are open systems (CBK, 2011).

There are a number of local studies that have been done to find out how various organizations have responded to environment challenges. Adoyo (2005) focused his study on responses to changes in the external environment at Postbank. Chepkwony (2001) made an enquiry into strategic responses of petroleum firms in Kenya to challenges of increased competition in the industry. Sheikh (2001) studied the strategic responses and adjustments in strategic variables that insurance companies in Kenya have adopted following liberalization. Kandie (2001) was concerned with strategic responses, Telkom Kenya Ltd is using to cope with the competitive environment. Gitonga (2001) set to identify the strategies that commercial banks have adopted to changes in the environment. Gitonga (2008) studied response strategies of Equity bank to competition in the banking industry. Muchau (2009) and, (Ohaga, 2004) studied strategies adopted by commercial banks in Kenya in response to environmental changes. Gathogo (2001) identified factors affecting commercial banks in Kenya, among them global and local competition, bargaining power of suppliers, increasing demand by customers, changes in information and technology and the threat of substitute products. Machau (2009) and Gitonga (2008) and the rest findings are not exhaustive because there are other ways in which a firm can respond to changes in the environment.

These studies have revealed that different organizations respond to changes in the environment in various ways. Due to contextual differences in the above organizations,

responses adopted may be different. On the basis of extensive literature review this study endeavored to bring out the responses adopted by the commercial banks in Kenya and sought to fill the gap in this area of study; which response strategies commercial banks in Kenya adopt during turbulent economic environment.

1.3 Research Objectives

The objective of this study was to determine response strategies adopted by commercial banks to changes in economic environment in Kenya.

1.4. Value of the Study

The study contributes to the general understanding of changes in the Kenya,s economic environment and it has provided a detailed examination on how banks respond to the changing environment and it has shown that no particular response strategy can guarantee survival and success. Much depends on other contingent factors. There is need for banks to keep continuously scanning the environment. Over reliance of pre-changes success is not a reliable indicator of post-changes success. This suggests that commercial banks in Kenya might be required to adapt to the environmental changes conditions in superior ways that lead to advantages over competitors. Banks adaptation during turbulent economic changes may vary in scope and quality.

Other organizations will benefit from this research as this will help them evaluate their current strategies and plan for the future. Much analysis and commentary is descriptive, and often prescriptive, rather than explanatory. There is a need to draw on studies of adaptation to environmental changes. The relevance of such studies is to understand business adaptation under turbulent economic conditions.

Many studies identify particular adaptations under recession conditions, such as adjustments in marketing, R&D, training, and pricing. They tend not to report, however, whether such changes constitute a fundamental response changes, for example, as part of a retrenchment or investment strategy, as distinct from an operational change. This study provides a foundation for rigorous academic studies focusing specifically on response adaptation under economic environmental conditions, and a basis to elaborate the internal (business) and external (market, institutional, cultural) conditions that make particular response strategies possible, or impossible. This study will also provide a foundation for management of various banks to link response strategy with performance outcomes, or to explain why some banks strategies are more successful than others.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter review literature on the concept of strategy, strategic responses and economic environment as advanced by different authors. It looks at how organizations adapt to their ever changing environment by way of strategic responses which come about when organizations match their strategies to the environment while taking into account their capabilities. Change requires a shift in the assumptions made by the organization and its managers and can result in an organization that differs significantly in structure, processes, culture and strategy. It may conceivably result in becoming an organization that operates in developmental mode, one that continuously learns, adapts and improves (Senge, 1990).

2.2 The Economic Environment

Economic environment have historically been prone to fluctuations - booms and slumps - in aggregate activity over time. These fluctuations, or long waves, were brought to international attention by Kondratiev in the mid-1920s (Mager 1987). Investigating international data on prices from the late-18th century through to the start of the 20th, Kondratiev identified three phases of the economic cycle - expansion, stagnation and recession – each complete cycle taking approximately 50 years. At that time, Kondratiev claimed to have identified three cycles. Economists have subsequently claimed to have detected a fourth and a fifth ‘Kondratiev wave’ based around oil, cars and mass production, and information and communications technologies respectively (e.g. Freeman 1984).

Although many analysts accept that economic fluctuations occur, there is less agreement as to their causes. Some attribute fluctuations to the bunching of innovations; others link fluctuations to the collapse of aggregate demand, itself due to declining investment and ‘animal spirits’ among businesspeople; yet others view the recurrent upswings and downturns as an inherent feature of the economic system rather than as a consequence of shocks such as new innovations. Under the latter view, market economies are perceived as prone to over-accumulation as firms’ pursuit of profit encourages continued investment until a situation of over-capacity is created, with too many goods and services produced relative to the level of aggregate demand. Over-capacity ultimately leads to a crisis of declining profitability, business failure, rising unemployment, and declining consumption – a ‘consumption crisis’. Access to credit can support consumption for a period of time, but not indefinitely. If credit becomes restricted, or consumers become unable to service their debt, then consumption is likely to decline with consequences for GDP and other macroeconomic indicators. Regulation theory provides a way of understanding how economic, social and cultural institutions and norms play a role in stabilizing economic environment and creating the conditions for continued business profitability (e.g. Jessop 1990).

Economic crisis encourages Governments to reconstruct the conditions for profitable business activity through redesigning the institutional and cultural framework within which firms operate. There is no guarantee, however, that any specific set of Government policies will resolve the crisis. Changes in the economic environment impact unevenly on industries, countries, regions and firms (e.g. Connaughton and Madsen 2009) and contribute to structural economic change as resources are transferred between existing industries, and from existing to new industries. Particular economic changes present particular threats to, and enable particular opportunities for, particular firms with implications for strategy and performance. A key issue, therefore, is what lessons the experience of previous economic changes provides to businesses and policy makers.

