BUILDING COMPETITIVE ADVANTAGE THROUGH DIVERSIFICATION: A CASE STUDY OF THE KENOL / KOBIL OIL CORPORATION

NJOROGE, ISAAC MUNGAI

A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION, SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI

JULY 2006
DECLARATION

I declare that this project is my original work and has never been presented for academic purposes in any other University.

CANDIDATE: ISAAC MUNGAI NJOROGE

SIGNED: ISAAC MUNGAI NJOROGE

DATE: 29/11/2006

This research project has been submitted for examination with my approval as the University Supervisor

SIGNED: Prof. Peter K'Obonyo

DATE: 30/11/2006

Prof. Peter K'Obonyo
Professor of Management
Department Of Business Administration,
School Of Business,
University Of Nairobi
I dedicate this project to

My Wife Catherine, daughter Lynne and son Chris who have been loving

and supporting throughout my studies. I am grateful to my mother who

has given me lots of love throughout my academic life.
ACKNOWLEDGEMENT

I wish to acknowledge the contributions that were made in the course of this project by several individuals and organizations.

I wish to acknowledge gratefully the following people, whose effort influenced the content and direction of this project.

My first thanks go to my Supervisor Prof. Peter K'Obonyo for his constant analytical criticism and encouragement. Thanks a lot.

My thanks go to my family for standing by me during the time of study and doing the project. I am very grateful to them.

I wish to thank my friends for a lot of support and encouragement to me in pursuit of this goal. My thanks also go to Kenol/Kobil Public Relations Department who despite their busy schedules were available for the interviews.

For all whose names have been indicated and many more who contributed though their names have not been indicated I say God bless you all.

Thank you.
ABSTRACT

This was a case study on building competitive advantage through geographic diversification. The study was done as a case study of Kenol/Kobil Petroleum Company in Kenya. The data collection instrument was an interview guide. Secondary data was also collected.

The geographic diversification strategy pursued by Kenol/Kobil in general has enabled the company to expand to five other countries in the region apart from internal expansion in Kenya. Even within the country, the country has adopted the same strategy. This strategy is backed by acquisition strategy as an entry strategy into a new market. It is evident that this strategy would not succeed without professional and financial backup. The company has adopted what in their term is called trading strategy where the company has diversified into various fields to enable it raise funds to support their expansions geographically.

In conclusion, the objective of the study was to determine whether Kenol/Kobil has attained competitive advantage through geographic diversification, the factors used by Kenol/Kobil in pursuit of its geographic diversification strategy, and the factors considered by Kenol/Kobil in selecting geographic areas to diversify into. All the three objectives the study were achieved. It is evident from the study that Kenol/Kobil has been able to increase its market share both locally and regionally through acquisitions of rival companies. In Kenya, it has increased its market share to 20%. It has also acquired Shell in Rwanda and is successful in Tanzania. The factors considered by the company in diversifying include the possibility of dominating and the state of competition in those areas. It also considers financial capabilities of the company in meeting the objectives it has set for itself.
TABLE OF CONTENTS

DECLARATION......................................................................................................i
DEDICATION.........................................................................................................ii
ACKNOWLEDGEMENT......................................................................................iii
ABSTRACT...........................................................................................................iv
TABLE OF CONTENTS........................................................................................v
LIST OF TABLES...............................................................................................vii
ABBREVIATIONS..............................................................................................viii
CHAPTER ONE: INTRODUCTION.................................................................1
  1.1 Background...............................................................................................1
  1.2 The Kenol/Kobil Group............................................................................5
  1.3 Statement of the Problem ........................................................................9
  1.4 Objectives Of The Study.........................................................................11
  1.5 Importance Of The Study.......................................................................11
CHAPTER TWO: LITERATURE REVIEW........................................................12
  2.1 The Concept of Corporate Strategy.......................................................12
  2.2 Competitive Advantage.........................................................................14
  2.3 Diversification..........................................................................................17
     2.3.1 Motives of Diversification.............................................................18
     2.3.2 Trends and views of Diversification.............................................20
     2.3.3 Classification of Diversification...................................................23
  2.4 Summary..................................................................................................26
CHAPTER THREE: RESEARCH METHODOLOGY.........................................28
  3.1 Research Design......................................................................................28
  3.2 Data Collection.......................................................................................28
  3.3 Data Analysis..........................................................................................28
CHAPTER FOUR: FINDINGS AND DISCUSSION.........................................29
  4.1 Introduction............................................................................................29
     4.1.1 Profile.............................................................................................29
     4.1.2 Profitability....................................................................................31
4.1.3 Business Expansion ................................................................. 32
4.2 Competitive Advantage through Diversification ...................... 34
4.2.1 Long Term Strategic Issues ...................................................... 34
4.3 Strategies Communication for Successful Diversification .......... 36
4.3.1 Diversification Strategy ............................................................ 36
4.3.2 Financial Strategy ................................................................. 36
4.3.3 Resource Acquisition and Deployment ................................. 38
4.4 Competitive Diversification Strategies ................................. 40
4.5 Political Environment and Response to Change ................. 44

