

**STRATEGIC RESPONSES BY STOCKBROKERS IN KENYA TO EXTERNAL  
ENVIRONMENT**

**BY**

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## DECLARATION

This project is my original work and has not been submitted for a degree to any other University.

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Date.....

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This project has been submitted for examination with my approval as University supervisor.

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## **DEDICATION**

I humbly dedicate this work to my dear parents Mr. and Mrs. Muthaura for their unconditional love and support. To both of you thanks and may God bless you for helping me achieve my career dream.

## **ACKNOWLEDGEMENT**

The information herein, which follows the successful completion of Masters of Business Administration, was successful with the help of different individual groups.

First and foremost I would like to thank God for His strength and providence throughout this project.

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## **ABSTRACT**

The purpose of this study was to determine the challenges that emanate from external environment and establish strategic responses employed by stockbrokers in Kenya to deal those challenges. The study sought to answer the following research questions; i) What are the challenges that face stockbrokers in Kenya? And ii) What strategic responses stockbrokers employ to counter the challenges?

This research problem was solved through the use of a descriptive survey design. The target population of this study was all the 17 stockbrokers operating in the NSE as at June 2011. Data for the purpose of the study was collected using questionnaires to the senior administrators of these stock brokerage firms.

Study findings indicated that major specific threats affecting stockbrokers include stiff competition for the few customers participating in the sector, CMA regulations, negative publicity of stockbrokers due to poor corporate governance in the sector and poor financial performance of stockbrokerage firms. Change in technology was another major challenge. On strategic responses applied to counter environmental threats, findings indicate technological adoption, improving customer service and aligning with the demands of the regulators were the major responses.

The following recommendations are made. First, CMA should introduce effective reforms incorporating views of all the stakeholders. Secondly, the political environment should be stabilized to attract foreign investors. Thirdly, NSE should put measures in place to ensure that the current trading system which runs through a wide area network is expanded to cover other major towns in Kenya. Lastly, the study recommends to all stockbrokers to curb insider trading, fraud and unauthorized trading in their companies.

## TABLE OF CONTENTS

<b>DECLARATION.....</b>	<b>i</b>
<b>DEDICATION.....</b>	<b>ii</b>
<b>ACKNOWLEDGEMENT.....</b>	<b>iii</b>
<b>ABSTRACT.....</b>	<b>iv</b>
<b>CHAPTER ONE: INTRODUCTION.....</b>	<b>1</b>
1.1 Background of the Study.....	1
1.2 Research Problem.....	4
1.3 Research Objectives .....	5
1.4 Value of the Study.....	6
<b>CHAPTER TWO: LITERATURE REVIEW.....</b>	<b>7</b>
2.1 Introduction .....	7
2.2 Strategic Responses.....	7
2.3 Concept of Strategy.....	10
2.4 Strategic Management.....	11
2.5 Organizations and The Environment.....	13
<b>CHAPTER THREE: RESEARCH METHODOLOGY .....</b>	<b>18</b>
3.1 Introduction .....	18
3.2 Research Design.....	18
3.3 Target Population .....	18
3.4 Data Collection.....	19
3.5 Data Analysis .....	20
<b>CHAPTER FOUR: DATA ANALYSIS, INTERPRETATIONS AND DISCUSSIONS.....</b>	<b>21</b>
4.1 Introduction .....	21
4.2 Response Rate .....	21
4.3 General Information .....	21

4.4 Challenges From External Environment .....	23
4.5 Strategic Responses to Environmental Challenges .....	27
4.6 Discussion .....	31
<b>CHAPTER FIVE: SUMMARY CONCLUSIONS AND RECOMMENDATIONS.</b>	<b>34</b>
5.1 Summary of findings .....	34
5.2 Conclusions .....	37
5.3 Recommendations for Policy and Practice.....	38
5.4 Recommendations for Further Research .....	39
<b>REFERENCES.....</b>	<b>40</b>
<b>APPENDICES .....</b>	<b>43</b>
Appendix I: Questionnaire To Senior Administrators In Stockbrokerage Firms.....	43
Appendix II: List of Stockbrokers.....	47

## **CHAPTER ONE: INTRODUCTION**

### **1.1 Background of the Study**

Scholes and Johnson (2008) noted that industries are responding to customer's demand by becoming more innovative in their new ways of approaching the changed environment. They adopt strategies such as improved customer services, credit facility, post-paid cards and provision of convenience goods and services. Rapid technological change has created a new business environment where innovation has become a top competitive strategy. According to Ansoff and McDonnell (1990), increased competition has created fundamental shift in economic environment whereas no organization can hope to stay afloat if it fails to come up with proper strategic responses. Terminologies such as retrenchment, mergers, rightsizing and cost reduction have become a routine for survival.

#### **1.1.1 Strategic Responses**

Ansoff and McDonnell (1990) noted that strategic responses involve changes in the firm's strategic behaviors to assure success in transforming future environment. Andrews (1987) defined strategic responses as the set of decisions and actions that result in the formalization and implementation of plans designed to achieve a firm's objectives. Therefore it is a reaction to what is happening in the economic environment of organizations. Porter (2005), views operational responses as part of a planning process that coordinates operational goals with those of the larger organization. Hence operational issues are mostly concerned with certain broad policies and policies for utilizing the resources of a firm to the best support of its long term competitive strategy.

#### **1.1.2 Environmental Changes**

Environmental issues have increasingly attracted corporate attention in recent years. The environment in which organizations operate is constantly changing with different factors influencing the organizations (Welch and Welch, 2005). Since the turn of the millennium, the general business environment has become more volatile, unpredictable and very competitive. Coping with the increasingly competitive environment has called on firms to



rethink their marketing strategies (Pearce and Robinson, 2001). The days when firms could simply wait for clients to beat a path to their door are long gone. Organizations must realize that their services and products, regardless of how good they are, simply do not sell themselves (Welch and Welch, 2005).

Policy and institutional factors play a key role in development of the capital markets. Investors require confidence, protection and information to participate in the market. Firms look for fiscal incentives, ease of entry and the internal firm policy. For a capital or money market to contribute significantly in the development process it requires that the market cater for a diverse risk preferences, be liquid, efficient and have minimal volatility. To achieve this, there must be a sound fiscal and monetary policy, effective legal and regulatory framework, secure and efficient settlement and custodial system, effective information disclosure system, a diversified investor base, favourable tax policies and an effective financial system.

### **1.1.3 Capital Markets in Kenya**

The capital market in Kenya is made up of stock market, bonds, development financial institutions, and pension funds. While the stock market has been in existence since 1920s, it failed to pick the growth momentum and currently, the market has just about 50 listed firms which are less than what the country inherited at independence. The bonds market is in its infancy stage almost getting to its youthful stage. DFIs have faced various problems from managerial to financial making it difficult for them to perform their initially desired role.

The stock market saw in early 1990s the set up of the capital market authority that was given the double responsibility for development and regulation of the market operations. However, the performance of the market is an indication that the CMA is not delivering its services adequately. The development role calls for diversification of the financial assets and attracting IPOs. With the regulatory responsibility CMA is expected to keep surveillance of the market. The recent experience with stock brokers failing is an indication that the market is missing out in terms of surveillance. With institutional

development, the market has witnessed, centralization of trading and automation aimed to reduce the transaction period. The market has also seen entry of investment banks that are expected to play various roles including, market making and underwriting. However, they have not managed to perform these roles adequately. The performance of the stock market indicates that the market has not managed to make significant contribution to financing economic growth.

#### **1.1.4 Stockbrokers in Kenya**

The NSE was registered as a limited company under the Companies Act in 1991. With the 1994 CMA Act (Amendments), it became mandatory that a stock exchange approved by the CMA was to be a company limited by guarantee. The NSE Board was expanded from the original five members to incorporate the interests of other market players in the decision-making process. The new Board comprised of 5 brokers drawn from the main brokerage firms, 2 members from listed companies and 3 members to represent investors' interests.

In July 1994, stock brokerage firms were increased for the first time with licensing of seven more stockbrokers. An additional eight stockbrokers were licensed in June 1995 and with the suspension of one stockbroker, the total number of stockbrokers was twenty. The expansion of brokerage firms was meant to enhance competitiveness in trading. In addition, there were considerations to encourage participation of foreign brokers and fund management companies in the domestic capital markets through joint ventures.

Today, there are 19 stockbrokers in the NSE. Kenya's Nairobi Stocks Exchange (NSE) has witnessed a surge of turbulent times for stockbrokers. The most recent example is the Nyaga Stock Brokers which was marred in allegations of unauthorized trading in client's shares and Francis Thuo Stock brokerage firm that went down in similar circumstances. Discount securities and Ngenye Kariuki are other stockbrokers under statutory management. CMA has enhanced regulation of stockbrokers to curb the high mortality rate. An integrated robust regulator will encourage a saving and investing culture among Kenyans. The number of stock brokerage players at the NSE has remained 18 since the

NSE was founded in 1950. The recent entry of Renaissance capital Ltd. only replaced the ill-fated Francis Thuo. This leaves very small room for competition, creating a cartel of few players who decide on who joins the market and how the market is regulated. This has led to the formation of numerous stocks agents that charge exorbitant fees and provide very unprofessional services to their clients.

