

APPLICATION OF PORTER S GENERIC STRATEGIES BY COMMERCIAL BANKS IN KENYA

BY

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A Management Research P-oject Submitted in Partial Fulfillment
of the Requirements for the Award of the Degree of Master of Business
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University of Nairobi.

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DECLARATION

This management project is my original work and has not been submitted for degree award in any other university.

Signed:

Date:.....M I . I . 9 . j . . 0 6

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D/61/P/9031/01

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

Signed: Date:.

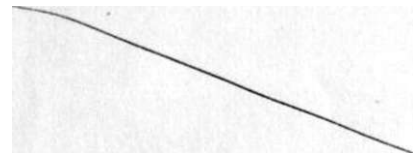
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DEDICATION

This project is dedicated to my parents, James Gakumo Nduma and Peninah Wanjiku Gakumo who instilled in me the value of education and hard work.



ACKNOWLEDGEMENT

I thank all those who contributed in one way or another for the successful completion of this project.

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My The Almighty God bless you all.

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ABSTRACT

The study sought to investigate the application of Porter's generic strategies by commercial banks in Kenya. The study targeted all the 42 commercial banks operating as at the time of the study. Out of the 42 commercial banks, 20 responded constituting 47.6% response rate.

The data was collected using a structured questionnaire which was administered using the "drop and pick later" method. The data collected was analyzed by use of statistical package for social sciences (SPSS) presented in form of percentages, frequency tables and other descriptive statistics such as mean and standard deviation.

The study concludes that 60% of the commercial banks use Porter's generic strategies. Of the respondents, 40% applied differentiation, 15% applied focus while 5% applied cost leadership. A further 40% of the commercial banks were stuck in the middle implying that that they fail to develop their strategy in at least one of the three directions as proposed by Porter.

CHAPTER ONE

INTRODUCTION

1.1 Background

1.1.1 Generic Strategies

All organizations exist in an open system. They affect and are affected by external conditions that are largely beyond their control. A firm's external environment consists of all the conditions that affect its strategic options and define its competitive situation (Pearce and Robinson, 1997). Ansoff and McDonnell (1990), asserts that all organizations are environment dependent. Organizations obtain their inputs from their environment and after transformation they discharge their outputs into the same environment (Porter, 1985). Therefore for an organization to succeed in achieving its objectives, it must pay close attention to its external environment.

Johnson and Scholes (2002), define 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 and to fulfill stakeholder expectations. Hofer and Schendel (1979), define strategy as the basic characteristic of the match an organization achieves with its environment. According to Pearce and Robinson (1997), by strategy, managers mean their large-scale, future-oriented plans for interacting with the competitive environment to optimize achievement of organization objectives. A strategy represents a firm's "game plan" and reflects a company's awareness of how to compete, against whom, when, where and for what. Aosa (1992) argues that strategy is creating a fit between the external characteristics and internal conditions of an organization to a strategic problem, which is a mismatch between the internal characteristics of an organization and its external environment.

According to Porter (1998) competition is at the core of the success or failure of organizations. Competitive strategy is a broad formula for how a business is going to compete that is what its goals should be, and what policies will be

needed to carry out those goals. Strategy relates an organization to its environment. Lynch (2000) defines competitive advantage as the significant advantages that an organization has over its competitors which allow the organization to add more value than its competitors in the same market. Competitive advantage thus answers the question: how should we compete?

To gain competitive advantage in an industry, there is need to understand the industry forces in order to adopt an appropriate competitive strategy (Porter 1998). Porter's five forces model offers an important basis for understanding the nature of competition in an industry .The five competitive forces are: threat of new entrants, threat of substitute products, bargaining power of buyers, bargaining power of suppliers and rivalry among existing competitors. An effective competitive strategy takes offensive or defensive action in order to create a defendable position against the five competitive forces.

The concept of generic strategies is based on the premise that there are a number of ways in which competitive advantage can be achieved depending on the industry structure. If all firms in an industry followed the principles of competitive strategy, each would choose different bases for competitive advantage and while not all would succeed, the generic strategies provide alternate routes to superior performance. The generic strategies are approaches to outperforming competitors in the industry. Porter (1998) identifies three potentially successful generic strategic approaches to outperforming other firms in an industry. These are: overall cost leadership, differentiation and focus.

Overall cost leadership implies that an organization is the low cost producer in an industry for a given level of quality. The organization sells its products either at average industry prices to earn a profit higher than that of rivals, or below the average industry prices to gain market share. On the other hand a differentiation strategy calls for the development of a product or service that offers unique attributes that are valued by customers and that customers perceive to be better

than or different from the products of the competitors. The unique attributes may allow the organization to charge a premium price for the product. The focus strategy concentrates on a narrow segment and within that segment attempts to achieve either a cost advantage or differentiation. The premise is that the needs of the group can be better serviced by focusing entirely on it.

1.1.2 Banking Industry in Kenya

The Banking Act Chapter 488 Laws of Kenya defines a bank as a company, which carries on banking business in Kenya and includes the Co-operative Bank of Kenya Limited but does not include the Central Bank. According to the act, banking business means: the accepting from members of the public money on deposit repayable on demand or at the expiry of a fixed period or after notice, the accepting from members of the public of money on current account and payment on and acceptance of cheques; and the employing of money held on deposit or on current account, or any part of the money, by lending, investment or in any other manner for the account and at the risk of the person so employing the money. Thus a bank is a financial institution that basically accepts deposits from the public and lends the same to persons that require credit the so-called intermediation.

As at June 2005, the Central Bank of Kenya (CBK) monthly economic review indicates that the banking sector comprised of 48 financial institutions with 42 commercial banks (see appendix I), 2 non-bank financial institutions (NBFIs) (one operating and one winding up), 2 mortgage finance companies and 2 building societies. There were also a total of 89 foreign exchange bureaus.