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS  
5.1 Summary .............................................................................. 45
5.2 Conclusion ........................................................................... 46
5.3 Limitations of the Study ......................................................... 47
5.4 Recommendations for further study ..................................... 47

REFERENCES .................................................................................... 48
APPENDIX 1: INTERVIEW GUIDE .................................................... 52
APPENDIX 2: SECONDARY DATA SOURCES FOR THE CASE STUDY .. 55
LIST OF TABLES

TABLE 1: CHANGES IN DIVERSITY FOR THE FORTUNE 500, 1949-1974 ............... 20
TABLE 2: CHANGES IN DIVERSITY OF THE 305 LARGEST BRITISH MANUFACTURING COMPANIES, 1960-1980 ................................................................................ 21
TABLE 3: DIVERSIFICATION AMONG 118 JAPANESE INDUSTRIAL CORPORATION, 1958-1973 .................................................................................................... 21
TABLE 4: EXPORT DEPARTMENT'S ACTIVITIES ............................................. 33
TABLE 5: GROWTH IN SALES AND SHORT-TERM CAPITAL REQUIREMENTS .......... 37
TABLE 6: NETWORK EXPANSION ............................................................................. 38
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>BP</td>
<td>British Petroleum</td>
</tr>
<tr>
<td>CEO</td>
<td>Chief Executive Officer</td>
</tr>
<tr>
<td>GE</td>
<td>General Electric</td>
</tr>
<tr>
<td>HBS</td>
<td>Harvard Business School</td>
</tr>
<tr>
<td>HRD</td>
<td>Human resources Department</td>
</tr>
<tr>
<td>IMB</td>
<td>International Business Machines</td>
</tr>
<tr>
<td>ISI</td>
<td>Import-substitution-industrialization</td>
</tr>
<tr>
<td>KENOL</td>
<td>Kenya Oil Company Ltd.</td>
</tr>
<tr>
<td>KPC</td>
<td>Kenya Pipeline Corporation</td>
</tr>
<tr>
<td>KPRL</td>
<td>Kenya Petroleum Refineries Limited</td>
</tr>
<tr>
<td>LPG</td>
<td>Liquefied Petroleum Gas</td>
</tr>
<tr>
<td>PR</td>
<td>Public Relations</td>
</tr>
<tr>
<td>UK</td>
<td>United Kingdom</td>
</tr>
<tr>
<td>USA</td>
<td>United States of America</td>
</tr>
</tbody>
</table>
CHAPTER ONE: INTRODUCTION

1.1 Background

Miners accidentally discovered oil in the USA in form of methane gas (LPG) while digging for coal in 1873 (Balabanis, 2001). Since then, there have been several developments in this field, resulting in the discovery of many oil wells worldwide. There are large deposits in the USA, Russia, Middle East, Africa and Europe. Oil companies were formed after the discovery to exploit the new opportunity. With geographical diversification, the world has witnessed the creation of the world’s giant oil companies. This resulted in major oil companies such as Exxon/Mobil, BP Amoco Arco, Royal Dutch Shell, Total Fina Elf, and Chevron Texaco.

Diversification has also affected Kenya. The Royal Dutch Shell was the first company to operate in Kenya in 1899 when they started selling Kerosene. The industry has continued to grow with the major oil companies in Kenya being Shell/BP Kenya, Limited Caltex Oil (K) Limited, Exxon/Mobil, Total Kenya limited and Kenol/Kobil petroleum.

Oil is a very politicized product in the world today. Oil reserves in many countries have been the major causes of conflicts and wars. There have been several wars especially in the Middle East based on oil. Examples of such wars were: Iran and Iraq in 1980s, the Gulf War of 1991, and the latest invasion of Iraq by America and its allies. Until the Middle East crisis of 1973, oil products used to be comparatively cheap. Due to the prevailing political situation at the time, price increased dramatically in a spate of a few days
from US $2 per Barrel to US $12 per Barrel. The price has been fluctuating since then, increasing tremendously to the point of the current gulf war when the price reached $45/barrel.

Kenya’s economy continues to perform dismally (GoK Economic Survey 2003). This has not helped to support the prices of petroleum and other products in the market. The result of the collapse of the economies of South East Asia resulted in a glut of oil in the market in 1997, giving rise to price variability, which dipped to a six-year low of $11/barrel in 1999. The retail prices of oil products have fluctuated in line with international product prices. In response, oil companies have developed new and diverse strategic ways of gaining competitive advantage in order to remain in the market.

Global issues on oil have adversely affected Kenya. The incomes of most Kenyans declined in purchasing power due to dismal performance of the economy. The continued reliance on donor funding to bridge the budget deficits has continued to put pressure on the Kenya shilling against hard currencies (US$, the Euro and Sterling Pound). Real and perceived corruption and quasi-corrupt practices in the public sector has also contributed to the slow pace of economic recovery (Adepoju, 2000).