## **1.2 Research Problem**

The environment from time to time brings threats from all the forces as indicated by Porter (1980). Ansoff (1965) asserts that when a firm fails to respond to a threat, the losses that results continue to accumulate. The strategic response process is initiated once the rational trigger point is reached. This is the point at which accumulated data shows that there is serious decline in performance which cannot be reversed and that special counter measures are required.

Stock market in Kenya has experienced various changes from the changing from the open outcry system to the new electronic trading. There have also been a trend by commercial banks to either acquire brokerage firms or establish securities departments which has added to the number of dealers. The policy framework has changed in Kenya to make the environment conducive for capital market development as a wide range of fiscal and other incentives have been put in place to encourage capital market activities. Legal and regulatory framework for capital markets in Kenya has experienced major changes between 2002 and 2010. Banks in Kenya have dominated long-term financial intermediation in spite of the presence of other financial institutions such as insurance companies, mutual funds, mortgage firms and the stock market. However, in the last decade there has been a gradual shift from an emphasis on the development of banks to the development of the stock market and other institutions alongside banks. Improvement of market infrastructure through the development of an automated central clearing, settlement and depository system (CDS) intended to serve the East African region is also another major change. Pension reform in Kenya has also affected the stock market due to the requirement of mandatory professional management of pension funds. These and other general socio-economic, political and technological changes have made it necessary

for stock exchange players to change their tactics. These changes have culminated in the demise of firms such as Nyaga Stockbrokers and Discount securities and the placement under statutory management of firms such as Ngenye Kariuki Stockbrokers. This indicates that firms which do not change as environment changes will not see tomorrow.

Various studies have been carried out on stockbrokers in Kenya. An example is Kasinga (2001) who studied strategic planning practices employed by stockbrokers in Kenya. In her study she found that various stockbrokers were engaged in formal strategic planning but a few were yet to incorporate formal strategic planning. The current study is different since it will seek to establish the strategic responses established to cope with environmental threats. Another study was by Angulu (2007) which studied response strategies to challenges posed by electronic trading system at the NSE. This study specifically focused on the challenges that cropped up after introduction of electronic trading system which replaced the public outcry system. This study will study responses applied to all the major environmental changes that have affected the firms. Other studies include a study by Nyalle (2007) which studied stock indicators used by stockbrokers and Gatune (2009) who studied corporate governance practices of stock brokerage firms in Kenya. There is a dearth of literature and studies on strategic responses to environmental threats. This study therefore aimed at contributing in filling this gap by answering the following research questions; i) What are the challenges that face stockbrokers in Kenya that emanate from the external environment? And ii) What are the strategic responses employed by stockbrokers in Kenya to counter the challenges?

### **1.3 Research Objectives**

The objectives of the study were to;

- i) Establish strategic responses employed by stockbrokers in Kenya to deal with challenges that emanate from the external environment
- ii) Determine the challenges facing stockbrokers in Kenya that emanate from the external environment

## **1.4 Value of the Study**

This research study will get results that will be of importance to the institutions themselves, the governments which directs policy and regulations in the sector, and the academic community at large. The stockbrokers will have an insight into the strategic responses that are effective in dealing with the environmental challenges in the capital markets. The stockbrokers can therefore copy such responses and fine-tune them to their conditions to deal with various challenges. The management of stock brokerage firms can also find the study results useful by highlighting the major challenges which can inform management on what challenges are prevalent and hence be well equipped to deal with them.

The findings can also be of importance to government and its policy and regulatory framework: Nairobi Stock Exchange and Capital markets Authority. The government will be in a position to put in place effective policies and regulations to help the capital markets and its stakeholders in dealing with the challenges and to ensure that the policy and regulatory framework is conducive to development of the capital markets in Kenya. This can be achieved by having clearly thought and negotiated regulations and policy to drive growth in the sector. The study findings can also be used as input in the policy and regulatory framework design.

The findings also will prove to be important to academic community. The academic community will have added knowledge which can guide training, policy and further research. This study will fill a gap in knowledge that will give students, faculty and the general academic fraternity added knowledge in the field of strategic management.

## **CHAPTER TWO: LITERATURE REVIEW**

### **2.1 Introduction**

The chapter presents literature review on strategy and strategic management and strategic responses that have been applied by businesses globally, regionally and locally. The chapter is organized as follows. First is the discussion of the concept of strategy. Then, strategic management is discussed. Organizations and how they cope with their environments is also discussed and the chapter closes with the responses applied by organizations to cope with their challenges.

### **2.2 Strategic Responses**

According to Johnson and Scholes (2002), dealing with the environment is difficult because of three factors. First is the diversity of the different influences that affect a business. Identifying the environmental influences may be possible but it may not be of much use because no overall picture emerges of the really important influences on the organization. The second difficulty is the speed of change. Managers typically feel that the pace of technological change and the speed of global communications mean more and faster changes than ever before. Third is the problem of complexity. Managers are no different from other individuals in the way they cope with complexities; they try to simplify what is happening by focusing on those few aspects of the environment which have been important historically. It is important to avoid these tendencies whilst achieving an understanding of the environment which is both usable and oriented towards the future.

Ansoff (1965) asserts that when a firm fails to respond to a threat, the losses that results continue to accumulate. The strategic response process is initiated once the rational trigger point is reached. This is the point at which accumulated data shows that there is serious decline in performance which cannot be reversed and that special counter measures are required. Reactive management occurs if the start of the response is delayed past the trigger point. The start of response is delayed past the rational trigger

point due to four factors; systems delay, verification delay, political delay and unfamiliarity delay (Ansoff and McDonnell, 1990).

Systems delay typically occurs in large firms due, in part, to the time consumed in observing, interpreting, collating and transmitting information to responsible managers. In another part, it due to the time consumed by these managers in communicating with one another and establishing a common understanding as well as the time necessary for processing the decisions among the responsible groups and decision levels (Eisenhardt and Martin, 2000). A verification delay may be invoked because some managers will argue that, even though the level of impact has reached unacceptable proportions, there is never an ironclad assurance that the threat is real and that the impact is permanent. They will opt for waiting a little longer to see if the threat will 'blow itself out.' A political delay may occur if certain managers, whose domain contributes to the crisis, feel that the recognition of a crisis will reflect on their reputation and/or will cause them to loose power. Even if they are convinced that the threat is real, they want to fight a delaying action to avoid becoming scapegoats, to gain breathing space to develop a line of defense, or to line up a line of retreat. Unfamiliarity rejection delay would contribute to other three if, as is typical in the Western managerial culture, the managers are trained to trust prior and familiar experiences and reject unfamiliar ones as improbable and invalid. These delays will substantially increase the total cost to the firm. Such response is referred to as reactive management.

The organization will incur two types of costs as a result of delayed response to discontinuous changes. These are the cumulative loss of profit and the cost incurred in arresting or reversing the loss. Management problem is to minimize the total losses (Ansoff and McDonnell, 1990). To survive in a dynamic and highly competitive business environment, different organizations have had to engage various strategic responses to survive. If a firm wants to remain vibrant and successful in the long run, it must make impact assessment of the external environment, especially such relevant groups as customers, competitors, consumers, suppliers, creditors and the government and how they impact on its operations success is dependent on productivity, customer satisfaction and

competitor strength. Critical success factors are crucial to an organization because it takes into consideration fundamental changes in the environment thus making firms proactive rather than reactive. Strategy has an important role in helping businesses position themselves in an industry.

Effective strategic responses may enable a business to influence the environment in its favour and even defend itself against competition. Hamel and Prahalad (1994) also adds that given the current focus in business, there is need to understand competitor strengths in the market and then position one's own offerings to take advantage of weaknesses and avoid head on clashes against strengths. Kanter (2004) says that to adapt to environmental changes, firms require effective leadership. He further states that, while leadership is crucial, most organizations are over-managed and others under-led. In this regard therefore it is necessary to examine what impacts leadership and strategic management have on an organization in relation to its external environment. If a firm wants to remain vibrant and successful in the long run, it must make impact assessment of the external environment, especially such relevant groups as customers, competitors, consumers, suppliers, creditors and the government and how they impact on its operations success is dependent on productivity, customer satisfaction and competitor strength.