The Market Intelligence business and finance journal, Special Annual Edition 2005, indicates that the banking industry asset base had increased by 16.5% from Kshs 485 billion as at 31st December 2003 to Kshs 565 billion in 2004. The overall profitability of the industry had improved by 6.5% from 14 billion in 2003 to 14.9 billion in 2004. The industry had witnessed entries and exits of both local

and foreign players, successful and failed mergers, and acquisitions. The banking industry environment is highly competitive with introduction of new products the key driver being technology. The banking industry has been liberalized since the early nineteen nineties. The CBK is the regulator of the industry. CBK carries out control measures, supervision and implements prudential regulation. The Kenyan government implements monetary policy through the CBK. This may become more conspicuous with the formation of the monetary policy advisory committee (MPAC).

Various challenges face the banking industry. The most problematic issue has been that of high non-performing loans (NPLs). As at end of May 2005, the NPLs were Ksh71.1 billion or 19.7% of total loans (Central Bank of Kenya). There is stiff competition among the existing banks as many have removed their funds from the government securities especially the treasury bills due to the low interest rates and are now competing to woo customers to take loans from them. Micro-finance institutions and Savings and Credit Societies (SACCOs) are emerging as key players in the delivery of financial services, particularly to marginalized groups. Insurance companies and investment banks are competing with commercial banks in offering some of the financial services. The CBK ensures that all banks comply with section 44 of the banking act, which requires banks to seek approval from CBK whenever they want to make adjustment to their tariffs. From time to time CBK also publishes in the local printed media the various charges and commissions by the various banks. The planned implementation of the in duplum rule whereby banks cease charging interest to a client account once the interest charges in total equal to original loan amount will pose a further challenge to commercial banks. The poor economic performance in the last few years has also been a major challenge but the economy has shown signs of recovery. General insecurity in the country has impacted negatively on the banks, as they have to hire expensive security details.

For any of the banks in the industry to attain a rate of profit above the competitive level then it has to have a competitive advantage by adopting the appropriate competitive strategies. Porter's generic strategies provide a powerful and an important tool for systematically diagnosing the chief competitive pressures in a market and assessing how strong each one is (Thompson and Strickland, 1998). To out-perform their competitors' banks may need to choose and apply Porter's generic strategies. All industries regardless of whether they are in manufacturing, service or not-for-profit organizations can pursue the strategies (Hill and Jones, 2001).

4.1 Statement of the Research Problem

Environmental changes impact on organizations, as they are environment dependent entities. The banking industry has changed from being highly regulated by the government before 1990 to a liberalized industry from the 1990s although some aspects of control are still in place. Globalization, technological advancement and more enlightened, more educated and more demanding customers are other significant changes to impact the banking industry. The banking industry is faced with high non-performing loans, stiff competition from the existing banks and also from other institutions such as micro-finance institutions, saving and credit societies, insurance companies and investment banks. To match the changed environment, commercial banks have to come up with new strategies. According to Porter (1998), competition is at the core of the success or failure of organizations. Competitive strategy is the search for a favourable competitive position in an industry. The two types of competitive advantage an organization can possess are low cost or differentiation. These leads to Porter's three generic strategies: cost leadership, differentiation and focus. With the stiff competition in the banking industry, the individual banks need to adopt certain strategies to outperform the competitors.

Various studies have been conducted touching on various aspects of strategic management in the banking industry. Okode (2004) looked at the application of differentiation strategy in commercial banking in Kenya. Gathoga (2001) researched on the competitive strategies applied by commercial banks. Ohaga (2004) looked at strategic responses of commercial banks in Kenya to changes in their environment. There have also been various case studies covering either change management or strategic responses to environmental changes. These include Musa (2004), Kathuku (2004), Mbogo (2003), Kiptugen (2003) and Goro (2003). In other industries, Gitonga (2003) looked at the application of Porter's generic strategies framework in hospitality establishments in Nairobi. Karanja (2002) carried out a study entitled - Competitive strategies of real estate firms: The perspective of Porter's generic model.

The banking industry faces different challenges from other industries although some of the challenges may be common across many industries. Porter's generic strategies model was found suitable for this study because all businesses or industries regardless of whether they are in manufacturing, service or not -for-profit enterprises can pursue the strategies. The products or services of the different banks are more-or-less equally available. Thompson and Strickland (1998) argue that Porter's generic strategies provide a powerful and an important tool for systematically diagnosing the chief competitive pressures in a market and assessing how strong each one is.

No study on the application of the three Porter's generic strategies by commercial banks in Kenya has been carried out. This raises the following question:

Are commercial banks in Kenya applying Porter's generic strategies?

1.3 Objective of the Study

To establish the application of Porter's generic strategies by commercial banks in Kenya.

1.4 Importance of the Study

(a) This study may provide information to the managers in the banking industry that can be used for industry analysis, strategic planning, change management and choice of strategic options.

(b) The Central Bank of Kenya may benefit from the results of this study in its regulatory role especially on bank charges and commissions.

(c) The study will contribute knowledge to existing literature, which will be a useful reference point to scholars, academicians and researchers.

(d) Other stakeholders such as the Kenya Bankers Association, the Ministry of Finance and various business and finance journals may benefit from the research findings especially in their understanding of the competitive strategies applied in the banking industry.

CHAPTER TWO

LITERATURE REVIEW

2.1 Competition and Industry Forces

According to Porter (1998), every organization competing in an industry has a competitive strategy, which is a broad formula for how a business is going to compete that is what its goals should be and what policies will be needed to carry out those goals. Competitive strategies enable an organization to prosper within an industry and establish a competitive advantage over its rivals.