2.3 The concept of Strategy

Different organizations will respond differently to the changes in the environment. Strategy concerns itself with what an organization is doing in order to gain a sustainable competitive advantage (Porter, 1980). The principal concern of an organization strategy is identifying the business areas in which an organization should participate in to maximize its long run profitability. Business strategy is essentially about two questions: what kind of business is the firm in? And, given this choice, how do firms compete? Strategic management is concerned with how firms generate and sustain competitive advantage in order to generate superior profit. In developing strategy, firms undertake three sets of activities: strategic analysis, strategic choice and strategic implementation. Typically, businesses are reported to assess their strategic position by: scanning the environment for potential market opportunities and threats then evaluating their strategic capability and, assessing the enablers and constraints of strategy. Firms differ in how they undertake these activities. In large enterprises, strategic analysis, choice and implementation are often distinct activities, carried out by different people, whereas in small firms, a single person might perform all three, often at the same time (Curran 1996; O’Gorman 2006).

There are two mainstream schools of strategy in the contemporary literature: the ‘positioning school’ and the ‘resource-based view’ (RBV). The positioning school, popularized by Porter (1980), views the firm as concerned with achieving ‘strategic fit’ with its environment; that is, with evaluating the competitive forces operating within the environment (Porters’ Five forces) to assess where and how best to compete. In the RBV School, initiated by Penrose (1959) and later developed by Rumelt (1984), Wernerfelt

(1984), and Barney (1991), a firm's competitive advantage lies mainly in the bundle of resources at its disposal and how it can stretch these to achieve competitive advantage. Recent analysts have extended the RBV using the concept of 'dynamic capabilities' to refer to the firm's ability to develop and extend resources and competences to adapt to a changing environment (Teece, et al., 1997; Eisenhardt and Martin, 2000; Teece, 2007). In a radically changing environment, such as the current recession, the concept of dynamic capabilities may be helpful in developing a framework for understanding why some firms succeed, some eke out survival, and some fail. There are, therefore, dual concepts of strategic fit and strategic stretch, or more colloquially looking at the firm from the outside in, or from the inside out. Both perspectives are important in explaining business Behaviour, including adaptation under recession conditions.

Johnson and Scholes (1999) view strategy as the direction and scope of an organization over the long term, which achieves advantage for the organization through its configuration of resources within a changing environment, to meet the needs of markets and fulfill stakeholders' expectations. Goldsmith (1995) points out that strategy comprises actions employed to meet a firm's long-term objectives. Pearce and Robison (2000) have recommended three critical ingredients for the success of strategy. These are: Strategy must be consistent with conditions in the competitive environment, it must take advantage of existing and emerging opportunities and minimize the impact of major threats, and strategy must place realistic requirement on the firm's resources.

Strategy, according to Hill and Jones (2001) is an action that a company takes to attain one or more of its goals. More precisely, it is the action that an organization takes to

attain superior performance. Strategy is the pattern of organizational moves and managerial approaches used to achieve organizational objectives and to pursue the organization's mission (Thompson and Strickland, 1993). Andrews (1971) in a more elaborative version, recognized strategy as the pattern of major objectives, purposes of goals, stated in such a way as to define what business the company is in or is to be in, and the kind of company it is to be. Johnson and Scholes (1990) view strategic responses as strategic fit and stretch. The basis of this argument is that strategy is the matching of the resources and activities of an organization to the environment in which it operates. Strategic fit is when an organization develops strategy by identifying opportunities in the business environment and adapting resources and competencies so as to take advantage. This calls for the organization to position itself to meet identified market needs-strategic fit. Stretch is the leverage of the resources and competitive advantage and/or yield new opportunities. This is achieved through differentiation based on the competencies suited to or creating market needs.

According to Thompson (1997) response involves changes in the organizations strategic behavior. The responses may take many forms depending on the organizations capability and the environment in which it operates. Well-developed strategic response is formidable weapon for a firm in acquiring and sustaining a competitive edge. Strategic response may be environmental based, capability based or expectations based. Environmental based response is fitting the strategies to changing environment while capability based is stretching and exploiting of the resources and competencies within the organization. Expectation based response is the meeting of the expectations created by the cultural and political context. Organizations response may fall into two categories

which are the strategic and operational. This could be in the form of market and product coverage, technology, culture change, change leadership and restructuring.

The relationship between business level strategy and environment have been widely discussed in the extent literature (Hambrick 1983; Kim and Lim, 1988, Muller, 1998). Organizations face significant constraints and contingencies from their environment and their competitiveness depends on their ability to monitor the environment and adapt their strategies accordingly (Jennings, 2003).

2.4 Response Strategies to Changes in the Economic Environment

Typically, businesses are reported to assess their strategic position by scanning the environment for potential market opportunities and threats; evaluating their strategic capability; and assessing the enablers and constraints of strategy. Firms differ in how they undertake these activities (Curran 1996; O’Gorman 2006). (John.et.al, 2009) notes that in hyper-competitive or crisis situations, short-term considerations might be dominant. Business restructuring in the form of replacement of managerial elites, functional reorganizations, and other changes to internal arrangements are often a precursor to, or a consequence of, strategic adaptation to inflation (Whittington 1991; Geroski and Gregg 1994).

Economic crises hit consumers psychologically as well as economically. During such times, consumers feel less secure in their employment and argue more about financial matters; they feel the need to work more just to maintain their lifestyle, and that they no longer find any enjoyment in being a consumer (Shama, 1978). Consumers also adapt

their shopping behavior and habits, to be able to adjust to the changing economic conditions. Studies reported in the literature show how consumers affected by crises in Asia and South America made adjustments accordingly and also shows that companies are also affected in many different ways by economic crises. Some are forced to close down and others to drop their production capacity because of insufficient consumer demand for their products and services combined with fierce competition in the marketplace.

Along with the economic crisis, input prices go up and result in higher costs for companies, which inevitably increase their prices to customers. All this negatively affects their competitiveness in the marketplace. Companies are also forced to lay off some of their personnel, and reduce wages, posing considerable managerial challenges (Zehir and Savi, 2004). Managers are furthermore urged to delay or abandon investment projects. Companies react to these changes in the marketplace by taking the appropriate measures to adjust their corporate behavior, as consumers adapt their consumption behavior. The best known general measures include reducing costs, cutting production, reducing investment, entering foreign markets, working more with equity capital, improving efficiency, re-structuring debt, these can have no positive impact on company performance unless they increase sales (Zehir, 2005; Laitinen, 2000; Uslu, 1999; Beaver and Ross, 1999; Pearce and Michael; 1997).