Due to the above reasons the Kenyan economy has not been investor friendly. The operating environment for businesses has been very unfriendly to companies. The economic performance of the manufacturing sector has also been very poor resulting in a growth of 1.5% in the year 2003. Quite a
number of industries have closed due to availability of cheaper imported products and thus resulted in shrinking the market for fuel products. Frequent drought and rain shortfalls have increased food shortages. The high fuel and food prices have continuously eroded the purchasing power of the individual, causing persistent inflation. Consumers have been severely drained and thus the need for oil companies to seek different markets and different operating environments and put in place different competitive strategies to improve on their volume sales and share of the shrinking market.

The new entrants and the independent petroleum dealers have increased the competition in the market. As a way of diversifying in scale, several companies have merged in order to take advantage of economies of scale thus reducing costs in some areas with an improved contribution margin. In Kenya recently, Shell/BP acquired Agip Kenya Limited and Kenol/Kobil took up Mid Oil Africa Limited, while Mobil took over all operations of Esso. This in essence helps them to reduce their operating costs through economies of scale.

Liberalization of the oil industry in Kenya in October 1994 brought in a new dimension of competition. Earlier, the government controlled prices and the companies had no way of setting their own profit margins. With liberalization however, the companies are now able to set the prices of their oil products, taking into account customers' sensitivity to price and possible reactions of the competitors. In addition, they have had to strategies to realize their objections. The new entrants have continued to grow their market share at the
expense of the established oil firms. The market has also witnessed significant volumes of illegally imported products (duty and taxes not paid) that have distorted pricing of petroleum products within Kenya and especially the high volume area of Nairobi. These products are sold in the market at much lower price differences due to tax factors (*Daily Nation, Business Week, July 14 1999:5*)

The big companies buy oil in joint shipments and their costs are the same. Processing at the Kenya Petroleum Refinery Limited (KPRL) is also the same. What then makes the difference? Kenol/Kobil is one of the few local oil companies that have aggressively pursued geographical diversification strategy within Kenya and in the East and Central Africa. Unlike any other Kenyan oil company, Kenol/Kobil has made mergers and acquisition central to its corporate strategy. This paper is meant to determine how Kenol/Kobil Oil Company has gained competitive advantage through geographic diversification compared to other peer companies in the oil industry, which is divided into two groups of companies, namely multi nationals and the independent petroleum dealers. Kenol/Kobil in itself is a unique organisational set up. These are two companies, which have entered into a Joint Management Agreement but trade under different individual brand names. They share their overhead costs pro-rata to the size of business transacted. For that reason it is interesting to study how the two companies’ strategies rhyme and thus makes for a worthy case study for this study.
1.2 The Kenol/Kobil Group

The Kenyan oil industry is the most diverse in East Africa with Kenol / Kobil group being certainly the fastest growing of all the oil companies in Kenya and east Africa as a whole. The other major oil companies have been pulling out of regions especially western Kenya. Kenol was founded and incorporated as a Private Limited Company in Kenya on May 13, 1959. It became a Public Company in September of the same year. The company’s shares are quoted at the Nairobi Stock Exchange. Kobil Petroleum Limited was established in 1984 after acquiring the assets of the then Mobil Oil in Kenya (www.kenolkobil.com)

In 1987, the two companies entered into a Joint Management Agreement. Kenol and Kobil trade under their individual brand names, and their overhead costs are shared pro-rata to the size of the business transacted under the terms of the Operating Agreement. The company has diversified into new geographies in Zambia, Rwanda, Uganda and Tanzania. In Zambia the company acquired all assets and operations of the South African Oil Company, Jovenna.

The firm has been consistent in its good performance record over the period of its existence. However, it was not until 1994 that the group became a force to reckon with in the oil industry. In the said year, the government liberalized the oil marketing and distribution sector creating completely new challenges for the existing players. From then on, the group got into the market in east Africa with a bang. The company had hitherto traded in fuels only. It expanded
into the lubrications, car care product, fuel treatment products, asphalt and emulsions, chemical cleaners and lately into Liquefied Petroleum Gases (LPG). This expansion created new competitive horizons as well as exposing new market gaps that have a great potential for profitability. True to this calculation, the expansion or growth as it were, has yielded a good return to the investor. Recently the group announced a 25% leap in turnover (Chairperson’s report 2003). It attributed this to among other things the strong growth in the market share of its subsidiaries (Kenol and Kobil, after disposal of Mid Oil Africa).

Such performance amidst the challenges of diversification creates a bright picture of diversification. Certainly some strategic issues that have governed the whole process have come up. Issues of why the company chose diversification, the extent of diversification and the implementation process have become of paramount importance in understanding the concept of diversification and competitive advantage. Thus to understand this concept, it has become necessary to document the group’s experience and probably by doing so it would be possible to provide a guideline on diversification.