Lynch (2000), defines competitive advantage as the significant advantages that an organization has over its competitors, which allow the organization to add more value than competitors in the same market. An organization has a competitive advantage whenever it has edge over rivals in attracting customers and defending against competitive forces. Competitive advantage is about how a firm puts the generic strategies into practice.

To gain competitive advantage in an industry, there is need to understand the industry forces in order to adopt an appropriate competitive strategy. Porter's five forces model offers an important basis for understanding the nature of competition in an industry .The collective strength of these forces determines the ultimate profit potential in the industry (Porter, 1998). The five competitive forces are: threat of new entrants, threat of substitute products, bargaining power of buyers, bargaining power of suppliers and rivalry among current competitors. The primary determinant of a firm's profitability is the attractiveness of the industry in which it operates and a secondary determinant being its position within that industry.

The most powerful of the five competitive forces is usually the competitive battle among rival firms (Thompson and Strickland, 1998). How vigorously sellers use the competitive weapons at their disposal to jockey for a stronger market position

and win a competitive edge over rivals shows the strength of this competitive force. For most industries the major determinant of the overall state of competition and the general level of profitability is competition among firms within the industry (Grant, 1998) Porter's generic strategies are the tools or the 'weapons' that industry competitors use to outmaneuver one another.

2.2 Rivalry among Existing Competitors

Rivalry is as a result of competitors trying to outdo each other as each competitor tries to improve its position. Porter (1998) argues that rivalry among existing competitors takes the form of jockeying for position using tactics like price competition, advertising battles, product introductions and increased customer service or warranties. According to the author there are a number of interacting structural factors that result in intense rivalry. These are: numerous or equally balanced competitors, slow industry growth, high fixed or storage costs, lack of differentiation or switching costs, capacity augmented in large increments, diverse competitors, high strategic stakes and high exit barriers.

Rivalry changes i.e. it is dynamic. Thompson and Strickland (1998) suggests two important principles of competitive rivalry: a powerful competitive strategy used by one company intensifies competitive pressures on the other companies, and the manner in which rivals employ various competitive weapons to try outmaneuver one another shapes the rules of competition in the industry and determines the requirements for competitive success. Once an industry's rules of competition are understood, then judgments can be made regarding whether competitive rivalry is cutthroat, intense, normal to moderate or attractively weak.

2.3 Competitive Strategy Models

There are various competitive strategy models which have been developed by various authors and research groups. These includes Ansoffs growth/share matrix, Boston Consulting Group's product portfolio matrix, General Electric

planning grid, Cliff Bowman's competitive strategies and Porter's generic strategies. Pearce and Robinson (1997) also propose the grand strategies.

Ansoff's product-market expansion grid is a marketing tool that is used by firms which have the objective of intensive growth. Ansoff's matrix offers four strategic choices to achieve the growth objective. These are market penetration strategy, market development strategy, product development strategy and diversification strategy (Ansoff, 1990). An organization pursuing a market penetration strategy seeks to gain more market share with its current products in their current markets. A market development strategy entails developing new markets for the current products. Product development strategy entails developing new products in the current markets. The diversification strategy seeks to develop new products for new markets.

The Boston Consulting Group's product portfolio matrix was developed by the Boston consulting group and is an approach to portfolio planning. It has two controlling aspects namely relative market share (i.e. relative to competition) and market growth (Hunger, 1996). The model evaluates strategic business units based on market growth rate and relative market share enabling the management to give consideration to both the future potential of the market and the strategic business units' competitive position. The growth-share matrix is divided into four cells; each indicating a different type of business (Kotler, 2002). These are question marks, stars, cash cows and dogs. Question marks are businesses that operate in high growth markets but have low relative market shares. A star is a leader in a high-growth market. Cash cows are businesses with a high market share in low growth markets. Dogs are businesses that have weak market shares in low growth markets. The four strategic choices are to build, to hold, to harvest or to divest. Under the build strategy the objective is to increase market share. The hold strategy seeks to preserve market share. The objective under the harvest strategy is to increase short-term cash flow

regardless of long-term effect. The divest strategy seeks to sell or liquidate the business because resources can be better used elsewhere.

The General Electric planning grid model is a business portfolio evaluation model based on the argument that it is not always possible to develop objectives or make investment decisions solely on the basis of growth/share matrix. According to Kotler (2002), a strategic business unit's appropriate objective cannot be determined solely by its position in the growth-share matrix. If additional factors are considered, the growth-share matrix can be seen as a special case of a multifactor portfolio matrix that General Electric pioneered. The model identifies business units in terms of market attractiveness and business strengths. The four strategic options under this model are investment and growth, selective growth, selectivity and harvest/divest.

The Bowman's "strategy clock" compares an organization's competitive position in comparison to the offerings of competitors. Bowman considers competitive advantage in relation to cost advantage or differentiation advantage just like Porter's generic strategies. According to Johnson and Scholes (2002), the eight strategic options under this model are low price/low added value('no frills' strategy), low price, hybrid, differentiation, focused differentiation, increased price/standard value, increased price/low values and low value/ standard price. A 'no frills' strategy combines a low price; low perceived added value and a focus on a price-sensitive market segment. A low price strategy seeks to achieve a lower price than competitors whilst trying to maintain similar value of product or service to that offered by competitors. A differentiation strategy seeks to provide products or services unique or different from those of competitors in terms of dimensions widely valued by buyers. A hybrid strategy seeks simultaneously to achieve differentiation and a price lower than that of competitors. A focused differentiation strategy seeks to provide a high perceived value justifying a substantial price premium, usually to a selected market segment. The increased price/standard value strategy suggests increasing price without increasing value

to the customer. This is common with monopoly organizations. The increased price/low value strategy involves the reduction in value of a product or service, whilst increasing relative price. It is only feasible in a monopoly situation. The low value/standard price strategy involves a reduction in value whilst maintaining price.