Porter (2005) observes that for firms to be able to retain competitive advantage, they need to examine their environment both internal and external and respond accordingly. Ansoff and McDonnell (1990) also point out that the success of every organization is determined by the match between its strategic responsiveness and strategic aggressiveness and how these are matched to level environmental turbulence. This is because each level of environmental turbulence has different characteristics, requires different strategies and requires different firm capabilities. Therefore, each level of environmental turbulence requires a matching strategy and the strategy has to be matched by appropriate organizational capability for survival, growth and development. To be successful over time, an organization must be in tune with its external environment. There must be a strategic fit between what the environment wants and what the firm has to offer, as well



as between what the firm needs and what the environment can provide. The speed or response time to the environment challenges has been identified (Johnson and Scholes, 2002) as a major source of competitive advantage for numerous firms in today's intensely competitive global economy. It's thus imperative to quickly adjust and formulate strategic responses so as not to be overtaken by events. This implies that stockbrokers in Kenya must devise strategic responses to enable them cope with the challenges that emanate from changes in their external environment.

### **2.3 Concept of Strategy**

Strategy is a multi dimensional concept and various authors have defined strategy in different ways. Linn (2007) depicted strategy as the match between an organization's resources and skills and the environmental opportunities as well as the risks it faces and the purposes it wishes to accomplish. Strategy is meant to provide guidance and direction for the activities of the organization. Since strategic decisions influence the way organizations respond to their environment, it is very important for a firm to make strategic plans and define strategy in terms of its function to the environment. The purpose of strategy is to provide directional cues to the organization that permit it to achieve its objectives while responding to the opportunities and threats in the environment (Pearce and Robinson, 2001).

Porter (2005) describes competitive strategy as the search for a favorable competitive position in an industry. Porter further explains the aim of competitive strategy as to establish a profitable and sustainable position against the forces that determine industry competition. This involves identifying sources of competition in the ever-changing environment then developing strategies that match organizational capabilities to the changes in the environment. According to Porter (2005), competitive strategy is about being different. This means deliberately performing activities differently and in better ways than competitors. Strategy, where it comes from and how it operates, are contentious issues in management theory, as witnessed by the volumes of writing on the subject. Hamel and Prahalad (1994) identified ten schools of strategy formulation, but

theirs are one among many attempts to categorize the vast literature and subtly varying approaches on offer.

Ansoff (1965) viewed strategy in terms of market and product choices. According to his view, strategy is the “common thread” among an organization’s activities and the market. Johnson and Scholes (2002) defined strategy as the direction and scope of an organization that ideally matches the results of its changing environment and in particular its markets and customers so as to meet stakeholder expectation. According to Delmar and Shane (2003), strategy is a unified and integrated plan that relates the strategic advantages of the firm to the challenges of the environment and that is designed to ensure that the basic objectives of the enterprise are achieved through proper execution by the organization.

Eisenhardt and Martin (2000) perceive strategy as a pattern or a plan that integrates organization’s major goals, policies and action into a cohesive whole. Porter (2005) has defined strategy as a creation of a unique and vulnerable position of tradeoffs in competing, involving a set of activities that neatly fit together, that are simply consistent, reinforce each other and ensure optimization of effort. Pearce and Robinson (2001) defined strategy as the company’s “game plan” which results in future oriented plans interacting with the competitive environment to achieve the company’s objectives. This definition of strategy is important in this study as it reflects competitiveness in the environment and the game plan aspects, which organizations put into place to be able to compete effectively. Lambert and Knemeyer (2004) stated that managers develop strategies to guide how an organization conducts its business and how it will achieve its objectives.

## **2.4 Strategic Management**

Strategic management as a discipline originated in the 1950s where Selznick introduced the idea of matching the organization's internal factors with external environmental circumstances (Hamel and Prahalad, 1994). This core idea was developed into what we now call strengths, weaknesses, opportunities and threats (SWOT) analysis by Learned,

Andrews, and others at the Harvard Business School General Management Group. Ansoff (1965) built this work by adding a range of strategic concepts and inventing a whole new vocabulary. He developed a strategy grid that compared market penetration strategies, product development strategies, market development strategies and horizontal and vertical integration and diversification strategies. He felt that management could use these strategies to systematically prepare for future opportunities and challenges.

Strategic management is the art and science of formulating, implementing and evaluating cross-functional decisions that will enable an organization to achieve its objectives (Kanter, 2004). It is the process of specifying the organization's objectives, developing policies and plans to achieve these objectives, and allocating resources to implement the policies and plans to achieve the organization's objectives. Strategic management, therefore, combines the activities of the various functional areas of a business to achieve organizational objectives. It is the highest level of managerial activity, usually formulated by the Board of directors and performed by the organization's Chief Executive Officer (CEO) and executive team. Strategic management provides overall direction to the enterprise and is closely related to the field of Organization Studies (Collins, 2001). Ansoff and McDonnell (1990) views strategic management as the determination of the basic long-term goals and objectives of an enterprise, the adoption of courses of action and the allocation of resources necessary for carrying out these goals.

Strategic management is the process of specifying an organization's objectives, developing policies and plans to achieve these objectives, and allocating resources so as to implement the plans. It is the highest level of managerial activity, usually performed by the company's top management and executive team and it is aimed at providing overall direction to the whole enterprise. Strategic management is the set of decisions and actions that result in the formulation and implementation of plans designed to achieve a company's objectives (Pearce and Robinson, 2001). According to McNeilly (2001), strategic management focuses on the total enterprise as well as the environment in which it operates; the direction management intends it to head; management's strategic plan for

getting the enterprise moving in that direction; the managerial task of implementing and executing the chosen plan successfully.

According to Pearce and Robinson (2001), strategic management refocuses the management process, dealing rather with the long term issues instead of operational issues. Many of the challenges faced by managers during earlier periods were similar to those faced by managers today. Managers continue to face many challenges such as increasing worker productivity; meeting the challenge of international competition; replacing obsolete work methods and equipment with newer; more expensive equipment; developing and introducing new products; maintaining employee motivation and morale.

Strategic actions are influenced by the environmental factors. Changes in the environment will lead to changes in objectives and strategy (Pearce and Robinson, 2001). The environment is complex and ever changing and it will continue to change rapidly, radically and unpredictably (Porter, 2005). Therefore managers have to keep reviewing their strategy to match the environmental demand. In order to enhance preparedness in handling surprising events an organization needs to augment the timeliness of managerial response to the surprising changes. This requires the establishment of real time strategic issue management (SIM) systems.

## **2.5 Organizations and The Environment**

One of the primary functions of effective management is to organize and use the available resources in ways which minimize the impact of environmental threats and pressures on the organization (Lambert and Knemeyer, 2004). Organizations must adapt to their environments if they are to remain viable. Welch and Welch (2005) maintain that to maximize long-term effectiveness, organizations need to develop the capability not only to cope with daily events in the environment, but also to cope with external events that are both unexpected and of critical importance. For many organizations crises are unique and rare events. However, in many industries crises may be a regular feature of corporate life. Consequently, a central issue in the process of organizational adaptation is

not only coping with uncertainty, but understanding situations where uncertainty can degenerate into a crisis.

Although the external environments of organizations have been conceptualized in various ways (Lane, 2003), several important dimensions have been underscored. Two major dimensions are of concern for this study: stability and complexity. The concept of turbulence and its opposite, placidity, are key factors. Turbulence is a measure of change as it occurs in the factors or components of an organization's environment. At one end of a continuum of change there is a static environmental state (placidity or no change); at the other end there is a turbulent or dynamic state where all factors are in constant flux (Linn, 2007). The amount of environmental turbulence is closely related to the degree of uncertainty facing an organization.

The rate of change, in addition to the absolute amount of turbulence, is a critical factor. Collins (2001) suggests that the rate of change can be defined by measuring the amount of alteration to major goals in a given period. Andrews (1987) proposes that the higher the change rate in the environment, the higher the number of major organizational goals that must be altered and vice versa. In several studies (Welch and Welch, 2005) the terms discontinuity, dynamism and volatility have been used interchangeably to refer to the rate (or degree) of environmental change.

Complexity is the second critical dimension of the external environment. It refers to the number of factors in the environment that must be taken into consideration by the organization in a decision-making situation (Ansoff, 1965). Scholes and Johnson (2008) defined complexity as the heterogeneity and range of activities relevant to organizational operations. Porter (2005) argues that a simple environment is one in which the external factors with which an organization must deal are few in number and relatively homogeneous. Ansoff and McDonnell (1990) assert that a simple environment frees an organization from the necessities of sophisticated information systems, since there would only be a limited number of information categories to be monitored that would be critical for organizational decision making. Complex environment not only place greater

demands on an information system, but also calls for a higher-quality to account for diverse constituencies in the environment (Pearce and Robinson, 2001).