Competition is the process of striving against others to win or achieve something. Competition is both complex and sophisticated (Pettinger, Richard 1996). The capability to compete is essential for the business to gain customers and potential customers. This is the ability to satisfy that part of wants and needs to the exclusion of others who are in direct competition. Competition exists where there is choice. Choices are taken in varied and
sophisticated ways, according to the means, circumstances and preference, quite apart from any inherent or supposed nature and strength of the choices offered. Competition has also to be seen as competing for scarce, limited and definite resources. This scarcity largely defines the nature and level of competition. Levels of disposable income and the extent to which the offerings are essential, desirable, non-essential, luxury, general, peripheral and marginal therefore affect it. For any firm to gain the most, it needs to create a differential advantage position from its rivals hence the concept of competitive advantage. Business competition is very much like sports. In business, teams face each other in competition for employment, customers, product innovations, and profits- among other goals.

The three generic strategies for achieving competitive advantage as outlined by Porter (1985) are cost advantage, differentiation and focus. What Porter gave us was the firm's proper setting: its industry, and a structured way of looking at it. It is true that he raised as many questions as he answered. (For instance: What constitutes an industry? How does one define an exit barrier? He simply stated that creating competitive advantage is a simple process, and by implication, that competition was better avoided than sought. Formisino (2004) says Strategy is the selection of ideas and assets to meet long term business goals. On the contrary, the complexities in the business world are increasing everyday making it difficult to apply these strategies. It is difficult to achieve an advantage using these strategies in their raw form. This has prompted the use of secondary means e.g. diversification and information difference to achieve competitive advantage.
According to Bennett (1999), numerous empirical studies that have investigated whether diversification leads to higher profitability have given conflicting conclusions. This has increased the complexity of this strategy with several gaps in the existing literature. Diversification as a strategy of creating value has been highly questionable and has been regarded as a remote way of achieving competitive advantage (Njoroge, 2003). The failure rate of those firms adopting this strategy is alarming considering it is aimed at creating an advantage to the firm and by extension value to the owners. However, some success stories exist. Firms such as IBM, Kodak, GE, DuPont and Procter & Gamble have successfully exploited diversification. Porter (1985), Makides (1987) and Rumelt (1987) define diversification move as any entry into a new product-market activity or market that requires, or implies an appreciable increase in the available managerial competence within the firm. On critical analysis however, one can perceive a ‘thin line’ of difference between successful and unsuccessful firms. This line is the competitive advantage. This may be the reason why Porter (1987) argues that if diversification does not create competitive advantage, it should not be used. This study therefore seeks to establish competitive advantages in diversified firms.

The choice of the Kenol / Kobil Group is a deliberate one. The firm is well diversified and has consistently superior results compared to its peer competitors in the newly liberalized oil industry. It posted a seven per-cent increase in profits and a 25 per-cent increase in turnover (Nathoo, 2004). How it is able to do so is the subject of this study. Its corporate strategy, the
interaction between its business units in its circumstances can and should be very insightful. It is hoped that at the end of the study, one should be able to understand some mechanisms of building competitive advantage through diversification. The different modes, motives, complexities and benefits will be analysed in detail.

1.3 Statement of the Problem

Firms diversify when their objectives can no longer be adequately met within the scope of their present operating environment. Growth can be seen from the strategic objective of a firm moving beyond its current boundaries. If a firm's objectives cannot be achieved in the current market, diversification may be the option to take (Howe 1986). If opportunities are presented to the firm in new market areas than accruing from its existing market then a diversification program may be undertaken to benefit from such opportunities (Ansoff 1968). Since product diversification is the first option for a firm in an increasingly competitive environment, geographic diversification is the key that unlocks the potential of a firm's competitive capability.

Kenya's economy has experienced drastic changes in the last few decades. Increased competition due to economic liberalization and globalisation has resulted in the market having more players fighting for the same customer. The advent of liberalization in October 1994 in Kenya's Petroleum sub-sector has witnessed unprecedented influx of players into this sub-sector. This has led to stiff competition, as the fight for customers seems to be a never-ending
war. To survive in such a competitive environment oil firms have had to adjust their responses by critically assessing their corporate strategies.

Few studies have looked at the strategic response of firms due to changed environmental conditions, but none has looked at the diversification in the oil industry. Koech (2001) addressed the competitive advantage of oil companies using benchmarking though the Terry Hills Model. Wamathu (1999) addressed the issue of strategic postures and action evaluation in the Kenyan Oil Industry, Chepkwony (2001) looked at the strategic responses of petroleum firms in Kenya to challenges of increased competition in the industry. Murage (2001) looked at the competitive strategies adopted by members of the Kenya Independent Petroleum Dealers Association.

The above researches have not dealt with diversification strategy, particularly geographic diversification. Geographic diversification being an important strategic choice in the quest for competitive advantage, there is need to study it.

Kenol/Kobil has diversified both product wise and geographically but it was after it crossed the border to Uganda in 1994 that it's performance improved drastically. For that reason, this study attempts to establish whether there are peculiar factors in geographic diversification that gives a firm increased performance. The researcher is not aware of any research done in Kenya that has looked into the geographic diversification strategies in oil industry to achieve superior performance. This study will focus on the use of this strategy by Kenol / Kobil company to gain competitive advantage. The study attempts
to answer the questions: Whether Kenol/Kobil has attained competitive advantage through geographic diversification? What are the factors the firm used in pursuit of its geographic diversification strategy that gives the company competitive advantage? Which factors were considered in selecting geographic areas to diversify into?