According to Pearce and Robinson (1997) grand strategies, often called master or business strategies provide basic direction for strategic actions. They are the basis of coordinated and sustained efforts directed toward achieving long-term business objectives. The authors further define a grand strategy as a comprehensive general approach that guides a firm's major actions. The fourteen principal grand strategies are concentrated growth, market development, product development, innovation, horizontal integration, vertical integration, concentric diversification, conglomerate diversification, turnaround, divestiture, liquidation, joint ventures, strategic alliances and consortia.

2.4 Porter's Generic Strategies

An effective competitive strategy takes offensive or defensive action in order to create a defensible position against the five competitive forces thereby yield a superior return on investment for the firm (Porter 1998). Though a firm can have a myriad of strengths and weaknesses vis-a-vis its competitors, there are two basic types of competitive advantage a firm can possess: low cost or differentiation. The significance of any strength or weakness a firm possesses is ultimately a function of its impact on the relative cost or differentiation. The two basic types of competitive advantage combined with the scope of activity for which a firm seeks to achieve leads to three generic strategies for achieving above average performance in an industry (Porter, 1998). These are: overall cost leadership, differentiation and focus. These strategies are called generic because all businesses or industries can pursue them regardless of whether they are manufacturing, service or not-for-profit enterprises (Hill and Jones, 2001). The authors further argue that each of the generic strategies results from an

organization making consistent choices on product, market, and distinctive competences. The choices have to reinforce each other. Porter (1998) indicates that firms cannot focus solely on a cost leadership or differentiation strategy to the exclusion of other strategies. He contends that cost leaders must devote some resources to differentiation activity and those that pursue a differentiation strategy cannot do so to the detriment of their cost structure.

Porter illustrates the three generic strategies in the following diagram:

		COMPETITIVE ADVANTAGE	
		Lower cost	Differentiation
COMPETITIVE SCOPE	Broad Target	1 .Cost Leadership	2. Differentiation
	Narrow Target	3A. Cost Focus	3B. Differentiation Focus

Figure 1: Porter's Three Generic Strategies

Source: Porter, M.E. (1998). Competitive Advantage: Creating and Sustaining Superior Performance. The Free Press

2.4.1 Overall Cost Leadership

This generic strategy calls for being the low cost producer in an industry for a given level of quality. It seeks to attract customers based on cost or price and is very meaningful if the market is price sensitive. According to Kotler and Armstrong (2001), the organization works very hard to achieve the lowest costs of production and distribution so that it can price lower than its competitors and win a large market share. Organizations that achieve low-cost leadership typically make low cost relative to competitors the theme of their entire business strategy (Thompson and Strickland, 1998). The organization sells its products either at average industry prices to earn a profit higher than that of rivals, or below the average industry prices to gain market share. Organizations may acquire cost advantages by improving process efficiencies, gaining unique access to a large source of lower cost materials, making optimal outsourcing and vertical integration decisions, or avoiding some costs altogether. According to Porter (1998), cost leadership requires aggressive construction of efficient-scale facilities, vigorous pursuit of cost reductions from experience, tight cost and overhead control, avoidance of marginal customer accounts and cost minimization in areas like research and development, service, sales force, advertising etc. Porter further suggests various commonly required skills and resources and organizational requirements. These includes substained capital investment and access to capital, process engineering skills, intense supervision of labour, products designed for ease in manufacture, low cost distribution system, tight cost control, detailed and frequent control reports, structured organization and responsibilities and incentives based on meeting strict quantitative targets.

There are certain risks associated with overall cost leadership (Porter, 1998). These are technological change that nullifies past investments on learning, low cost learning by industry newcomers or followers through imitation or through their ability to invest in state-of-the-art facilities, inability to see required product or marketing change because of the attention placed on cost and, inflation in

costs that narrow the firm's ability to maintain enough of a price differential to offset competitors brand images or other approaches to differentiation. A research by Gitonga (2003), found cost leadership to be one of the strategies applied by hospitality establishments in Nairobi.

2.4.2 Differentiation

Differentiation is the development of a product or a service that is perceived industry wide as being unique. Differentiation seeks to provide unique products with unique features. Customers value the unique attributes and the value added by the uniqueness of the product may allow the firm to charge a premium price for it. The organization concentrates on creating a highly differentiated product line and marketing program so that it comes across as the class leader in the industry (Kotler and Armstrong, 2001). Approaches to differentiating can take many forms (Porter 1998): design or brand image, technology, features, customer service, dealer network or other dimensions. Clark (2000) proposes that an organization can make its products different from those of its rivals in terms of quality, branding, aesthetics, durability, taste etc. The firm differentiates along several dimensions. By differentiating an organization seeks to acquire brand loyalty by customers with a resultant lower sensitivity to price. Differentiation does not necessary result in the gaining of a high market share indeed it may be incompatible with a high market share. Profits are made on margins and not volumes. A differentiator still worries about cost because it will influence the margins. According to Porter (1998), achieving differentiation will imply a trade-off with cost position if the activities required in creating it are inherently costly, such as extensive research, product design, high quality materials or intensive customer support.

Differentiation faces a number of risks. These include: imitation from other competitors that reduce the uniqueness, changes in customer tastes and unwillingness by customers to pay the premium price when the cost differential between the low-cost competitors and the differentiated firm becomes too great for

differentiation to hold brand loyalty. A research by Okode (2004) found that commercial banks in Kenya generally applied differentiation strategy as a means of gaining competitive advantage.