Environmental complexity may be viewed as a function of both the number of environmental variables and constraints important to the organization, and as a function of the diversity, and number of different components, of the environment (e.g. technological, political, and legal) containing important variables or constraints (Collins, 2001). McNeilly (2001) contend that uncertainty and equivocality are two forces influencing information processing in organizations. During times of rapid technological change and development, within emerging industries, or during the launch of new products, organizations face high uncertainty and high equivocality. The concept of high velocity environments is used to designate those environments which are characterized by rapid and discontinuous changes in demand, competitors, technology, and/or regulation such that information is often inaccurate, unavailable or obsolete (D'Aveni, 2004). This concept implies that there are continuous dynamisms (Linn, 2007) or volatility (Delmar and Shane, 2003), but these are overlaid by sharp, discontinuous change. Dynamism is characterized by the rate of change and innovation in the industry as well as the uncertainty or unpredictability of the actions of customers and competitors (Lane, 2003). Industries operating in high velocity environments, e.g. microcomputers, airlines, and banking, experience such an extreme rate of change that information is often of questionable accuracy and is quickly obsolete (Drejer, 2002).

The environment under which stockbrokers operate in has significantly changed from inception the stock exchange to date. The Government has viewed the reform of the sector as the best option especially if the economy is to shift its reliance on domestic resources to finance domestic investment (Government of Kenya, 1974/78). Despite the Government realizing that the capital market was playing a insignificant role in the development process in the early 1970s, as characterized by weak development of financial institutions and a thin and inactive stock market, revitalization reforms were only implemented in the 1990s following the IFC/CBK (1984) study whose recommendations became a blueprint in the reform process. The Government reaffirmed

its commitment to the reform process in Sessional Paper No. 1 of 1986 (GoK, 1986). The recommendations emphasized the need to develop money and capital markets by diversifying money market instruments and removing taxation differences between the debt and equity finance in order to achieve diversity in the sector. The reform process has been implemented simultaneously with the overall financial sector reforms aimed at enhancing efficiency in the price discovery process, reducing transaction costs, facilitating competitiveness and increasing liquidity. A statutory regulatory framework has been adopted during the reform period charged with the responsibility of protecting the interests of investors in addition to developing the stock market.

A statutory regulatory framework was established as part of the ongoing capital market reforms in an effort to strengthen the regulatory infrastructure. The establishment of CMA was the first step. The main purpose of setting up the CMA was to have a body specifically charged with the responsibility of promoting and facilitating the revitalization process in the stock market. As spelt out in the Capital Markets Authority Act (Cap 485A, 2(11)) the aim of the CMA is to develop all aspects of the capital market with particular emphasis on the removal of impediments and the creation of incentives for long-term investment in productive enterprises. It also targets to protect investors' interests by operating a comprehensive fund to cushion investors from financial loss arising from the failure of a licensed broker or dealer to meet contractual obligations.

Other significant changes in the stock market include changes in the trading system, adoption of technology in share and other securities trading, diversification of number of instruments being traded, change in know-how and preferences of investors and changes required in corporate governance of registered stockbrokers. Various challenges are faced by stockbrokers as their operating environment changes. Key challenges identified are: lack of stock market integration to achieve risk diversification, non-consistent and non predictable macroeconomic environment, lack of proper legal and regulatory framework, little demand of securities from individual investors, low supply of securities, poor market infrastructure, underdeveloped local investment vehicles and lack of adequate positioning to seize the market advantages arising from globalization. Additionally, many

players regulate the Kenyan capital market. They are: the Central Bank of Kenya, Retirement Benefits Authority, Capital Markets Authority and the Commissioner of Insurance. They enact policies that are non-coordinated and sometimes conflicting leading to poor performance of NSE. Weak investor confidence, politics of privatization and parastatal reform have also affected the environment of the stock market.



## **CHAPTER THREE: RESEARCH METHODOLOGY**

### **3.1 Introduction**

This chapter presents the methodology that was used to carry out the study. The chapter considers in detail the methods that were used to collect any primary or secondary data required in the study. In this chapter, the researcher discusses the research design, population size and sample that were used. The researcher also discusses how this data was analyzed giving details of any models or programmes that were used in analysis with reasons as to why these particular models or programmes were used.

### **3.2 Research Design**

This research problem was solved through the use of a descriptive survey design. This enabled an analysis of the strategic responses employed by the stockbrokers in Kenya to take opportunities and counter threats in their external environment. According to Doyle (2004), a survey research refers to a body of techniques for collecting data on human characteristics, attitudes, thoughts, and behavior by obtaining responses from individuals to a set of prepared questions.

### **3.3 Target Population**

The target population of this study was all the 17 stockbrokers operating in the NSE as at June 2011. The study chose this population due to the collapse of 3 stockbrokers which reduced the number of stockbrokers in NSE to 17 from 20. At the time of this study, there were 19 stockbrokers of whom 2 were under statutory management ([www.nse.co.ke](http://www.nse.co.ke)) and were not included in the survey. The researcher viewed that those stockbrokers who are in receivership or who have gone under could not cope with challenges in their external or internal environment hence could not provide important information on the subject. The stock market had also received a lot of attention in the recent past in regards to politicization, reforms and media attention. The stock market is also a very important segment of the capital market that plays a pivotal role in capital deepening. These reasons combined with the collapse of three stockbrokers in a span of two years made this sector an important area of research. The current number of stockholders was therefore

perceived to be in a position to provide in-depth knowledge on how strategic responses are employed in countering challenges in the stock market.

### **3.4 Data Collection**

Data for the purpose of the study was collected using questionnaires to the senior administrators of these stock brokerage firms. The questionnaire was structured to be filled by a senior person in the stock brokerage firm especially those who are at board level. This is because formulation and implementation of strategic responses are top level decisions and information appertaining to these decisions can only be derived from these senior personnel. The questionnaire was the only primary data collection instrument. It was distributed to the senior administrators of each stockbrokerage firm physically at their offices. This resulted to a total of 17 questionnaires being distributed to all the targeted stockbrokers.

The questionnaire was designed to address the research questions. It was divided into three sections; A, B and C. Section A addressed the general information about the stockbrokers and their operations. Section B addressed the specific environmental changes and resultant challenges emanating from these changes while section C dealt with questions about strategic responses the particular stockbroker had devised over the years to counter challenges from the external environment. The questionnaire consisted of open ended and closed-ended questions that were intended at weighing perceptions of respondents on the factors under study.

After designing the questionnaire, the researcher pilot tested the effectiveness of the questionnaire on 3 senior employees from one of the stockbrokerage firms. Respondents were required to critique the questionnaire on content, design and validity for the purpose at hand. This pretest was done to detect and correct any weaknesses in the questionnaire. After the pretest, the researcher made amendments that were deemed necessary.

The researcher then distributed the final questionnaire personally to the senior administrators. An introductory letter accompanied the questionnaire so as to give

authenticity to the research and explain the purpose of the survey. The researcher requested the questionnaire to be filled and collected as arranged and communicated within a period of 5 working days.

### **3.5 Data Analysis**

The data and information obtained through the questionnaire was first checked for completeness. The questionnaires found correctly filled and fit for analysis were coded and all the data entered into statistical package for social sciences and analyzed based on descriptive statistics. The descriptive statistics that were used include mean scores, percentages and ratios. Cross tabulation was also employed on weighing those environmental challenges that are prevalent and those strategic responses that are usually employed in the sector.

Percentages were used to determine the importance of designing strategic responses that are effective in countering environmental challenges. Ratios were used to establish the level of strategic involvement in the response decision. Mean scores were measured to establish the level of importance of a strategic response or environmental change in devising a strategic response. The results from the analysis were then presented using tables, pie charts and bar graphs for easier interpretation.

## **CHAPTER FOUR: DATA ANALYSIS, INTERPRETATIONS AND DISCUSSIONS**

### **4.1 Introduction**

This chapter considers the results and findings from the questionnaire survey. The findings of the study are presented according to the research questions. There were 17 questionnaires distributed to the selected senior employees in the stockbrokerage firms in Nairobi city. The analysis of findings is according to the returned questionnaires from the 17 stockbrokers.

### **4.2 Response Rate**

Of the 17 questionnaires sent to the sampled subjects, all were filled and returned which translated to 100% response rate. This high response rate was achieved since the targeted subjects were few and this enabled the researcher to follow up closely.

### **4.3 General Information**

#### **4.3.1 Years of Operation of the Stockbrokers**

The study sought to establish the number of years the stockbrokers had operated in the industry. Findings are presented in table 4.1.

**Table 4.1: Years of Operation of the Stockbrokers**

<b>Number of years</b>	<b>Frequency</b>	<b>Percent</b>
Below 5 years	1	6
6 - 15 years	11	65
Above 16 years	5	29
<b>Total</b>	<b>17</b>	<b>100</b>

Findings presented in table 4.1 indicate that 1(6%) of the stockbrokers have been operating for less than 5 years while 11 (65%) stockbrokers indicated to have been in operation for between 6 and 15 years. Five (29%) of the stockbrokers had been in the

business for above 20 years. This is an indication that most of these stockbrokers had been in the business for long to have a good understanding of the external environment.