1.4 Objectives Of The Study

The objectives of this study are:

1. To determine whether Kenol/Kobil has attained competitive advantage through geographic diversification.

2. To determine the factors used by Kenol/Kobil in pursuit of its geographic diversification strategy.

3. To determine factors considered by Kenol/Kobil in selecting geographic areas to diversify into.

1.5 Importance Of The Study

This study will be beneficial to various groups: To the shareholders the study will provide insight on how diversification has contributed to the performance of their organisation. It is important to the industry because the study will provide for an underpinning for management excellence. The researchers will benefit from the study because it will contribute to the existing literature in strategic management and stimulate a basis for further research.
CHAPTER TWO: LITERATURE REVIEW

2.1 The Concept of Corporate Strategy

Drucker (1955) made the distinction, in the practice of management, between tactical and strategic decisions, not perhaps quite in the way that we do today, but perhaps quite close for us to recognize certain gaps that still exists, requiring further research.

Business strategy may be defined as the totality of management decisions that determine the purpose and direction of the enterprise and hence its fundamental goals, activities, and the policies it selects in order to attain its objectives (Bennett, 1999). Businesses depend on the environment for their provision of inputs and dispose of their output to the same. If nothing ever changed in our world and markets, then we could rely on market adjustments to current performance, to map the future (Formisano, 2004). In light of this, it is understandable that, organizations cannot survive, let alone succeed, if they cannot match the environmental requirements. To be able to do so, organizations require strategy, which becomes a link between the organization and its environment (Ansoff, 1990). Strategy describes the way an organization will pursue its goals, given the threats and opportunities in the environment and the resources and capabilities of the organization (Rue and Holland, 1986). Strategy is a detailed plan for achieving success, the bundle of decisions and activities that we undertake to achieve long term goals (Formisano, 2004)
Strategy explores the ways in which a firm can develop a favourable "portfolio strategy" for the activities (Wheeler and Hunger, 1989). More specifically it is indicative of the pattern of decisions regarding which industries or markets a firm should be involved, in order to increase its profitability (Grant, 1998; Wheeler and Hunger, 1989). Corporate strategy is a 'pattern of decisions which a company makes that determines shapes and reveals its objectives, purposes and goals. Strategy also defines which produces the principal policies and plans for achieving these goals; which defines the business that the company intends to be in, and the sort of organization that it intends to be. Ettlie, (2000) If strategy were defined as above, corporate strategy would then be seen to be concerned with the purpose and scope of an organization as a whole (Collins and Montgomery, 1998). It looks at the entire firm and specifies the firm's overall approach to the achievement of its mission and objectives. (Bennett, 1999).

When the competitive domain and the growth potential starts to shrink, strategic options are either to attempt a more intensive implementation of the current line of business, or to begin to search for more opportunities in other industries or markets (Thompson and Strickland, 1990). These choices are a must if a firm has any regard for its survival (Wheeler and Hunger, 1989). Growth strategies are therefore partly a reaction to environmental turbulence besides other factors. As noted earlier, growth can be by concentration in one industry or by diversification into other industries (Grant 1998). If the current industry is highly attractive concentration of resources on that one industry makes sense. However, if the current industry is low in attractiveness, the firm
The first dimension of competitive advantage is material (no human) and second is the interpretation (human) domains and the second one, which divides the competitive terrain into domains of action that fall either outside or inside a focal firm (i.e. the internal and external sources of competitive advantage). In the first one, the competitive terrain is defined, not only by the resource conditions in various markets and potential rents associated with them (Scherer and Ross, 1990), but also by the knowledge, expectations and articulation of firm's managers and of the stake holders that interact with firms in an industry. According to the latter, which is also the most important of the two dimensions, the external sources look at the key success factors that answer the questions, 'what do our customer want? And what does the firm need to survive competition?' while internal sources look at the potential offered by firms resources and capabilities. Thus, by considering resources and capability the focus is on the capability strategy interface while the former is on the strategy –environmental interface. Therefore for a firm to establish competitive advantage its key resources and capability must be consistent with the key success factor within the environment.

Triggered by Levitt's (1973) charge of 'marketing myopia', and concerned by the future of the oil market after the 1973 Arab- Israeli war, several oil companies redefined their business as energy supply, and diversified into coal. This forced the oil companies to diversify to areas of their non core businesses.
The core business is the set of markets in which the firm's distinctive ability gives it competitive advantage. To achieve competitive advantage, diversification, three ways have been suggested; the use of market power, competence transfer and economies of scope. The most general argument concerning the benefits of diversification focuses on the presence of economies of scale in common resources (Grant, 1998). Economies of scale occur by eliminating duplication of facilities between businesses and creating a single facility thereby spreading the costs. Thus each business has to invest in the shared function (Teece, 1890), (Baumaol et al, 1982). Managers never need to be aware that the bureaucratic costs of coordination necessary to achieve economies of scope often outweigh the value they create (Hill and Hoskissos, 1987). Any strategy should be pursued only when it can generate significant competitive advantage.