2.4.3 Focus

The focus strategy concentrates on a narrow segment and within that segment attempts to achieve either a cost advantage or differentiation. The focus strategy concentrates on a niche market and offers personalized services. The premise is that focusing entirely on it and serving the particular target very well can better service the needs of the group. An organization pursuing a focus strategy achieves either differentiation from better meeting the needs of the particular target, or lower costs in serving this target or both. Focus involves a trade-off between profitability and sales volume (Porter, 1998).

Risks associated with focus strategy are: other focusers may be able to carve out sub-segments that they can serve even better, it may be fairly easy for a broad-market cost leader to adapt in order to compete directly, changes in the target market and imitation. The risk of focus is that you attract major competitors that have waited for your business to prove the market (Pearce and Robinson, 1997). Gitonga (2003) found out some hospitality establishments in Nairobi were applying focus strategy in their operations.

2.4.4 Stuck in the middle

A firm is said to be stuck in the middle if it fails to develop its strategy in at least one of the three directions (Porter 1998). Such a firm will not achieve a competitive advantage and will be in an extremely poor strategic situation. The author further argues that such firms lack the market share, capital investment and resolve to play the low cost game, the industry wide differentiation necessary to obviate the need for a low cost position, or the focus to create differentiation or low-cost position in a more limited sphere. The firm stuck in the middle

experiences low profitability resulting from losses of high-volume customers who are price sensitive to low cost firms and losses of high margin customers to overall differentiated firms. The firm may also portray a confusing image and suffers from a blurred corporate culture and a conflicting set of organizational arrangements and motivation system. Kotler and Armstrong (2001), argues that middle-of-the-roaders try to be good on all strategic counts, but end up being not very good at anything. A research by Karanja (2002), covering the real estate firms found that there were a percentage of firms stuck in the middle who were more or less guaranteed of low profitability.

The requirements for the generic strategies have been summarized by Porter as per the following table:

GENERIC STRATEGY	COMMONLY REQUIRED SKILLS AND RESOURCES	COMMON ORGANIZATIONAL REQUIREMENTS
Overall cost leadership	Sustained capital investment and access to capital. Process engineering skills, intense supervision of labour. Products designed for ease in manufacture. Low-cost distribution system.	Tight cost control. Frequent, detailed control reports. Structured organization and responsibilities. Incentives based on meeting strict quantitative targets.
Differentiation	Strong marketing abilities. Product engineering. Creative flair. Strong capability in basic research. Corporate reputation for quality or technological leadership. Long tradition in the industry or unique combination of skills drawn from other businesses. Strong cooperation from channels.	Strong coordination among function in research and development, product development and marketing. Subjective measurement and incentives instead of quantitative measures. Amenities to attract highly skilled labour, scientists, or creative people.
Focus	Combination of the above policies directed at the particular strategic target.	Combination of the above policies directed at the particular strategic target.

Figure 2: Requirements of the Generic Strategies

Source: Porter, M. E. (1998), Competitive Strategy: Techniques for Analyzing Industries and Competitors. The Free Press.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Research Design

The study will be conducted by way of a census survey. It will seek to establish the application of Porter's generic strategies by commercial banks in Kenya.

3.2 Population of Study

The research will be a census study involving a survey of all the 42 commercial banks in Kenya (Central Bank of Kenya, June 2005). A census of the banks will be necessary due to the relatively small size of the population. This will provide an overall picture of the application of Porter's generic strategies in the commercial banking sector.

3.3 Data Collection

Primary data for the purpose of this study will be collected using a structured questionnaire (see appendix 2). One respondent for each bank will be interviewed. The respondents will be the persons vested with the responsibility of managing the organizations and setting strategy in commercial banks from the different bank's head offices. The questionnaire will consist of two parts, A and B. Part A will contain questions on the general characteristics of the banks while part B will address the objective of the study. The questionnaires will be administered using the "drop and pick later" method.

3.4 Data Analysis

The data collected will be edited and then coded. Descriptive statistics will be used to analyze the data. These will include percentages, frequency distribution tables and other descriptive statistics such as mean and standard deviation. The statistical package for social sciences (SPSS) will be used for this analysis. This analysis is suitable where there are several variables under consideration, a group of which refer to one major variable. This will establish which of the Porter's generic strategies are being pursued by the commercial banks

CHAPTER FOUR DATA ANALYSIS AND FINDINGS

4.1 Introduction

This chapter presents analysis and findings of the research. From the study population targets of 42 banks, 20 responded to the questionnaire, constituting 47.6% response rate. The data in the study was summarized and presented in the form of percentages, tables and other descriptive statistics such as mean and standard deviation.

4.2 General Information

Table 1: Classification of commercial banks by ownership

Ownership	Frequency	Percentage
Locally owned	11	55.0
Foreign owned	2	10.0
Both local and foreign	7	35.0
Total	20	100.0

Table 1 shows that 55% of the respondent banks were locally owned, 10% foreign owned and 35% as both foreign and locally owned.

Ownership may be important in the choice of strategy an organization seeks to pursue. Foreign banks sometimes have to pursue the strategies of its foreign based parent bank.

Table 2: Government participation in the ownership of commercial banks

Response	Frequency	Percentage
Yes	3	15.0
No	17	85.0
Total	20	100.0

On government participation, the results were as per Table 2 whereby 15% of the respondents said their banks had government participation, while 85% did not have any government participation.

Government participation is important in the strategy a particular bank pursues. Government may sometimes put more emphasis on social and political factors than economic factors in choice of its strategy.

Table 3: Number of years the bank has been in operation in Kenya

Operating duration	Frequency	Percentage
11-20 years	5	25.0
Over 20 years	15	75.0
Total	20	100.0

Table 3 indicates that 25% of the respondents had been in operation for a period in the range of 11-20 years while 75% had been operating for at least 20 years. The number of years the bank has been operating in Kenya is important for purposes of establishing growth trends in the industry. Commercial banks above 20 years of operation were the majority, representing 75% of the total respondents. This shows that the industry has had very few entrants within the last 10 years.