There are a number of approaches to explaining how firms adapt under different conditions. One view argues that incumbent firms suffer from organizational inertia, which prevents them from adapting to new, hostile environmental conditions (Cyert and March 1963).

Businesses are more likely to have slack capacity during periods of falling sales, as resource stocks exceed current use. Under such circumstances, businesses might bring forward investment and innovation plans to take p the resource surplus and because incentives to continue business as usual are reduced. On the other hand, success also creates organizational slack, generating additional resources for innovation (Bourgeois III, 1981).

2.4.1 Retrenchment Strategies

Retrenchment strategies involve cutting operating costs and divestment of non-core assets. In times of turbulent environment, business horizons often shorten with owners/managers focusing on immediate survival rather than on long-term aims. Believing it is easier to reduce costs than generate additional revenue, many businesses choose to retrench. Commentators report divestment of businesses, establishment closure, reductions in working hours and employment, expenditure cuts on a wide range of activities including R&D, marketing and employee training (Rones 1981; Shama 1993; Geroski and Gregg 1997; Michael and Robbins 1998; DeDee and Vorhies 1998).

Geroski and Gregg's (1997) study of 600 mainly large UK manufacturing and service companies during the early-1990s inflation found that most firms adapted by refocusing the business, understood largely in terms of controlling costs, particularly by laying off labor and closing establishments. Expanding or reducing product lines was much less common. The authors argued that, during economic crises, firms have additional incentives to cut costs, in contrast to cyclical upturns where there is less incentive to do so because revenues are rising. Investment in plant and equipment declined but investment in intangibles like training, R&D and advertising was affected less by this. Only a small number of businesses brought forward investment plans because they had the resources and time to do so.

In summary, retrenchment strategies appear to be the most common approach adopted by businesses to deal with economic crisis conditions, especially in the short-term, cutting operating costs and divestment of non-core assets. Looked at in a negative light, cost and asset-cutting might be considered a knee-jerk reaction to adverse market conditions, rather than a proactive strategic repositioning of the firm, and one that weakens the capacity of the business to respond when conditions improve. There is some sensitivity to the variable impacts of economic environmental changes on particular businesses and to the heterogeneity of business responses but beyond that, there is often little analysis elaborating why firms choose to retrench, the conditions enabling or constraining retrenchment, or the connections between retrenchment and business performance.

2.4.2 Investment Strategies

Analysts have identified firms choosing to adapt during economic changes by pursuing investment strategies. In contrast with retrenchment, such firms perceive these changes as opportunities to invest, innovate and expand into new markets in order to achieve or extend a competitive advantage during the changes and beyond. Many of today's household names launched successful businesses during economic crisis. Rockefeller and Carnegie established dominant positions in the emerging oil and steel industries during the 1870s economic environment by taking advantage of new refining and steel production technologies and of the weakness of competitors (Bryan and Farrell 2008), and Edison established General Electric (Lynn 2009). Hershey developed their brand and distribution advantages during the 1893-97 depression and Kellogg's grew out of the 1920s depression (Rumelt 2008). The motor, electrical and chemical industries that were crucial to post-war British industry became prominent during the 1930s. The Microsoft and Apple corporations were both founded in the mid-1970s, following the oil-crisis.

Several studies argue that firms adapt to economic environmental conditions by implementing business strategies centered on investment, innovation and market diversification, and that such strategies lead to higher levels of business performance. Examples include: new product development and targeting new market niches (Clifford 1977; Hayter 1985; Picard and Rimmer 1999); increased marketing spending (Goodell and Martin 1992; Pearce II and Michael 1997; Roberts 2003; Srinivasan et al. 2005; Pearce II and Michael 2006); 'value-centric' pricing strategies, whereby resource-rich firms emphasize quality and brand rather than low prices to attract customers, or, alternatively, adopting 'predatory pricing' policies, to maintain low prices in price-

sensitive markets (Chou and Chen 2002). (Navarro, 2005) gives examples of US-based companies that implemented counter-cyclical strategies regarding human resource management, capital expenditure, acquisition and leveraging macroeconomic risk. These studies provide descriptive data on firms' adaptations to economic environmental conditions but, in most cases, lack insight into why businesses adjust as they do, or are unable to explain why such strategies generate higher levels of performance.

Chou and Chen (2002) are unusual in linking strategy under economic environmental conditions to the firm's resources. Retailers with limited resources were much less likely to be successful in either price- or non-price sensitive markets. Pettigrew (1985) reports that ICI sales rose substantially in the aftermath of the 1973 oil crisis, as shortages of petroleum-based raw materials brought about higher prices.

In summary, the evidence on businesses adopting investment strategies to manage through economic environmental conditions is patchy. Such strategies are risky and many businesses are likely to be too preoccupied with short-term survival to think about innovation and growth. Investment strategies require resources finance, managerial skills, and technical expertise and, firms with limited resources are less able to implement them. Nevertheless, history has shown that companies can secure competitive advantage during turbulent economic environmental conditions through innovation in products, services and business models and by entering new markets. But studies often make little attempt to explain why particular firms adopt investment strategies or to elaborate the conditions that make such strategies possible or, indeed, the potential risks of attempting such strategies. Such accounts imply that where businesses adopt investment strategies,

success necessarily follows. The process of implementing investment strategies and achieving successful outcomes is likely to be much more complex than this suggests. In times of turbulent economic environmental conditions, when many customers trade down to cheaper products, market conditions may not support a wide range of new innovations or a large number of firms seeking to diversify (Pettigrew, 1985).