#### **4.3.2 Number of Clients with CDS accounts**

The study sought to establish the number of clients the stockbrokers had who had opened CDSC accounts as required by the Capital markets Authority for securities trading. Findings are presented in table 4.2.

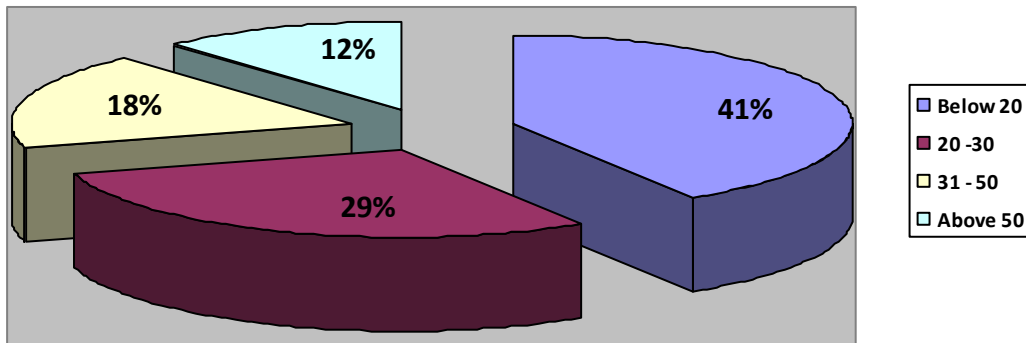
**Table 4.2: Number of Clients with CDSC Accounts**

<b>Education level</b>	<b>Frequency</b>	<b>Percent</b>
Below 10,000	2	12
10,001 – 20,000	3	18
20,001 – 30,000	3	18
30,001 – 40,000	6	36
Above 40,000	3	18
<b>Total</b>	<b>17</b>	<b>100</b>

Findings presented in table 4.2 indicate that 12% of stockbrokers had less than 10,000 customers who had opened CDSC accounts with them. Those stockbrokers who had between 10,000 and 20,000 customers, between 20,000 and 30,000 and above 40,000 customers were 18% in each category. Most of the stockbrokers had between 30,000 and 40000 customers which represented 36% of all stockbrokers. This shows that there are very few individuals who engage in stockbrokerage through stockbrokers compared to the whole population. This is a challenge since it can point to lack of confidence in the investors.

#### **4.3.3 Number of Employees in the Stockbrokerage Firms**

The study sought to find out the number of employees the stockbrokers had. The number of employees indicates the size of the stockbroker which can be a pointer of financial health and performance. Results are presented in figure 4.1.



**Figure 4.1: Number of Employees in Stockbrokerage Firms**

Results presented in figure 4.1 indicate that 41% of the stockbrokerage firms had below 20 employees while those with between 21 and 30 employees were 29%. Those stockbrokers with between 31 and 50 employees were 18% and those with over 50 employees were 12%. The findings show that most of the stockbrokers are small and medium companies with around 50 employees.

#### 4.4 Challenges From External Environment

On challenges from the external environment, the first question to the respondents was on whether the stockbrokerage firms monitor the external environment to establish any threats facing it. Results indicate that all firms followed the events happening in the external environment to ensure that they were well versed with what was going on.

To further assess the challenges that affect stockbrokers from the external environment, respondents were required to state their extent of agreement on some provided statements. These statements were aimed at finding out the threats emanating from the environment that affected stockbrokers. Rating was as follows; Very Great Extent = 5; Great extent = 4; Moderate Extent = 3; Low Extent = 2 and Very Low Extent = 1. Results of analysis of the responses are represented in table 4.3.

**Table 4.3: Changes in stockbrokerage Environment**

Statement	Mean score
The environment under which the stockbroker operates is highly turbulent with a lot of changes that affect our strategy	3.65
There is limited talented pool of employees to provide the stockbroker with requisite skills	2.14

Government usually bring policies and regulations which are costly to cope with	4.12
The stock market is continually changing necessitating the stockbroker to continually transform itself and provide value	4.14
The Stockbroker faces challenges of complying with the capital requirements by CMA	3.65
The stock market is usually affected by political climate in the country at any one time	4.14
The Stockbroker faces problems in trying to source for clients in a market where investor confidence is low	4.21
Competition in the industry is high	3.58
The stockbroker is affected by the changes in technology and finds it hard to cope with such changes	3.75

Findings presented in table 4.3 indicate that the major challenges facing stockbrokers in Kenya include turbulent environment with complexity and dynamic forces with a lot of changes that affect stockbrokers' strategies (3.65). Another major challenge is where the government through its regulatory authority CMA usually brings policies and regulations which are costly to cope with (4.12) and the stock market continually changing necessitating stockbrokers to continually transform themselves (4.14). Stockbrokers facing challenges of complying with the capital requirements by CMA was another major challenge fronted by the respondents (3.65). The political climate in Kenya was also mentioned to affect the stock market (4.14). This was mentioned mostly following the 2007/08 post election violence which caused huge erosion of investor confidence. The political squabbling within the coalition governments was mentioned as a major threat to business in the stockbrokerage sector. Findings also indicate that stockbrokers face problems in trying to source for clients in a market where investor confidence is low (4.21). Competition in the industry (3.58) and technological changes mostly following automation of trading at NSE has affected stockbrokers much (3.75).

#### **4.4.1 Major Threats in Stockbrokerage Sector**

The study sought to establish the major threats facing the stockbrokers from the external environment. Challenges which were mostly mentioned by respondents included stiff competition for the few customers participating in the sector, CMA regulations which were referred to as rigid, negative publicity of stockbrokers due to poor corporate

governance in the sector and poor financial performance of stockbrokerage firms. The industry suffers from perception of low standards of corporate governance. NSE or the brokers were reported not to publish their corporate governance report. Respondents also mentioned another major challenge to be lack of depth in the NSE product offering (e.g. derivatives, option, and securitization). The market was also closely tied to political climate due to the participation of foreign investors who value political stability.

The study established that low investor confidence was a major threat in the stockbrokerage sector. Investor confidence in the country was reported to be picking up by respondents from an all time low in 2010 when retail investors fled the market following the collapse of Francis Thuo and Partners, Nyaga Stockbrokers and Discount Securities with an estimated Sh2.7 billion owed to investors.

Change in regulatory systems to a risk- based instead of a compliance- based approach has also affected stockbrokers according to the study. The Capital Markets Authority was reported to believe that the change will enhance investor protection because its regular performance reporting structure enables quick interventions as soon as liquidity problems emerge. The market regulator introduced the risk based capital adequacy (RBCA) on regular reporting to detect firms that could be at risk unlike the compliance approach whose reliance on historical records means the alarm is raised long after danger looms. However, this change has meant more resources by stockbrokers will be applied towards reporting and compliance. Under new laws, the study established that investment banks were required to raise their minimum capital to Sh250 million, from Sh30 million, while stockbrokers were required to increase their capital to Sh50 million, up from Sh5 million, by the end of March 2011 in order to acquire an operating licence. This was mentioned as a big challenge that threatened some stockbrokers due to the short compliance time provided.

Change in technology was mentioned as another major challenge that has affected stockbrokers in the NSE. The shift from manual trading to the automated system in 2006 ushered in a wave of change including need to install new systems, employ new and



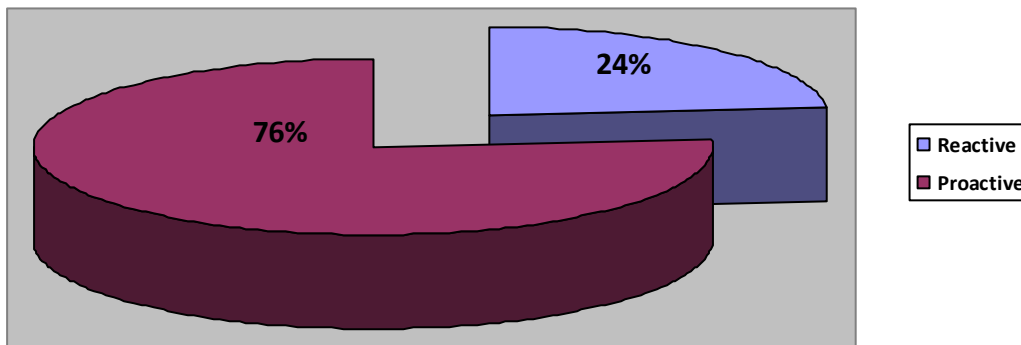
technically versatile employees and train existing employees to use the new system. Stock market jobs have opened to a new breed of dynamic graduates, as stockbroking firms have been forced to change their recruitment by computer trading thus replacing an old elite club of traders with bright young professionals on higher salaries during a time of tough trading and lower volumes. This according to the study has not been helped by the poor performance in the bourse. The pace of the change in staffing to the economics of the sluggish performance of bourse has forced brokerage firms to lay off dealers due to low business. The study established that most of the dealers that were there during the open outcry system have gone. The stockbrokers now have new dealers, some very young, just straight from the university who are on higher salaries thus resulting to a higher wage bill to the brokers. The automated system runs on a wider area network, and is currently only accessible in Nairobi. This makes it not possible for dealers outside the city to access the systems which brings another challenge.