Table 4: Branch Network

Number of branches	Frequency	Percentage
1-5	6	30.0
6-10	7	35.0
Over 10	7	35.0
Total	20	100.0

Of the respondent banks, 30% had between 1-5 branches, 35% had 6-10 branches while a further 35% had over 10 as per Table 4 above. Thus, in terms of number of branches, there was relatively equal distribution between small, medium and large banks. The number of branch outlets set up by a firm is often an indicator of the market potential in any given industry or of the scope of operation of the firms in the industry.

4.3 Porter's Generic Strategies

Table 5: Vision statement

Response	Frequency	Percentage
Yes	20	100.0
No	0	0.0
Total	20	100.0

As shown in Table 6 above all the respondents indicated that their banks had a vision statement.

A strategic vision is the management view of the kind of company it is trying to create and the kind of business position it wants to stake out in the years to come. Johnson and Scholes (2002), defines vision or strategic intent as the desired future state or the aspiration of the organization.

Table 6: Mission statement

Response	Frequency	Percentage
Yes	20	100.0
No	0	0.0
Total	20	100.0

Table 6 shows that 100% of the respondents had formulated mission statements for their banks.

A mission is defined as overriding purpose in line with the values or expectations of stakeholders (Johnson and Scholes, 2002). For many, an organization's mission is a key vehicle for communicating strategy and thus the 100 per cent with mission statement is evidence that most commercial banks have strategic plans and goals.

Table 7: Formality in strategy formulation

Response	Frequency	Percentage
Yes	20	100.0
No	0	0.0
Total	20	100.0

All the respondents agreed that the process of strategy formulation was formal through meetings and formal documentation as Table 7 above shows. Formality of strategic management systems, that is the degree to which participant's responsibility, authority and direction in decision-making are specified, varies widely among companies and is subject to factors such as size and age of the firm. Greater formality is generally associated with cost reductions, comprehensiveness, accuracy and success in planning.

Table 8: Level of response to environmental changes

Response	Frequency	Percentage
To no extent at all	0	0.0
To a small extent	0	0.0
To a moderate extent	5	25.0
To a great extent	9	45.0
To a very great extent	6	30.0
Total	20	100.0

From the data in Table 8 all the commercial banks exhibited a certain level of response to environmental changes. The commercial banks are therefore in a position to shape their strategies in response to environmental changes.

Table 9: Respondents view on whether they had had changed their way of competition

Response	Frequency	Percentage
Yes	19	95.0
No	1	5.0
Total	20	100.0

As per Table 9, 95% respondents said that in the last five years their banks had changed the way they competed in the industry. 5% said they had not changed their way of competition. The state and nature of competition in firms is mainly based on the environment. The banking industry in Kenya had witnessed many changes. New opportunities for banks in the industry have come up, while new challenges too have to be countered. Only those firms constantly reviewing their strategies will survive in the long term.

Table 10: State of competition in the banking industry

State of competition	Frequency	Percentage
Very stiff	13	65.0
Stiff	6	30.0
Fairly stiff	1	5.0
Not stiff	0	0.0
None at all	0	0.0
Total	20	100.0

As per Table 10 above all the respondents agreed that there was stiff competition between banks. 65% of the respondent rated the competition in the industry very stiff, 35% as stiff, while 5% fairly stiff.

Table 11: Competitive scope

Competitive Scope	Frequency	Percentage
Broad	9	45
Narrow	11	55
Total	20	100.0

Table 11 shows that 55% of the respondent's bank's operations were to target a particular market segment. 45% of the respondents said that the bank's method of operation was to deal with all the segments of the market with no particular market segment or class of customers targeted.

Table 12: Basis of competitive Advantage

Competitive advantage	Frequency	Percentage
Cost	1	5
Differentiation	11	55
Stuck in the middle	8	40
Total	20	100

Table 12 shows that 5% of the banks based their competition by charging prices lower than those their competitors were charging while 55% said that their banks based their competition on providing a service that is very different from the others. 40% of the respondents were stuck in the middle with no particular emphasis either on cost or differentiation. The two basic types of competitive advantage are low cost and differentiation.

Table 13: Choice of generic strategies

Strategy	Frequency	Percentage
Overall cost leadership	1	5.0
Differentiation broad	8	40
Cost focus	0	0.0
Differentiation focus	3	15.0
Stuck in the middle	8	40.0
Total	20	100.0

The research findings as per Table 13 indicate that the most preferred strategy by commercial banks is differentiation broad (40% of the respondents). Stuck in the middle also was 40% of sampled banks while focus strategy followed with a 15% preference. Overall cost leadership was applied by 5%. Cost focus was the least popular with no respondent at all.

By combining the two basic types of competitive advantage i.e. low cost and differentiation with the scope within which an organization seeks to achieve the advantage leads to the three generic strategies for achieving above average performance in an industry as expounded by Porter. These are overall cost leadership, differentiation and focus. Focus strategy has two variants of cost focus and differentiation focus. An organization that is not pursuing any particular strategy but is choosing between various aspects of the different strategies is said to be stuck in the middle.

EXPLANATION FOR TABLES: 14, 15 AND 16.

To analyze the extent of specific cost leadership and differentiation strategies used, the key used in the questionnaire was as follows:

Key Used	Weights Assigned	Mean Score Analysis
Not at all	1	1
Very little	2	2
To some extent	3	3
To a great extent	4	4
Very great extent	5	5

To compute the mean, weights (x) were assigned to frequencies (f) as shown above and the product of the two established ($f \times x = (Zf_x)$). The sum of $f_x (= \sum f_x)$ was divided by the total number of observations (N). The following formula was applied: $(\sum f_x)/N$.