2.4.3 Ambidextrous Strategies

Ambidextrous organizations combine incremental change with discontinuous change, or the exploitation of existing resources to improve efficiency, with exploration of new sources of competitive advantage and innovation (He and Wong, 2004; Raisch and Birkinshaw 2008). Such organizations are said to combine retrenchment and investment strategies. Indeed, it is likely that most firms adapt under dynamic economic environmental conditions through judicious cost/asset-cutting behavior and through selective investment in product innovation and market development. Accenture (2003b) reported that this was related to what businesses do during good times as well as during dynamic economic environmental conditions. Firms are likely to need to combine increased efficiency with increased innovation in order to position themselves for an upturn. Cost-cutting alone can leave businesses unable to take advantage of an improvement in trading conditions (Accenture ,2003).

Choosing the appropriate investments to make and costs to cut, takes on additional importance during changing economic environmental conditions, when market selection pressures are at their most severe. Geroski and Gregg (1994, 1997), for example, identified firms implementing a wide range of investment and cost-cutting activities.

Whittington (1989), in case studies of eight large enterprises in the UK domestic appliance and office furniture manufacturing industries, found that companies are able to exercise strategic choice even during turbulent periods. Firms, especially large ones, possess the resources to shape their environments and to choose a strategy likely to bring success in that environment. Inflation for example imposes no single logic of cost – or asset-reduction on businesses. Companies responded to inflation with varying mixes of cost-cutting, divestment, capacity expansion and market diversification, and achieved varying levels of performance. Effective response to economic environment changes depends on firms adapting in ways appropriate to their particular circumstances. Not all options were available to all businesses and successful strategies cannot be imitated easily. The most successful companies maintained pricing policies; ‘stuck to the knitting’ regarding product range but invested heavily in production capacity, had strong leadership, high management morale and unusual freedom from parent companies and external shareholders. Stable top management was not necessary for success. Where managements were changed, the effects were generally beneficial although incumbent elites can often reform themselves effectively. Change does not necessarily work and should be done quickly.

Koksal and Ozgul (2007) in a study of 172 Turkish companies found that firms focusing R&D on product development to capture niche markets, and technology and production methods that save costs, perform most successfully during a inflation. Hall's (1980) survey of 64 large US corporations in eight industries in the late-1970s in 'hostile environments', found that high levels of business performance were most likely to be achieved by companies able to achieve either the lowest cost or most differentiated position. Survival is possible for those companies reducing asset commitments into niches and underrating meaningful diversification. Pre-emptive action might enable businesses to cope better once turbulence starts than reacting once difficult economic conditions have begun to bite (Bigelow and Chan, 1992). A study of Nokia reported the successful action taken during buoyant times in anticipation of expected industry changes (Carral and Kajanto 2008). The company disposed of many non-core activities in order to concentrate on the more lucrative mobile telephone market in the late – 1990s. The implication of the study is that businesses should always be looking ahead to anticipate environmental changes that will impact upon them, and take action to adapt before performance declines.

Pearce and Michael (1997), in a study of 188 US manufacturers during the early-1990s inflation, found that firms' prior marketing strategies influenced the extent of the economic impact on the business and the likelihood of a timely and full recovery. They suggest firms maintain marketing activities in the core business and, during peak periods, expand cautiously with an emphasis on marketing efficiency. Planning for inflation might be the best way of adapting to it once it arrives, and of facilitating

survival and possibly growth. In summary, ambidextrous strategies seem to offer firms both a short-term route to survival, as well as longer-term opportunity to secure competitive advantage. Neither retrenchment nor investment strategies alone can be regarded as universal panaceas for turbulent economic conditions. The judicious combination of exploitation (improving efficiency) with exploration (seeking new of competitive advantage) appears to be an important strategy in turbulent economic environment.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter includes a description of the research design, population, sample, data collection. In order to generate data of appropriate range and depth, a questionnaire was adopted.

3.2. Research Design

The research adopted a cross sectional descriptive survey design. Cross sectional descriptive design aimed, to describe or define a subject, by creating a profile of banks through the collection of data and tabulation of the frequencies on research variables or their interaction as indicated by Cooper and Schindler (2003).

A survey was deemed appropriate as it enabled the researcher to make comparisons based on differences in demographics by comparing commercial banks based on the ownership structure and year of incorporation etc. This required a broad range of data which is possible through a survey.

3.3 Population of the Study

The population of interest in this study comprised of all the commercial banks in Kenya. There were 43 commercial banks in Kenya as of December 2011 (CBK Report, 2011).

3.4 Data Collection

The study used a survey questionnaire administered to each member of the population. The questionnaire had both open and close-ended questions. Primary data collection was

through the use of a semi structured questionnaire that was administered by “drop and pick” to strategy managers/marketing managers of each commercial bank. The questionnaire was designed into three sections: A, B and, C. A addressed general information about the bank, B addressed the economic factors and, C addressed the Response strategies the commercial banks have employed to counter challenges emanating from the environment.

The questionnaire consisted of both open and closed-ended questions. The close ended questions provided more structured responses to facilitate tangible recommendations. The closed ended questions were used to the rating of various attributes and this will help in reducing the number of related responses in order to obtain more varied responses. The open-ended questions provided additional information that may not have been captured in the close-ended questions.

3.5 Data Analysis

Data and information obtained through the questionnaire was first checked for completeness. The questionnaires found correctly filled and fit for analysis were coded. Descriptive statistics data analysis method was applied to analyze quantitative data where data was scored by calculating the percentages and means specifically for the purpose of analyzing the quantitative data and presenting it in form of table, tables. Qualitative data analysis method was employed to analyze qualitative data gathered using open end questions. Percentages, means and standard deviation were used to determine the most common environmental challenges and responses strategies. The results from the analysis were presented using tables for easier interpretation.

CHAPTER FOUR

DATA ANALYSIS, FINDINGS AND DISCUSSIONS

4.1 Introduction

This chapter contains data analysis, the research findings and discussions. The objective of this study was to determine response strategies adopted by commercial banks to changes in economic environment in Kenya. The findings are presented in tables, in form of percentages, mean and standard deviations.

4.2. Response Rate

Primary data collection was through the use of a semi structured questionnaire which was administered by “drop and pick” to respondents of the study. The study targeted 43 questionnaires from the commercial banks in Kenya and out the 37 returned, 35 were used in the analysis.