Another challenge mentioned was training of dealers. The study established that there is no university or college that trains stock traders in Kenya. Stock brokerage firms therefore are forced to provide in-house training given by experienced traders. To be a certified dealer, traders must complete an Automated Trading System (ATS) course offered by the NSE. The two-week course is free, but is only open to member firms of the NSE. Stockbrokers must however offer their dealers more training which increases their costs. Dealers are taken through intensive practical sessions on the technical aspects of the automated system, including how to transact, security features, how to place orders, set alerts and monitor bids. Stock trading is a high energy, sensitive and information-based activity. Dealers need to have excellent research skills as well as an ability to see the bigger picture. Good communication skills and aptitude for figures are an added advantage. This however must be enhanced by the stockbrokers to make their dealers competitive in the business.

## 4.5 Strategic Responses to Environmental Challenges

The study was aimed at establishing the strategic responses employed by stockbrokers in Kenya to counter threats from the environment. This section provides the analysis of different responses from questions directed to respondents to find out how stockbrokers respond to environmental threats. The first question inquired on whether the stockbroker had in any way responded to the changes to the external environment mentioned. All replies indicated that the stockbrokers employed certain responses to major external environmental challenges and threats. .

### 4.5.1 Form of Responding To Environmental Changes



**Figure 4.2: Forms of responding to changes**

Findings presented in figure 4.2 indicate that 76% of stockbrokers applied a proactive way of responding to environmental changes while 24% only reacted to changes. This implies that these 24% of the firms did not have a way of monitoring and investigative changes in the environment and only reacted to situations as they emerged.

### 4.5.2 Strategic Responses to Environmental Changes

The study sought to establish what strategic responses the stockbrokers applied to deal with the challenges, changes and threats in the external environment. Various specific responses applicable by stockbrokers were mentioned where the respondents were required to indicate the extent to which the stockbroker applied that strategic response. Rating was on a scale of 1-5 where 1 represented very low extent while 5 represented very great extent. Findings are presented in table 4.4. Those responses with a mean score

above 3.00 were translated to be used greatly while those with a mean score below 3 were translated to be used on a low extent.

**Table 4.4: Changes in stockbrokerage Environment**

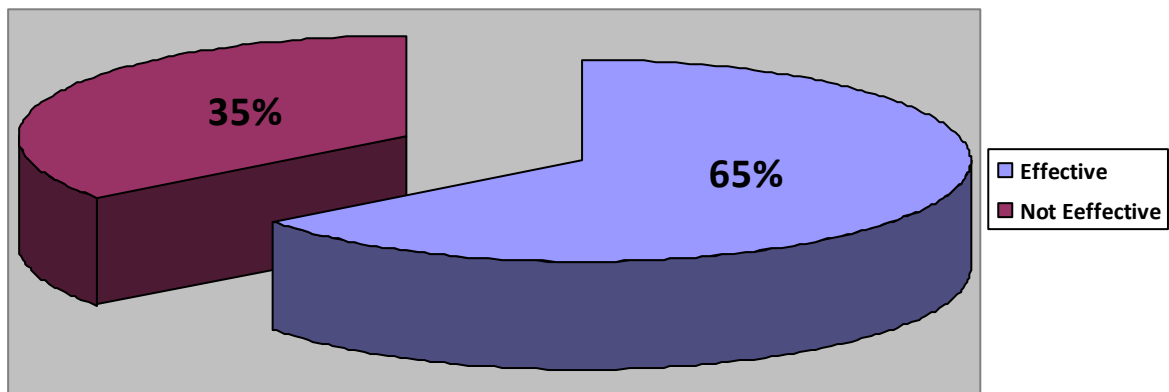
<b>Statement</b>	<b>Mean score</b>
There is a strategic approach to responses to our major challenges	3.32
Top Management provides the leadership and direction in formulating strategic responses	3.98
All stakeholders more so employees and staff are consulted in the designing strategic responses	3.82
There is top management support and commitment to the process of designing and implementing strategic responses	3.76
The stockbroker is fast in responding to environmental threats	3.65
Top Management provide adequate resources to formulate and implement strategic responses successfully	4.14
The stockbroker usually follows the actions of the others in the sector	3.54
The stockbroker usually monitors the environment continually to establish threats and act on them on a timely manner	3.66
Our strategic plans are altered along the way to fit to environmental changes	2.21
The stockbroker always ensures that there is a strategic fit between the strategies and the environment	3.43

Findings as presented in table 4.4 indicate how stockbrokers respond to changes in external environment and how these responses are formulated and implemented. Results indicate that top Management in the stockbrokerage firms provide the leadership and direction in formulating strategic responses (3.98). According to theory, to have effective responses, top management support and commitment is critical in the formulation and implementation phases. Further, results indicate that all stakeholders more so employees and staff are consulted in the designing strategic responses (3.82). This can be explained by the fact that stockbrokers in Kenya are small and medium companies considering the number of employees and hence are closely knit families where team work is crucial. Most of the stockbrokers were reported to be fast in responding to environmental threats

(3.65). Quick response in developing and applying strategic responses is mentioned as one of the major determinants of the effectiveness of the strategic responses. Results also indicate that stockbrokers in Kenya usually follow the steps of the leaders in the industry (3.54).

#### 4.5.3 Effectiveness of Strategic Responses

The study further sought to establish whether the applied strategic responses had been helpful in assisting the stockbroker cope with its challenges. Strategic responses are aimed at strengthening the position of the stockbrokers in taking opportunities and/or dealing with threats in the environment. Effectiveness of the applied strategic responses is critical if the organization needs to position itself well in the market. The findings on the effectiveness of strategic responses are presented in figure 4.3.



**Figure 4.3: Effectiveness of strategic responses**

Results indicate that 11 (65%) of the stockbrokers indicated their responses to be effective while 6 (35%) indicated that the applied responses were not effective. This can be related to the dynamism and complexity of the external environment which sometimes renders strategic responses ineffective due to the turbulent changes.

#### 4.5.4 Effective Ways of Countering Challenges

The study further sought form respondents the strategic responses that stockbrokers can apply to cope with external environment challenges. The most effective ways of countering indicated challenges was mentioned as technological adoption which was

mentioned to lower costs, improve customer service and align with the demands of the regulators. Other responses mentioned included risk management plans which were strategic in nature to reduce regulatory and compliance risks such as taxation and legal framework. Business restructuring and process reengineering were other responses many stockbrokers had applied to cope with the changing capital markets in Kenya. Most of them indicated to have changed materially the way they used to do business five years ago. This was achieved through technological advancement and systems changes and employee empowerment.

Additional capitalization was another response all stockbrokers are engaging in to cope with the requirement of CMA. Another effective strategic response was mentioned to be flexible brokerage commissions. Large clients were said to be involved in negotiations with stockbrokers on the commission to be charged which was not fixed. This paved the way for large clients to be attracted to such stockbrokers due to the negotiable commissions. Customer service was another major strategic responses mentioned to be effective in countering challenges. This was achieved through answering customer queries through e-mails, calls, SMSs and walk in customers.

The study established that installing new trading systems is another responses that many stockbrokers are applying to curb the challenge of fraud by employees and to improve service. Stockbrokers were reported to race towards installing a common and more secure trading system to curb cases of fraud by employees who exploit loopholes in the current operating platforms. The study established that the system, which will have a direct connection between brokers' IT systems and the stock exchange's automated trading system, will reduce fraud by limiting manual processing of investor orders. The study further established that the system has inbuilt alert features that send messages on attempted unauthorized actions for proactively managing any such risks. It has an audit trail functionality that tracks all changes made to data, and keeps a record of who changed it and when. Such changes are made available in a form that is easy to understand. The system was also reported by respondents to sort out dormant accounts and assign extra security authorization requirements before selling of any shares, a

feature that is supposed to protect against sale of shares owned by either inactive or deceased investors.

#### **4.6 Discussion**

This study was aimed at establishing the challenges and strategic responses to these challenges by stockbrokers in Kenya. Stockbrokers are the main players in any dealing of securities in the capital markets. Capital market development is an important component of financial sector development and supplements the role of the banking system in economic development. Specifically, capital markets assists in price discovery, liquidity provision, reduction in transactions costs, and risk transfer. This study established that stockbrokers were reported to race towards installing a common and more secure trading system to curb cases of fraud by employees who exploit loopholes in the current operating platforms. The study established that the system, which will have a direct connection between brokers' IT systems and the stock exchange's automated trading system, will reduce fraud by limiting manual processing of investor orders. This agrees with what Gatune (2009) had recommended after a study at the NSE. Gatune (2009) had indicated that stockbrokers needed to automate their systems to enhance efficiency and good service. Efficient brokers and markets reduce information cost through generation and dissemination of information on firms leading to efficient markets in which prices incorporate all available information. Overall, stock markets provide market liquidity that enables implementation of long term projects with long term payoffs thereby promoting a country's economic growth endeavour. Moreover, efficient capital markets not only avail resources to investors, they also facilitate inflow of foreign financial resources into the domestic economy.