A mean score of 5 indicates that the aspect of strategy is used to a great extent while a score of 1 indicates that it is not used at all. Once all mean scores were assigned to specific aspects of strategy, all the strategies were ranked from those with the highest mean to those with the lowest scores per category, as shown in Tables 14,15 and 16 below:

Table14: Cost controls used in cost leadership strategy

Position!	Mo.	Area of business	Mean	Std. Deviation
1	3	Cost control in overheads office costs	4.33	0.70
2	1	Cost control in advertising and marketing	4.20	0.63
3	5	Cost control in number of staff employed	4.11	1.27
4	6	Cost control in distribution system	4.00	1.32
5	2	Cost control in research and development	3.77	1.30
6	4	Cost control in customer service and care	3.66	0.87

The data in Table 14 shows that commercial banks exercised the highest cost control in overhead office costs followed by advertising and marketing. Cost control in customer service and care was the lowest followed by cost control in research and development. Banks being service organizations need to offer very high quality service in order to remain competitive. They also need to do a lot of market research in order to know customer preferences and develop new products and services hence the low level of cost control in these two business areas.

Table 15: Extent of cost leadership

Position	No.	Emphasis in aspects of cost leadership strategy	Mean	Std. Dev.
1	7	Capital Investment	4.22	0.44
2	2	Emphasis on organization structure and responsibilities	4.00	1.00
3	4	Frequency of control reports	4.00	1.00
4	5	Details of control reports	3.89	0.93
5	1	Labor supervision	3.67	1.12
6	3	Giving incentives to employees who meet strict targets	3.56	1.13
7	8	Specialization of jobs and functions	3.33	1.22
8	9	Use of volume sales techniques	3.11	1.36
9	6	Process engineering skills	3.11	1.54

Table 15 indicates that most commercial banks based their cost leadership strategy on a high level of capital investment and streamlined organizational structure. Process engineering skills and volume sale techniques were the least emphasized aspects of cost leadership strategy by commercial banks.

Table 16: Differentiation and the extent of use

Position	Mo.	Differentiation aspect	Mean	Std. Dev.
1	2	Reputation on quality and service	4.45	0.89
2	4	Use of corporate image of the firm as the selling point	4.25	0.97
3	5	Strength in marketing capabilities	4.10	0.97
4	3	Amenities to attract highly skilled labor	3.90	0.85
5	7	Qualitative performance targets and incentives	3.85	1.26
6	1	Reward on creativity among employees	3.65	1.35
7	6	Strength in carrying out basic research	3.10	1.25

The findings of the study as per Table 16 indicate that reputation on quality and service and use of corporate image were the most used differentiation aspects by the commercial banks as selling points. Commercial banks are service organizations hence the high mean scores on these two aspects. Strength in carrying out basic research and reward on creativity among employees were the least used differentiation aspects as selling points.

CHAPTER FIVE

CONCLUSION

5.1 Summary, Discussions and Conclusions

In this chapter the results of the study are summarized, discussed and conclusions drawn. The objective of the study was to establish the application of Porter's generic strategies by commercial banks in Kenya.

The results indicate that **60%** of the commercial banks use Porter's generic strategies. Differentiation with **40%** was the most common strategy used by commercial banks. Focus strategy followed with 15% while overall cost leadership was the least applied with only 5% of the commercial banks using it. A further **40%** of the commercial banks were stuck in the middle meaning that they fail to develop their strategy in at least one of the three directions.

There is stiff competition in the industry and for any particular bank to survive it has to adopt the appropriate strategies which matches it with its environment. The relatively high number of commercial banks stuck in the middle, at 40% may be as a result of the changes takings place in the industry and restriction on charges applied by the Central bank of Kenya. Some commercial banks which previously operated on a narrow focus are broadening to serve a wider market. Others which ignored particular markets are focusing on those particular segments. The study revealed that there is widespread application of Porter's generic strategies.

5.2 Limitations of the Study

A number of limitations were encountered in carrying out this study. These included low response rate. There was a general respondent apathy to fill the questionnaire. Even for the twenty respondents, the questionnaire had to be dropped up to even three or four times, and respondents soft spoken to and persuaded in order to respond. One bank flatly refused even to take the questionnaire. Although the twenty respondents were enough for our analysis it would have been a more comprehensive study if all the forty two banks had responded. The educational background of some of the respondents posed a challenge and hence unwillingness to respond.

5.3 Recommendations for Further Research

This study did not cover some of the areas. There is need for further research to determine the factors influencing the choice of the particular options of the Porters generic strategies. The application of Porters generic strategies over a long period of time can also be researched on.

5.4 Implications for Policy and Practice

The Central Bank of Kenya plays a supervisory role over the banking industry, thus impacting on the choice of strategy a particular bank decides to pursue. The notification and seeking of approval by commercial banks of any changes on its charges may limit the choice of strategy by a particular bank. Levying premium charges by banks which want to target particular segments may be controlled or limited by the Central Bank of Kenya.