Thus the study managed to achieve 81.4% valid response rate which is significant enough to provide a valid and reliable conclusion about response strategies adopted by commercial banks to changes in economic environment in Kenya. According to Dempsey (2003) a sample size of 50% is appropriate for generalization of the gathered findings in descriptive research.

4.3 Organizational Demographics

Demography seeks to explain properties of populations such as their composition (e.g. age, distribution) or the dynamics (e.g. growth rates), this is because population studies encompass a far broader range of issues and types of research than formal demography.

4.3.1 Years of operation in Kenya

The study sought to determine the number of years the banks had been in operation in Kenya (Table 4.1).

Table 4.1: Years of operation in Kenya

Period of existence in years	Frequency	Percentage
Less than 10 years	10	28.75
11-20 years	18	51.34
21-30 years	5	14.29
Over 30 years	2	5.72
Total	35	100

Source: Research Data, (2012)

Table 4.1 indicates that 51.34% of the banks have been in Kenya for a period of 11-20 years. It can therefore be concluded that commercial banks in Kenya have been in existence for quite a long period of time. It's clear from the literature that regardless of the number of years a bank has been in operation, it must be able to keep scanning the environment, and understand it since banks do not exist in a vacuum but in an environment.

4.3.2 The structure of the bank ownership

The respondents were asked to indicate the structure of ownership of the banks (Table 4.2)

Table 4.2: Distribution of banks by ownership

Ownership	Frequency	Percentage
Private Locally owned	25	71.42
Foreign owned	7	11.43
Public locally owned	3	17.14
Total	35	100

Source: Research Data, (2012)

Privately owned banks are the majority (71.42%). It can be concluded that most commercial banks in Kenya are locally owned.

4.3.1 Scope of Business

The study sought to establish the geographical presence of the banks (Figure 4.1)

Table 4.3: Scope of Business

Ownership	Frequency	Percentage
Nationally	29	82.9%
International	2	5.7%
Regionally	4	11.4%
Total	35	100

Source: Research Data, (2012)

From the figure 4.1, a majority (82.9%) of the banks operate nationally. This shows that the national environment is critical for the majority of the banks since they do not have branches in other countries.

4.4 Economic factors influencing banks operations

The respondents were asked to rate on a scale of 1 – 5, the scale ranged from 1 – not at all to 5 – very great extent, some of the key economic factors and challenges that are likely to impact on the banks. (Table 4.2) shows the results of frequencies, Percentages, mean and standard deviation. (F)=frequency, %=percentage

Table 4.4: Economic factors influencing banks’ operations

Economic factor	not at all	very little	to some extent	to a great extent	very great extent	Mean	Standard deviation
Inflation (f)	4	6	3	12	10		
(%)	11%	17%	9%	34%	29%	3.51	1.59
Foreign Exchange (f)	5	6	5	15	4		
(%)	14%	17%	14%	43%	11%	3.20	1.45
Ministry of Finance Fiscal Policy (f)	4	4	6	7	14		
(%)	11%	11%	17%	20%	40%	3.66	1.74
Unemployment (f)	14	6	5	5	5		
(%)	40%	17%	14%	14%	14%	2.46	1.93
Taxes (f)	5	6	7	8	9		
(%)	14%	17%	20%	23%	26%	3.29	1.63
Competition (f)	5	6	7	8	9		
(%)	6%	11%	14%	11%	57%	4.03	1.70

Source: Research Data, (2012)

From the table The Changes impacted unevenly on Kenya Commercial Banks with foreign Exchange at 43%. Other influences noted included disposable income, consumer spending patterns, consumer willingness to spend, and cost of factors of production, economic decline, liberalization, legislative changes increasing level of education and technological advancement. Identification of these particular factors influencing banks operations however, tells us nothing about how firms choose to adapt or why they do so in the ways they do, or what the consequences of adaptation are.

4.5 Response Strategies

The study sought to examine the response strategies commercial banks adopt a bid to survive due to the changes in the economic environment in Kenya. This section provides the analysis of different responses from questions directed to respondents to find out how the commercial banks respond to environmental changes. All replies indicated that the commercial banks employed certain response strategies.

4.5.1 Retrenchment strategies

The study sought to determine what retrenchment strategies, the banks had adopted in response to environmental challenges. The table 4.3 shows the responses percentages.

Table 4.5 Retrenchment strategies adopted by banks

Frequency (percentage per scale level)							
RETRENCHMENT STRATEGIES	not at all	very little	to some extent	to a great extent	very great extent	Mean	Standard deviation
Cutting operating costs	3%	11%	14%	23%	49%	4.03	1.46
Closing establishments	29%	14%	9%	26%	23%	3.00	2.09

Source: Research Data, (2012)

From table 4.4, a majority (49%) of the respondents indicated that they had cut operating costs as a strategy to responding to environmental challenges. The mean rating for cutting costs as a strategy was 4.03 with a standard deviation of 1.46. The banks reported using some of retrenchment strategies. They had re-examined their portfolios and focused on the core assets, as well as giving them a good reason for increasing efficiency by cutting operating costs and divestment of non-core assets.

4.5.2 Investment strategies

The study sought to determine what investment strategies, if any the banks had adopted in response to environmental challenges. The table 4.4 shows the responses.

Table 4.6: Frequencies of investment strategies

Frequency (percentage per scale level)							
Investment strategies	not at all	very little	to some extent	to a great extent	very great extent	Mean	Standard deviation
Innovation	9%	6%	14%	20%	51%	4.00	1.60
Expansion into new markets	11%	11%	20%	29%	29%	3.51	1.50
Refocusing the business	14%	17%	23%	23%	23%	3.23	1.55

Source: Research Data, (2012)

From table 4.5, a majority of respondents (51%) indicated that they had adopted innovation as a response strategy to a very great extent. Banks have reported adoption on investment strategies to manage through economic environmental conditions. Some of

the response strategies are however risky as they involve a lot of uncertainties. Investment strategies require use of a lot of resources and banks with limited resources are not likely able to implement them.