Companies seeking to diversify may wish to get into business that they can transfer their competencies. This goes beyond mere linkages and basic synergies between businesses a notion many get trapped to. The litmus check for this is the value created or the potential value to be created with the additional business unit(s). The idea to be noted here is that key to creating value is the ability of the diversified firm to share and transfer capabilities more efficiently than alternative institutional arrangements (Grant, 1999). Firms seeking related diversification find this arrangement particularly suitable meeting their objective of competence transferability. Any diversification would have synergy as it's driving force. The established business and organisation structure should not be destabilised. There is need for progress the existing activities of the organisation (Pettinger, 1996). It is important for
a firm to identify the relevant market, the relevant industry and the relevant strategic group.

Demand factors determine the market, while supply factors define the industry. Market power is the ability of a firm to manipulate its market conditions to create its own advantage. There are a number of ways in which a firm is able to do this. Grant (1999) suggests three mechanism of doing so. He says a firm can either use predatory pricing, reciprocal buying or mutual forbearance or any combination depending on its strategy.

2.3 Diversification

In this excerpt taken from the chapter entitled "From Trade to Investment," Harvard Business School visiting professor Geoffrey Jones traced the transition of the British trading companies from purely trading companies in the 1870s to "business groups" that actively engaged in trading, manufacturing and financial activities around the globe prior to World War I. The British trading companies played a significant role in opening new markets and developing new sources of supply in resources in the emerging global economy. Professor Jones describes the companies as "entrepreneurial firms, which pioneered new industries, from jute manufacture in India and cotton textile manufacture in China, to the oil industry in California."

Large businesses have expanded across geographical areas, across the value chain and across products, by diversification since the World War II (Galbraith and Kazanjian, 1999). "I don't know of any more difficult management problem than that of diversifying... while diversifying is fine as a
matter of abstract principle, it can result in so many different eggs in one basket that nothing really significant is hatched out of any of them' (Joseph T Wright). The scholars and researchers (Abell 1980, Bower 1986, Hamermesh 1986, Rumelt 1986, Weinhold and Salter 1979, Williamson 1985, Sayles and Burgelman 1988) sought to understand this concept in terms of its success as well as about the complications that it has brought. The developers and teachers (Digman 1990, Galbraith and Kazanjian 1987, Hofer and Schedel 1986, Pierce and Robinson 1988, Thomson and Strictland 1990, Johnson and Scholes 1999) have brought order to the conflict of practical approach to diversification. The success and the potential for it have been overwhelming, but so has been the failure (Makides 1997).

The market growth and its competitive position affect a firm. As the demand for new products and services increase, and therefore the market grows, firms have been left with external factors beyond their control. But their strategic capability is their internal strength. When the firm is placed within these two grids, (distinctive capabilities and product market growth) the option it adopts determines its survival. Salter and Einhold argue that using the above criteria; one can discriminate among motives of diversification with some ease.

2.3.1 Motives of Diversification

Firms diversify when their objectives can no longer be met within the scope of the present portfolio. (Ansoff, 1987). All reasons behind diversification have not been exhausted. A few of the reasons are growth, profitability and risk reduction. Growth can be seen from the strategic objective of a firm moving beyond their current boundaries. If a firm's objectives cannot be achieved in the current market, diversification may be the option to take (Howe, 1986). If
opportunities are presented to the firm in new market areas than accrue from its existing activities then a diversification program may be undertaken to benefit from such opportunities (Ansoff, 1968). Growth can be pursued for the interest of the chief executive (Kay, 1993). Objectivity may be compromised in coming up with the decision for the interest of the CEO, and the results are usually disastrous. Bennett (1999) outlines three advantages of diversification both from empirical studies and from critical examination of statistical evidence: Risks are spread over a disparate number of activities. Lucrative opportunities can be exploited as they emerge so that the firm’s profit earning potential is extended which increases the shareholder value. I.e. the industry chosen must be attractive enough to produce above average return on investments. Profits earned in certain areas of a diversified company can be used to reinforce activities elsewhere, without eroding the potential for competitive advantage to the firm.

**Risks:** Corporate diversification is often sought as a means of reducing corporate risk. ‘Diversification is therefore a necessary type of corporate insurance which management must achieve on the behalf of its stockholders, so that the risks of separate sectors are pooled (Geneen, 1984) This reason is a simple one, since shareholders can diversify their own portfolio of stocks by selecting those that best match their preferences and risk profiles (Salter and Weinhold, 1979) Shareholders do not need the corporation to do it for them (Kay, 1993)

**Profitability:** In the area of proximate and long-term profitability objectives the cause may be market saturation, general decline in demand, competitive pressures or product line obsolescence. A typical symptom is a drop in the
rate of return on investment into the present business; another is a 'dying up' of the stream of new opportunities (Ansoff, 1987). The underlying purpose of corporate diversification is to build shareholder value. Superior profit potential and ability of a firm to create competitive advantage can best describe this motivation.