The study established that the stock market had seen many forces that have changed the environment dramatically. The stock market saw in early 1990s the set up of the capital market authority that was given the double responsibility for development and regulation of the market operations. However, the study established that poor corporate governance and collapse of stockbrokers in the recent past has eroded investor confidence. The performance of the market is an indication that the CMA is not delivering its services

adequately. The development role calls for diversification of the financial assets and attracting IPOs. With the regulatory responsibility CMA is expected to keep surveillance of the market. Responses pointed out that the recent experience with stock brokers failing is an indication that the market is missing out in terms of surveillance. Respondents indicated that with institutional development, the market has witnessed, centralization of trading and automation aimed to reduce the transaction period to T+4. The market has also seen entry of investment banks that are expected to play various roles including, market making and underwriting. However, they have not managed to perform these roles adequately. These changes in the operating environment calls for continual surveillance of the market and devise appropriate responses for analyzed threats. This study found that stockbrokers in Kenya are continually monitoring the political, economic, social and technological environment to devise tomorrow's strategies. These findings agree with the observation of Welch and Welch (2005) who pointed out that the days when firms could simply wait for clients to beat a path to their door are long gone. Organizations must realize that their services and products, regardless of how good they are, simply do not sell themselves.

Another major challenge in the capital markets was reported to be lack of depth and diversity in product offering at the NSE. The products on offer remain limited with shares and bonds making the most of trading. There are limited derivative trading, securitization and other hybrid financial instruments. This has led to the poor performance of many stockbrokers who report poor financial results. This indicates that the stock market has not managed to make significant contribution to encouraging participation in trading of securities. This finding agreed with what Gatune (2009) who studied corporate governance practices of stock brokerage firms in Kenya established. Gatune (2009) indicated that securities on offer at the stock market were limited which required measures to ensure diversity and hence attract more investor and more companies requiring funds for investment or risk management options.

Another challenge mentioned to affect stockbrokers was policy and regulatory environment. CMA was mentioned to offer strict and rigid rules making stockbrokers to

go overboard to comply. Policy and institutional factors play a key role in development of the capital markets. Investors require confidence, protection and information to participate in the market. Firms look for fiscal incentives, ease of entry and the internal firm policy. For a capital or money market to contribute significantly in the development process it requires that the market cater for a diverse risk preferences, be liquid, efficient and have minimal volatility. To achieve this, there must be a sound fiscal and monetary policy, effective legal and regulatory framework, secure and efficient settlement and custodial system, effective information disclosure system, a diversified investor base, favourable tax policies and an effective financial system. The regulatory authorities were mentioned as reluctant to offer incentives to stockbrokers such that growth in the capital markets could be achieved. These results agree with those from a study by Angulu (2007) which studied response strategies to challenges posed by electronic trading system at the NSE. Angulu's study established that the electronic trading system challenged stockbrokers in terms of cost, time and training of employees to operate the new system.

The study established that stockbrokers had trained their workforce and top management was supportive in ensuring that appropriate responses were devised. This agrees with strategic management theory that teamwork and top management support, commitment and monitoring was important for any organization to respond effectively to organizational forces. This finding specifically agrees with Kanter's (2004) analysis that indicated that to adapt to environmental changes, firms require effective leadership. He further stated that, while leadership is crucial, most organizations are over-managed and others under-led. In this regard therefore it is necessary to examine what impacts leadership and strategic management have on an organization in relation to its external environment. If a firm wants to remain vibrant and successful in the long run, it must make impact assessment of the external environment, especially such relevant groups as customers, competitors, consumers, suppliers, creditors and the government and how they impact on its operations success is dependent on productivity, customer satisfaction and competitor strength. Stockbrokers were reported to do well on this area.



## **CHAPTER FIVE: SUMMARY CONCLUSIONS AND RECOMMENDATIONS**

### **5.1 Summary of findings**

This study had two twin objectives: to establish the challenges affecting stockbrokers in Kenya that emanate from the external environment and to establish the strategic responses these stockbrokers devise to counter these challenges. This study was necessitated by the continued developments in the capital markets and the external environments of political, economic, social and technological.

The study results indicate that 1(6%) of the stockbrokers have been operating for less than 5 years while 11 (65%) stockbrokers indicated to have been in operation for between 6 and 15 years. Five (29%) of the stockbrokers had been in the business for above 20 years. This is an indication that most of these stockbrokers had been in the business for long to have a good understanding of the external environment. On number of clients with CDS accounts, findings indicate that 12% of stockbrokers had less than 10,000 customers who had opened CDSC accounts with them. Those stockbrokers who had between 10,000 and 20,000 customers, between 20,000 and 30,000 and above 40,000 customers were 18% in each category. Most of the stockbrokers had between 30,000 and 40000 customers which represented 36% of all stockbrokers. This shows that there are very few individuals who engage in stockbrokerage through stockbrokers compared to the whole population. This is a challenge since it can point to lack of confidence in the investors. On number of employees, results indicate that 41% of the stockbrokerage firms had below 20 employees while those with between 21 and 30 employees were 29%. Those stockbrokers with between 31 and 50 employees were 18% and those with over 50 employees were 12%. The findings show that most of the stockbrokers are small and medium companies with around 50 employees.

On challenges from the external environment, results indicate that all firms followed the events happening in the external environment to ensure that they were well versed with what was going on. Further, findings indicate that the major challenges facing stockbrokers in Kenya include turbulent environment with complexity and dynamic

forces with a lot of changes that affect stockbrokers' strategies (3.65) and the stock market continually changing necessitating stockbrokers to continually transform themselves (4.14). Stockbrokers facing challenges of complying with the capital requirements by CMA was another major challenge fronted by the respondents (3.65). The political climate in Kenya was also mentioned to affect the stock market (4.14). This was mentioned mostly following the 2007/08 post election violence which caused huge erosion of investor confidence. The political squabbling within the coalition governments was mentioned as a major threat to business in the stockbrokerage sector. Findings also indicate that stockbrokers face problems in trying to source for clients in a market where investor confidence is low (4.21). Competition in the industry (3.58) and technological changes mostly following automation of trading at NSE has affected stockbrokers much (3.75). Major specific threats affecting stockbrokers identified from the study included stiff competition for the few customers participating in the sector, CMA regulations which were referred to as rigid, negative publicity of stockbrokers due to poor corporate governance in the sector and poor financial performance of stockbrokerage firms. The industry suffers from perception of low standards of corporate governance. NSE or the brokers were reported not to publish their corporate governance report. Respondents also mentioned another major challenge to be lack of depth in the NSE product offering (e.g. derivatives, option, and securitization). The market was also closely tied to political climate due to the participation of foreign investors who value political stability. Low investor confidence was a major threat in the stockbrokerage sector. Investor confidence in the country was reported to be picking up by respondents from an all time low in 2010 when retail investors fled the market following the collapse of Francis Thuo and Partners, Nyaga Stockbrokers and Discount Securities. Change in technology was mentioned as another major challenge that has affected stockbrokers in the NSE. The shift from manual trading to the automated system in 2006 ushered in a wave of change including need to install new systems, employ new and technically versatile employees and train existing employees to use the new system. Stock market jobs have opened to a new breed of dynamic graduates, as stockbroking firms have been forced to change their recruitment by computer trading thus replacing an old elite club of traders with bright young professionals on higher salaries during a time of tough trading and lower volumes.

Another challenge mentioned was training of dealers. The study established that there is no university or college that trains stock traders in Kenya. Stock brokerage firms therefore are forced to provide in-house training given by experienced traders.