According to the respondents investments strategies have been used where opportunities for differentiation, segmentation and competitive advantage have been identified, thus concentrating their efforts on specific customers and specific products, relating the two closely and coming up with appropriate service packages such as advantage banking.

Marketing development banking was also identified and banks have radically tried to expand the distribution channels to enhance the banks sales capacity. Some of the banks have opened through agents just like the M-pesa points, agents, co-op kwa jirani etc. Marketing development has also bemused to expand the market geographically and target new markets segments, some banks have reported opening branches especially in rural area and also in some regions outside Kenyan borders like Sudan to ensure that services are accessible to all hence reaching to customer easily. Some banks continue to partner with the Women's Trust Fund, Youth Enterprise Development Fund in order to help address the youth unemployment and other government initiatives. A partnership with lenders was also reported to have been used by some banks as a strategy.

4.5.3 Ambidextrous Strategies

The study sought to examine some of the key ambidextrous strategies used by businesses to remedy environmental challenges.

Table 4.7: Descriptive statistics for ambidextrous strategies

Frequency (percentage per scale level)							
Ambidextrous strategies	not at all	very little	to some extent	to a great extent	very great extent	Mean	Standard deviation
Competitive reward and remuneration package to attract and retain highly skilled labour	17%	26%	26%	14%	17%	2.89	1.48
Reputation on quality of products	2.9%	2.9%	14%	26%	54%	4.28	1.25
Efficiency and reliability in meeting client's needs	0%	2.9%	11%	23%	63%	4.46	1.06
Adopting modern technology in your operations such as e-marketing	2.9%	2.9%	6%	9%	80%	4.60	0.95
Diversifying into other products	2.9%	11%	14%	14%	57%	4.11	1.56
Increasing the number of outlets/branches	8.6%	17%	20%	26%	29%	3.49	1.51
Forming strategic alliances	14%	29%	23%	20%	14%	2.97	1.47
Moderate product diversification	14%	23%	20%	17%	26%	2.88	1.70
Protective diversification	5.7%	8.6%	14.3%	28.6%	43%	1.96	1.40
Rationalizing diversification	5.7%	17%	23%	26%	28.6%	2.06	1.43
Rationalizing focus	29%	20%	23%	20%	8.6%	2.47	1.57

Source: Research Data, (2012)

From table 4.6, adopting modern technology at 80% scored the highest and a mean of 4.60 and a SD of 0.95 meaning most banks responded to the changing economic environment by adopting modern technology.

4.6 Discussion

The objective of this study was to determine response strategies adopted by commercial banks to changes in economic environment in Kenya. From the study, economic environmental changes impact unevenly on Kenya Commercial Banks. There is, therefore, no single ‘effect’ for businesses, nor any particular ‘best way’ to adapt to environmental changes applicable to all businesses. A banks performance is optimized when the aggressiveness of its strategic behavior matches its environment turbulence, the responsiveness of the firm’s capability matches the aggressiveness of its strategy and the component of the firm’s capability supports each other as noted by Ansoff and McDonnell (1997).

The results of this study have also supported the hypothesis of Mintzberg’s (1977) notion that organizations through a stream of decisions develop a certain pattern to orient themselves towards the environment. Taking into account the nature of strategic decisions as including high resource commitments and affecting the overall scope and direction of a company, and building on former perspectives on strategic adaptation (e. g. Miles and Snow, 1978; Eunn et al., 2005; Dervitsiotis, 2006),

The researchers defines strategic adaptation for the purpose of this study as the process by which management actively aligns an organization to a changing environment through setting actions which involve high resource commitments and affect the organization’s overall scope and direction. Complex adaptive systems do not reach end points in which they are fully fitted to their environment – they rather improve, learn or align than optimize as (Holland, 1992; March, 2008) noted.

Changing environments can pose constraints as well as create opportunities for organizations (Hrebiniak and Joyce, 1985). Commercial banks in Kenya are faced by various economic changes regardless of the number of years in operation or scope of business from the changes in the environment. Commercial banks have a huge task of pleasing, retaining and attracting customers with varied preferences and tastes and, to keep up with competition and the same time meet its shareholders expectation profitably. Liberalization of the Kenyan economy has led to an increase in the number of financial institutions so most businesses have now to be competitive, thus making search for a competitive edge, a continuous preoccupation. Technological advancement has resulted in the concerns, home banking as well as internet banking however, not all of the factors impact to the banks at the same rate. The social cultural environment variables like younger population, more educated population and changing lifestyles such as spending patterns and social habits had some impact on banks. The high awareness of banks products as the population became elite was also cited. Such difficult economic conditions pose major threats to, but perhaps also offer important opportunities for, businesses. Strategies employed in turbulence impact on both short-term company performance as well as long-term performance in recovery (Whittington, 1991). Legislative changes have led to a reduction of interest margins at commercial banks. In addition conversion of non-banking institutions into commercial banks as well as the increase of micro-finance institutions and co-operative societies has intensified the competition facing commercial banks. Consequently reduction in income generated by commercial banks both interests and transaction charges. Increasing level of education, exposure and awareness among Kenyans, has led to the emergence of more interests and

demanding customer. Commercial Banks in Kenya have to understand marketing segmentation and develop a variety of products to satisfy the constantly changing customer needs. It was found that an over-reliance on retrenchment strategies can result in negative long-term effects (DeDee and Vorhies, 1998), while counter-cyclical investment strategies can potentially lead to higher performance during recovery (Whittington, 1991; Roberts, 2003; Wan and Yiu, 8 2009). Already Edith Penrose (1995) in her classic work *The Theory of the Growth of the Firm*, first published in 1959, found that “depression is sometimes looked on as a good time to expand: costs are low, plant can be constructed and equipment bought cheaply.