**Flexibility:** In flexibility objective, the cause may be a disproportionately large fraction of sales to a single customer, a generally narrow market or technological base, or influx of new technologies into the firm's product-market scope (Balmaceda, 2001)

### 2.3.2 Trends and views of Diversification

Using a sample of 44,288 firms, Denis et al (2002) found an increase in the extent of global diversification between 1984 and 1997. This study found that the global diversification increased value; the reverse was true.

<table>
<thead>
<tr>
<th>Table 1: Changes in diversity for the fortune 500, 1949-1974</th>
</tr>
</thead>
<tbody>
<tr>
<td>SBC</td>
</tr>
<tr>
<td>VIC</td>
</tr>
<tr>
<td>DBC</td>
</tr>
<tr>
<td>RBC</td>
</tr>
<tr>
<td>UBC</td>
</tr>
<tr>
<td>TOTAL (%)</td>
</tr>
</tbody>
</table>

Source: Rumelt (1982)

A study by Jammine (1984) on 305 largest British Manufacturing Firms found established a decline in the number of Single Business Companies, and an increase in the number of Unrelated Diversified companies.
Table 2: Changes in Diversity of the 305 Largest British Manufacturing Companies, 1960-1980

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>SBC</td>
<td>34</td>
<td>15</td>
<td>13</td>
<td>10</td>
</tr>
<tr>
<td>VIC</td>
<td>2</td>
<td>3</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>DBC</td>
<td>24</td>
<td>26</td>
<td>22</td>
<td>25</td>
</tr>
<tr>
<td>RBC</td>
<td>32</td>
<td>44</td>
<td>49</td>
<td>50</td>
</tr>
<tr>
<td>UBC</td>
<td>7</td>
<td>12</td>
<td>14</td>
<td>13</td>
</tr>
<tr>
<td>TOTAL (%)</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Jammine (1984)

A study by Itami et al (1982) on 118 Japanese Industrial Corporations established a decline in the number of Single Business Companies, and an increase in the number of Vertically Integrated Companies and Related Diversified companies.

Table 3: Diversification among 118 Japanese Industrial Corporation, 1958-1973

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>SBC</td>
<td>24</td>
<td>25</td>
<td>20</td>
<td>17</td>
</tr>
<tr>
<td>VIC</td>
<td>13</td>
<td>15</td>
<td>19</td>
<td>19</td>
</tr>
<tr>
<td>DBC</td>
<td>21</td>
<td>17</td>
<td>19</td>
<td>18</td>
</tr>
<tr>
<td>RBC</td>
<td>31</td>
<td>36</td>
<td>34</td>
<td>40</td>
</tr>
<tr>
<td>UBC</td>
<td>9</td>
<td>8</td>
<td>7</td>
<td>7</td>
</tr>
<tr>
<td>TOTAL (%)</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>


Key: Table 3

SBC – Single business companies
VIC – Vertically Integrated companies
DBC – Dominant business companies
RBC – Related Diversified Companies
UBC – Unrelated diversified companies

Attention has been drawn to the trends shown in tables 1, 2 and 3 above, particularly by the CEOs. It is therefore important to review these trends and understand the views that have characterized this phenomenon perhaps more insight can be drawn. Post World War II saw the development of new
management principles. These developments provide a shift from specialized management thinking to general management thinking, general management involves a common set of management principles and techniques, which are believed to be applicable across industries. As such those who posses this skills can manage organisations regardless of which industry or its circumstances since management to this extent is generic. The application of these Principles seemed to have justified a kind of a vicious circle of corporate growth and diversification, as they were deemed to add value to the firms (Thompson et al 1995). In the 1960s, however, the performance of most of the diversified firms was unsatisfactorily leading to search for a new approach to the corporate management of diversified firms. Note that during this period the quest for growth was largely accredited with the adoption of diversification strategy. It is however clear that this quest was not as a result of strategic motivation of he top management, nut rather the enhancement of the senior management ego interests. Empire building as an interest, superseded the desire to maximize profits and was in line with the theory of managerial capitalism which assumes that management growth preference encourage the firm to invest at a greater rate than is consistent with profit maximization (Thompson et al 1995).

Portfolio Planning Techniques were used to help resolve the problem of resource allocation in the multi-business firms in the 1970s. These analytic approaches however failed since they overlooked the problem of manageability and many companies found it difficult to mange businesses facing different strategic issues. During the 1980s, poor performance by
diversified firms still persisted and it was becoming increasingly clear that diversified firms did not add value. Turbulent business environment and pressure from shareholders led to rethinking diversification. Peters and Waterman (1992) led the campaign against diversification with the catch match phrase 'stick to the knitting', which meant that firms should stick to their core business (Kay 1993).