On strategic responses applied to counter environmental threats, findings indicate that 76% of stockbrokers applied a proactive way of responding to environmental changes while 24% only reacted to changes. Findings further indicated that top management in the stockbrokerage firms provides the leadership and direction in formulating strategic responses (3.98). Further, results indicate that all stakeholders more so employees and staff are consulted in the designing strategic responses (3.82). The study also established that most of the stockbrokers were reported to be fast in responding to environmental threats (3.65). Specific effective ways of responding to threats was inquired. The most effective ways of countering indicated challenges was mentioned as technological adoption which was mentioned to lower costs, improve customer service and align with the demands of the regulators. Other responses mentioned included risk management plans which were strategic in nature to reduce regulatory and compliance risks such as taxation and legal framework. Business restructuring and process reengineering were other responses many stockbrokers had applied to cope with the changing capital markets in Kenya. Most of them indicated to have changed materially the way they used to do business five years ago. This was achieved through technological advancement and systems changes and employee empowerment. Additional capitalization was another response all stockbrokers are engaging in to cope with the requirement of CMA. Another effective strategic response was mentioned to be flexible brokerage commissions. Large clients were said to be involved in negotiations with stockbrokers on the commission to be charged which was not fixed. This paved the way for large clients to be attracted to such stockbrokers due to the negotiable commissions. Customer service was another major strategic responses mentioned to be effective in countering challenges. This was achieved through answering customer queries through e-mails, calls, SMSs and walk in customers. The study further established that installing new trading systems is another response that many stockbrokers are applying to curb the challenge of fraud by employees and to improve service. Stockbrokers were reported to race towards installing

a common and more secure trading system to curb cases of fraud by employees who exploit loopholes in the current operating platforms.

## **5.2 Conclusions**

From the study findings, the study can make the following conclusions. First, political, regulatory, economic and technological challenges all affect the way stockbrokers operate. With inflation being high, interest rates rising and technological advancement demanding newer technology everyday, stockbrokers are forced to respond to these changes which jeopardize their profitability and even survival. There is a huge confusion in the capital markets and within the financial sector due to the rising cases of collapse of stockbrokers, fraud and weakening of the shilling. There is confusion for management teams, confusion for the customers and confusion for the partners. The Kenyan stockbrokerage sector is also becoming intensely competitive, as more and more players are vying for the same set of customers who are few due to the low investor confidence which went to an all time low in 2010. Stockbrokers are also challenge by the political climate in Kenya which has been not stable enough from the 2007/08 political violence. This has lowered confidence of foreign investors who form a considerable percentage of investors in the capital markets. Another major challenge is the regulatory and policy environment. CMA has introduced various laws and regulations that stockbrokers have to comply with within a short time. This brought panic and rush among the stockbrokers to comply or risk deregistration.

On strategic responses, the study concludes that stockbrokers are employing varied responses to cope with environmental threats. These range from implementing new systems, offering negotiable commissions to large volume trades, improving their customer service and improving corporate governance to reduce cases of fraud and insider trading. Other responses mentioned included risk management plans which were strategic in nature to reduce regulatory and compliance risks such as taxation and legal framework. Business restructuring and process reengineering were other responses many stockbrokers had applied to cope with the changing capital markets in Kenya. Most of them indicated to have changed materially the way they used to do business five years

ago. This was achieved through technological advancement and systems changes and employee empowerment. Additional capitalization was another response all stockbrokers are engaging in to cope with the requirement of CMA.

### **5.3 Recommendations for Policy and Practice**

The study was aimed at establishing the external environment challenges facing stockbrokers in Kenya and the strategic responses that have been employed thereof. Today's organizations engaging in businesses have to contend with the dynamics of a changing external environment. However the modern trend has shifted from external environmental analysis only to more sophisticated internal organizational analysis. The study recommends to stockbrokers in Kenya and other organizations in general having a strategic approach to designing responses to counter threats and take opportunities in the operating environment. The researcher made the following recommendations. First, though reforms are important, CMA should introduce the reforms by first considering the views of all the stakeholders and giving them ample time to align with the new regulations. Reforms are important in the sector to restore investor confidence. This role can be played by all the stakeholders including the government through ministry of finance and central bank. This is because the stock market is affected by all the happenings in the market be it political, economic, technological or social.

Secondly, the political environment should be stabilized to attract foreign investor who can contribute to the financial deepening of the capital markets. Political stability is a strong consideration by foreign investors before investing in the country. Political leaders therefore need to ensure that peace and political stability are paramount more so during this period when elections are nearing. Thirdly, NSE should put measures in place to ensure that the current trading systems which runs through a wide area network is expanded to cover other major towns in Kenya. This would ensure that dealers outside Nairobi can access the system in real time. Further, the study recommends to all stockbrokers to curb insider trading, fraud and unauthorized trading in their companies. This can be achieved by putting in systems that track transactions, dormant accounts and

ensuring that their staff is of high integrity. This would save many stockbrokers from collapse.

#### **5.4 Recommendations for Further Research**

The study was aimed at establishing the challenges facing stockbrokers in Kenya and the responses they employ to counter these threats. The study focused on the stockbrokers who make just a small percentage of the players in the financial markets. This study therefore excluded the investment banks, agents and independent dealers. For further research on strategic responses employed by firms in the financial markets, the researcher recommends another study that will include those players excluded from this study. Another data collection method such as an interview can be used to get in-depth information from the subjects. This would ensure that richer information will be collected.

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## APPENDICES

### **Appendix I: Questionnaire To Senior Administrators In Stockbrokerage Firms**

#### **SECTION A: GENERAL INFORMATION**

(Kindly [√] tick as appropriate or put your response on the space provided)

1. When did the firm start its operations?.....
2. How many clients does the firm have who have opened CDSC accounts?.....
3. How many employees does the firm currently have?.....

#### **SECTION B: CHALLENGES FROM EXTERNAL ENVIRONMENT**

1. Does the stockbroker monitor the external environment to establish any threats facing it?

Yes [ ]

No [ ]

2. State the extent to which you agree or disagree on the statements below (tick appropriately)

Very Great Extent [5]      Great extent [4]      Moderate Extent [3]

Low Extent [2]      Very Low Extent [1]

Statement	Response Ratings				
	1	2	3	4	5
The environment under which the stockbroker operates is highly turbulent with a lot of changes that affect our strategy					
There is limited talented pool of employees to provide the stockbroker with requisite skills					
Government usually bring policies and regulations which are costly to cope with					
The job market is continually changing necessitating the stockbroker to continually transform itself and provide value					
The Stockbroker faces challenges of complying with the capital					

requirements by CMA					
The stock market is usually affected by political climate in the country at any one time					
The Stockbroker faces problems in trying to source for clients in a market where investor confidence is low					
There are limited land/premise resources for expansion of the stockbroker					
Competition in the industry is high					
The stockbroker is affected by the changes in technology and finds it hard to cope with such changes					

3. In your view, what can you tell as the major threats facing the stockbroker from the external environment?

.....

.....

.....

.....

## SECTION B: STRATEGIC RESPONSES TO ENVIRONMENTAL CHALLENGES

1. Does the company employ formal strategic planning in dealing with environmental threats?

Yes [ ]

No [ ]

2. What type of response does the stockbroker usually apply when faced by a threat?

Reactive [ ]

Proactive [ ]

3. If your answer in question 1 is yes, how does the company carry out its strategic planning?

Top to down [ ]

Bottom up [ ]

Combination of the two [ ]

4. State the extent to which you agree or disagree on the statements below (tick appropriately)

Very Great Extent [5]      Great extent [4]      Moderate Extent [3]

Low Extent [2]      Very Low Extent [1]

Statement	Response Ratings				
	1	2	3	4	5
There is a strategic approach to responses to our major challenges					
Top Management provides the leadership and direction in formulating strategic responses					
All stakeholders more so employees and staff are consulted in the designing strategic responses					
There is top management support and commitment to the process of designing and implementing strategic responses					
The stockbroker is fast in responding to environmental threats					
Top Management provide adequate resources to formulate and implement strategic responses successfully					
The stockbroker usually follows the actions of the others in the sector					
The stockbroker usually monitors the environment continually to establish threats and act on them on a timely manner					
Our strategic plans are altered along the way to fit to environmental changes					
The stockbroker always ensures that there is a strategic fit between the strategies and the environment					

5. What are the most effective responses that the stockbroker have adopted which have proved to be very beneficial?.....

.....  
.....  
.....

6. Has the applied strategic responses been helpful in helping the stockbroker cope with its challenges?

Yes    [   ]

No     [   ]

7. What can you recommend to the stockbroker to enable it deal with its challenges and to make its current responses effective?

.....  
.....  
.....  
.....

**‘Thank you for your participation’**

## **Appendix II: List of Stockbrokers**

1. Dyer & Blair Investment Bank Ltd
2. Drummond Investment Bank Limited
3. Ngenye Kariuki & Co. Ltd. ( Under Statutory Management)
4. Suntra Investment Bank Ltd
5. Reliable Securities Ltd
6. CFC Stanbic Financial Services
7. Kingdom Securities Ltd
8. Afrika Investment Bank Ltd
9. ABC Capital Ltd
10. Sterling Investment Bank Ltd
11. ApexAfrica Capital Ltd
12. Faida Investment Bank Ltd
13. NIC Securities Limited
14. Standard Investment Bank Ltd
15. Kestrel Capital (EA) Limited
16. Discount Securities Ltd. (Under Statutory management)
17. African Alliance (Kenya) Securities Ltd
18. Renaissance Capital (Kenya) Ltd
19. Genghis Capital Ltd