Third, it was proposed by several authors (e.g. Chastain, 1982; Laitinen, 2000; Pearce and Michael, 2006; Kitching et al., 2009; Rhodes and Stelter, 2009) that a balanced (or ambidextrous in the words of Kitching et al., 2009) approach covering both short term efficiency improvements and selective market-oriented investments can lead to a higher chance of success both during as well as after the economic changes. Smith and Grimm (1987) and Haveman (1992) found that adapting an organization’s strategy under conditions of major environmental change raises both its chances of survival and its financial performance potential, with firms responding timely to environmental change being able to outperform those with longer reaction times. Firms need to co-evolve with their environment (Teece, 2007), which makes continuous adaptation to changes within a firm’s environment a basic prerequisite for effective strategic management (Hofer and Schendel, 1978; Chakravarthy and Lorange, 1984).

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter represents the summary, conclusion and recommendations from the finding. The overall purpose of the study was to identify the response strategies adopted by commercial banks in Kenya to changes in the economic environment. The study established that there are various response strategies that commercial banks in Kenya have adopted due to changes in the economic environment and each bank has been experimenting various available options.

5.2 Summary of findings

Results indicated that environmental changes have occurred in the economic environment in Kenya which has made an impact on commercial banks. Results also indicated that commercial banks are adopting various strategies a bid to survive. Business strategy and performance vary with resources and capabilities, owner/manager perceptions of the threats faced and opportunities. Firms' resources and capabilities may be exploited to increase operational efficiency, or dynamic capabilities may be developed to explore new opportunities for revenue generation. Johnson and Scholes (2003), noted that dealing with the environmental is difficult because of three main factors; the diversity of the different influences that affect businesses, the speed of change where the pace of technology is high and the speed of global communications which makes it impossible to identify all factors in play.

To leverage their capabilities, commercial banks in Kenya are implementing a variety of strategies, for example, portfolio strategy (divestment, acquisition, alliance, new product development), growth strategy (for example, consolidation, withdrawal, launching new products, entering new markets), business strategy (for example, cost focus, differentiation or hybrid) and financing strategy (for example, debt rescheduling, raising equity). Strategies are implemented through a range of revenue generation and efficiency-enhancing actions. Performance outcomes include sales, profit and market share achieved. Retrenchment strategies involve cutting operating costs and divestment of non-core assets.

Investment strategies may involve expenditure on innovation and market diversification. Recession can be regarded as an opportunity to implement strategic change that would otherwise not have occurred. The evidence on businesses adopting investment strategies to manage through economic changes is evident, however, it is patchy. Such strategies are risky and many firms are likely to be too preoccupied with short-term survival to think about innovation and growth, or lack the resources to implement such strategies effectively.

Ambidextrous strategies combined retrenchment and investment. It is likely that most firms adapt under recession conditions through judicious cost/asset-cutting behavior and through investment in product innovation and market development. Choosing the appropriate investments to make and, costs to cut, takes on additional importance for

commercial banks during turbulent economic changes when market selection pressures are at their most severe. It is impossible to survive in today's world without leveraging on new technology. In this regard, banks have been reported to have invested in the state of the art new core banking system, so that they can serve their customers better. With the mobile phone becoming a major driver of money transfer service delivery, they have introduced m-banking to enable tap into the growing channel. They have also continued to innovate new ways, and products and services that will bring financial services to the growing population and financial needs.

The banks are expected to continue exploring other areas of new product offering which are innovative and cost-effective in reaching their customers such as agency banking, internet banking amongst other in order to capture the growth opportunities. The banks are also reported to have adopted a marketing system to reach its clients alongside the use of modern information systems. In the process of creating these response strategies, Kenya Commercial banks have encountered a cost of financial expenditure like in the case of new and modern information system. Banks have also reported to have partnered with the government to bring the digital village to every constituency in the country. This is to enlighten the rural population and in recognition that without being digitally connected countrywide, they cannot play in the e-commerce world which is going to be the economy of tomorrow.

5.3 Conclusion

The objectives of this study were to identify response strategies adopted by commercial banks in Kenya to changes in economic environment. Considering that almost all these

institutions are locally owned and they have been in existence for quite a while in Kenya therefore, they must continuously scan the environment to be at par with the changes regardless of the size. In today's increasingly global economic environment, Kenya commercial banks might have to adapt to the economic environment in quite different ways in comparison with previous changes. Such a break is likely to require organizations to reconfigure their business models as well as their organizational structures and operations. Continuing 'business as usual' appears not to be an option for most, if not all, organizations.

Second, banks experiences of, and responses to, these changes are diverse. Businesses adopt a variety of strategic approaches to dealing with environmental conditions. Some firms focus on retrenchment activities, entailing cost/asset-reduction, in order to conserve resources; other businesses use changes to exploit opportunities to invest, innovate and diversify; yet others, perhaps most, adopt an 'ambidextrous' approach combining judicious cost/asset-reduction activity with equally carefully chosen investment projects to expand sales, profits and/or market share. Although widely regarded as giving business owners/managers good reasons to engage in retrenchment, environmental changes also creates opportunities for innovation by incumbent banks, to stay in the game, and by new entrants who spot an opportunity. Businesses, as the researcher concluded, are more likely to succeed if they combine strategies of cost efficiency and retrenchment (exploitation) with strategies of innovation and positioning for future growth (exploration).

Further, the study indicates that there is still need for more response strategies available for the banks to enable them to fully match the environment in which it operates. These include expediting services with speed and certainty and developing and motivating their employees through training. Effective response to these changes depends on firms adapting in ways appropriate to their particular circumstances. Not all options were available to all banks and successful strategies cannot be imitated easily considering each bank is unique.

There is no single 'best practice' strategy that guarantees banks's survival, or success, under these changing economic conditions. The available evidence offers no consensus as to whether retrenchment, investment or ambidextrous strategies are more likely to bring about survival or success. Banks need to be agile, to spot and exploit changes in the environment, as well as being able to absorb, to withstand market shifts, thus displaying agile absorption the ability to consistently identify and seize opportunities.

5.4 Recommendations for Policy and Practice

Based on the findings commercial banks have been identified that the commercial banks in Kenya must devise strategies in order to cope up with the environmental changes, they have to continuously scan the environment and be able to respond accordingly. The researcher recommends that Kenya Commercial banks should not only concentrate on attracting new customers but also emphasize on developing extensive distribution channels to gain a competitive edge in the market.