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KABUKU LIBRARY

Appendix 1

List of Commercial Banks in Kenya

1. African Banking Corporation
2. Akiba Bank Ltd
3. Bank of Africa Ltd
4. Bank of Baroda Kenya Ltd
5. Bank of India
6. Barclays Bank of Kenya Ltd
7. CFC Bank Ltd
8. Charterhouse Bank Ltd
9. Chase Bank Kenya Ltd
10. Citibank N.A.
11. City Finance Bank Ltd
12. Consolidated Bank of Kenya Ltd
13. Commercial Bank of Kenya Ltd
14. Co-operative Bank of Kenya Ltd
15. Credit Agricole Indosuez
16. Credit Bank Ltd
17. Development Bank of Kenya Ltd
18. Diamond Trust Bank Kenya Ltd
19. Dubai Bank Kenya Ltd
20. Equatorial Commercial Bank Ltd
21. Equity Bank Ltd
22. Fidelity Commercial Bank Ltd
23. Fina Bank Ltd
24. Giro Commercial Bank Ltd
25. Guardian Bank Ltd
26. Habib Bank A.G. Zurich
27. Habib Bank Ltd
28. Imperial Bank Ltd
29. Industrial Development Bank Ltd

30. Investment & Mortgages Bank Ltd
31. Kenya Commercial Bank Ltd
32. K-Rep Bank Ltd
33. Middle East Bank Kenya Ltd
34. National Bank of Kenya Ltd
35. National Industrial Credit Bank Ltd
36. Paramount Universal Bank Ltd
37. Prime Bank Ltd
38. Southern Credit Banking Corporation Ltd
39. Stanbic Bank Kenya Ltd
40. Standard Chartered Bank Kenya Ltd
41. Transnational Bank Ltd
42. Victoria Commercial Bank Ltd

Source: Central Bank of Kenya

Appendix 2

Letter of Introduction

UNIVERSITY OF NAIROBI
FACULTY OF COMMERCE
MBA PROGRAM - LOWER KABETE CAMPUS

Telephone 732160 Ext. 208
Telegrams "Varsity". Nairobi

P.O. BOX 30197,
Nairobi, Kenya.

DATE.

TO WHOM IT MAY CONCERN

The bearer of this letter

Registration No:

is a Master of Business Administration (MBA) student of the University of Nairobi.

He/she is required to submit as part of his/her coursework assessment a research project report on some management problem. We would like the students to do their projects on real problems affecting firms in Kenya. We would, therefore, appreciate if you assist him/her to collect data in your organization for the research.

The results of the report will be used solely for academic purposes and a copy of the same will be availed to the interviewed organizations on request.

Thank you.

JACKSON MAALU

CO-ORDINATOR, MBA PROGRAM

Appendix 2

RESEARCH QUESTIONNAIRE

(Note: while responding, please tick the appropriate box or fill information in the space provided)

SECTION A

1. Name of Bank__

2. Year established__

3. Respondent's position/Title__

4. Indicate the ownership of your Bank

Locally owned []

Foreign owned []

Both local and foreign []

5. Is there any government participation in the ownership of your bank?

Yes []

No []

6. How long has your bank been in operation in Kenya?

I - 10 years }
I

II - 20 years

Over 20 years 1

7. How many branches does your bank have in Kenya?

1 - 5

6 - 10 }
I

Over 10

SECTION B

1. Does your bank have the following?

Vision statement Yes [] No []

Mission statement Yes [] No []

2. Which of the following describes your process of strategy formulation?

[] Formal i.e. through meetings and elaborate documentation

[] Informal i.e. the responsibility of some individual and no elaborate documentation not necessarily involving meetings

3. To what extent does your bank respond to changes in the environment?

5	4	3	2	1
To a very great extent	To a great extent	To a moderate extent	To less extent	To no extent at all
[1	M	[1	[]	[1

4. Would you say that over the last 5 years you have changed the way you compete in the banking industry?

Yes []

No []

5. How would you rate the state of competition in the banking industry?

5	4	3	2	1
Very stiff	Stiff	Fairly stiff	Not stiff	None
[]	[]	[1	[1	[]

6. What approach is commonly used in your bank's operations?

[] Targeting a particular market segment/class of customers

[] Dealing with all segments of the market/no specific class of customers

7. On what criteria do you base your competition?

- a. Charging fair prices that are slightly lower than what your competitors are charging
- b. Providing a service that is very different from others i.e. differentiated
- c. You are not very particular about any of the two above

If your answer to the above question is (a), go to question 8 and 9 and skip question 10. If your answer was (b), go to question 10. If (c), answer all the questions.

8. To what extent do you undertake cost controls in the following areas of your business?

	5	4	3	2	1
	Very great extent	to a great extent	to some extent	very little extent	not at all
Advertising	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Research and Development	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Overhead office costs	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Customer service and care	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Number of staff employed	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Distribution system	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

9. How would you rate your bank on the following aspects?

	5	4	3	2	1
	Extremely high	High	Medium	Low	Extremely low
Labour supervision	[]	[]	[]	[]	[]
Emphasis on organization Structure and responsibilities	[]	[]	[]	[]	[]
Granting incentives to employees who meet strict quantitative targets	[]	[]	[]	[]	[]
Frequency of control reports	[]	[]	[]	[]	[]
Details of control reports	[]	[]	[]	[]	[]
Process engineering skills	[]	[]	[]	[]	[]
Capital investment	[]	[]	[]	[]	[]
Specialization of jobs and Functions	[]	[]	[]	[]	[]
Use of volume sales techniques	[]	[]	[]	[]	[]

10. To what extent does your organization lay emphasis on the following issues?

	5	4	3	2	1
	Very great extent	To a great extent	To some extent	Very little	Not at all
Rewards on creativity among employees	[]	[]	[]	[]	[]
Reputation on quality and service	[]	[]	[]	[]	[]
Amenities to attract highly skilled labour	[]	[]	[]	[]	[]

Use of the corporate image of the firm as a selling point	[]	[]	[1	[1	[1
Strength in Marketing capabilities	[]	[]	[1	1 1	[1
Strength in carrying out basic research	[]	[]	[1	[1	[1
Qualitative performance targets and incentives	[]	[]	[1	[1	[1

I sincerely thank you for the time you have taken to complete this questionnaire.