Recent advances in ICT sectors offer greater convenience and flexibility to consumers. The economic integration of the East African Community and the recent developments in Southern Sudan which offer more opportunities to Kenyans is an opportunity banks can pursue and they should invest on the research and development to seize the opportunities as they present themselves for expanding their businesses beyond the Kenyan borders.

The banks should also realign their organizational structure from vertical to horizontal to develop internal capability of quicker decision making and high feedback and this can also help the banks to facilitate specialized services and creating a niche for their customers. The study also recommends the use of product differentiation to counter competition. The current economic changes represent both a threat and an opportunity for Kenyan commercial banks. Grasping the opportunities would be key to securing the competitive advantage of Kenya commercial banks in the global arena. Policy can play a role in supporting Kenya commercial banks either to exploit the opportunities enabled by changes in the economic environment, or to manage the threats posed, but given the knowledge limitations and broader institutional constraints arising from globalizing tendencies, it should also be acknowledged that there are strong limits to what is possible.

5.5 Limitations of the Study

During the study a number of limitations were encountered, the researcher was not able to prescribe of how businesses ought to adapt because little attention is given to the conditions that make such adaptations possible and influence performance of various banks.

The researcher was not also able to know yet whether particular adjustments will increase banks performance or not and what the specific reasons for performance improvements might be, or what policy initiatives might restrict the severity of the changes and lay the foundations for improving the banks performance

The study focused on Kenyan banking industry and although, the industry maybe similar, there are specific factors such as size, which may not be universally applicable to all. The Kenya Banking Industry is growing and changing drastically therefore the finding of this research may have some variation.

5.6 Suggestions for Further Studies

This study was only for Commercial Banks in Kenya. The study can be conducted for commercial banks in other nations facing maybe similar challenges and see whether its applicability is to all.

There was very little analysis elaborating why banks choose to adopt any specific response strategy, the conditions enabling or constraining each strategy, or the connections between the response strategy and business performance in the short run so a study can be conducted to elaborate why banks choose to adopt certain response strategies and those enabling or constraining of the same.

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APPENDICES

Appendix 1: Letter of Introduction

April, 2012

To: The Management,
.....Ltd,
P. O. Box
Nairobi.

Dear Sir/Madam,

RE: REQUEST TO COLLECT DATA FOR MBA RESEARCH PROJECT

I am a student at the University of Nairobi pursuing a Masters Business Administration Program.

Pursuant to the pre-requisite course work, I would like to conduct a research project on **RESPONSE STRATEGIES ADOPTED BY COMMERCIAL BANKS IN KENYA TO CHANGES IN THE ECONOMIC ENVIRONEMNT**. The focus of my research will be the Commercial Banks in Kenya and this will involve use of questionnaires administered to members of the management team.

I kindly seek your authority to conduct the research in this bank through questionnaires and use of relevant documents. I have enclosed an introductory letter from the University. Your assistance is high valued. Thank you in advance.

Yours faithfully,

THURANIRA CONSOLATA
MBA, Student , University of Nairobi

Appendix II: Questionnaire

A study is being conducted on response strategies by response strategies adopted by commercial banks in Kenya to changes in economic environment. To enable the researcher to come up with a meaningful evaluation of the subject, please answer all the items in the questionnaire. Information given will be treated in strictest confidence.

SECTION A: GENERAL INFORMATION

1. Name of Bank (optional) _____

2. Position in the Bank _____

3. Year of Operation in Kenya (Tick whichever appropriate)

- | | | | |
|---------------|--------------------------|---------------|--------------------------|
| 0 - 5 Years | <input type="checkbox"/> | 5 - 10 Years | <input type="checkbox"/> |
| 10 - 15Years | <input type="checkbox"/> | 15 - 20 Years | <input type="checkbox"/> |
| 20 - 25Years | <input type="checkbox"/> | 25 - 30 Years | <input type="checkbox"/> |
| Over 30 Years | <input type="checkbox"/> | | |

4. Could you please describe the structure of the bank ownership?

5. Private Locally owned() Foreign owned()Public Locally owned ()

6. What is the scope of the banks business?

Nationally () International () `Regionally ()

SECTION B: - ECONOMIC FACTORS

The following are some of the economic factors that affect organizations? Using a scale of 1 to 5 where 1 = not at all, 2 = very little, 3 = to some extent, 4 = to a great extent and 5 = very great extent please indicate how they have affected your organization.

	1	2	3	4	5
Inflation					
Foreign Exchange					
Ministry of Finance Fiscal Policy					

Unemployment					
Taxes					
Competition					
Others (Specify).....					

SECTION C: RESPONSE STRATEGIES

1. The following are some of the response strategies an organization can employ to increased economic environmental changes? Using a scale of 1 to 5 where 1 = not at all, 2 = very little, 3 = to some extent, 4 = to a great extent and 5 = very great extent please indicate what your organization has employed.

STRATEGIC RESPONSES	1	2	3	4	5
RETRENCHMENT STRATEGIES:					

Cutting operating costs					
Closing establishments					
INVESTMENT STRATEGIES:					
Innovation					
Expansion into new markets					
Refocusing the business					
AMBIDEXTROUS' STRATEGIES:					
Moderate product diversification (protect resource base while undertaking some modest pre-emption in existing markets and diversification into others)					
Protective diversification (protect and pre-empt, stressing process innovation, introducing new products, improving existing products and increasing exports)					

Rationalizing diversification (reducing working capital and manpower but combine this with an emphasis on improving existing products and introducing new ones)					
Rationalizing focus (Stressing vertical disintegration, divestment, eliminating product lines, and cuts in manpower and working capital;					
Others (Specify).....					

Others	1	2	3	4	5
Competitive reward and remuneration package to attract and retain highly skilled labour					
Reputation on quality of products					
Efficiency and reliability in meeting client's needs					
Adopting modern technology in your operations such as e-marketing					
Diversifying into other products					
Increasing the number of outlets/branches					
Forming strategic alliances					
Others (Specify.....)					

Give any other comments on changes in economic environment and strategic responses adopted by the banks.

.....

THANK YOU FOR YOUR TIME!