From the 1990s to date, it has become increasingly questionable what 'stick to the knitting' in practice really implies and secondly, how should companies add value to the remaining core business especially where competitive advantage has been eroded and the industry attractiveness is low (Thompson et al 1995, Grant 1998). This has led to the emergence of themes like search for synergy and building of core competencies. However it is more apparent that these latter theories, especially from 1980s would work well if they are complementary. This to a large extend validates diversification but with exceptional regard to different circumstances of different firms.

2.3.3 Classification of Diversification

Diversification can take many forms. The researcher has will focus on major forms of classification: breadth, mode and geography. The researcher uses the Johnson and Scholes Model of Strategic management theory.

(a) Diversification by breadth

There are two forms of diversification by breadth: related and unrelated. Related diversification is also known as concentric diversification and refers to development beyond present product and market but still within the broad confines of the industry in which the company operates (Johnson and Scholes
1997). It involves the acquisition of business that is related to the acquiring firm in terms of technology, markets or products. The selected businesses possess a high degree of compatibility with the firm's current business (Pearce and Robinson 1994). Related diversification can further be disintegrated into vertical and horizontal integration.

Vertical integration refers to the integration of the adjacent (either forward or backward) activities in the value chain (Johnson and Scholes 1997). It determines the breadth of the value chain (Hax and Majluf 1996). The choice of vertical integration strategy is varied and sometimes less obvious. Main reason for backward integration in the desire to increase dependability of the supply or the quality of raw materials used (Pearce and Robinson 1994). The desire is especially large when the number of suppliers is small and the number of competitors is large. By vertically integrating, a firm can better control costs and thereby improve profit margins. The big disadvantage however is that it locks a firm deeper into an industry and unless it builds competitive advantage it is a questionable strategic move (Thompson and Strickland 1993). Diversification across the value chain fits into this category (Johnson and Scholes 1997).

On the other hand horizontal integration refers to the development into activities that are competitive with/or directly complementary to the companies present activities (Johnson and Scholes 1997). According to Pearce and Robinson 1994, the principle attractions of a horizontal interrogation grand strategy is that a firm is able to greatly expand its operation thereby achieving greater market share, improving economies of scale and increasing the
efficiency of capital use. One could argue that horizontal strategies are the primary sources for corporate advantage of diversified firms (Hax and Majluf 1996). Product diversification does fit into this category (Johnson and Scholes 1997). Under unrelated or conglomerate diversification, an organization moves beyond the confines of its current industry especially if a firm plans to acquire a business because it presents the most promising investment opportunity available. Pearce and Robinson 1994 argue that the principle concern and often the sole concerns are the profit pattern of the venture. Unlike concentric diversification there is little concern to creating product market synergy with existing markets.

(b) Diversification by mode
Porter (1997) says that diversification by mode is when a business or firm enter into new industries by acquisitions. Internal diversification would mean that a firm has built up from scratch the specific area of diversification. External diversification would encompass mergers and acquisitions. Strategic alliance may also be included to the extent that such an alliance is a joint venture and not collaboration.

(c) Diversification by geography
Beginning in the mid-1980s the primary development paradigm pursued by Latin American and Caribbean countries undertook a major shift from the concept of import-substitution-industrialization (ISI) to that of export-led growth and openness to international markets. (The International Trade Journal, Volume 17, Number 2/Summer 2003)
Diversification by geographic scope means that a firm moves beyond its current market in terms of the geographic location (Johnson and Scholes 1997). It may involve a local move as well as a move beyond international boundaries (Balabanis, 2001)

Firms are currently involved in diversification that cuts across geographic classification. A local example would be the Kenol / Kobil group's move to consolidate its growing regional presence in 2002, with the acquisition of a subsidiary of a major South African firm. It acquired the full stake in Jovenna Zambia Ltd. The Zambian operation became the third acquisition of a network by Kenol after Uganda and Tanzania, also 100% owned. The company said it would make inroads into Democratic Republic of Congo through the newly acquired Zambian business (Daily Nation, Business week Feb 19 2002:5). The acquisition aspect was by mode (external). It moved beyond the geographic scope and was a horizontal integration (i.e. by breadth).

2.4 Summary

If a firm's objectives cannot be achieved in the current market, diversification may be the option to take (Howe, 1986). The underlying purpose of corporate diversification is to build shareholder value. Superior profit potential and ability of a firm to create competitive advantage can best describe this motivation.

Product diversification does fit into this category (Johnson and Scholes, 1997). Unlike concentric diversification there is little concern to creating product market synergy with existing markets. Porter (1997) says that
Diversification by mode is when a business or firm enter into new industries by acquisitions. Internal diversification would mean that a firm has built up from scratch the specific area of diversification.

External diversification would encompass mergers and acquisitions. Diversification by geographic scope means that a firm moves beyond its current market in terms of the geographic location (Johnson and Scholes 1997). Issues of why the company chose diversification, the extent of diversification and the implementation process have become of paramount importance in understanding the concept of diversification and competitive advantage.
CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Research Design

This section sets out the research methodology that was used to meet the objectives of this study. A Case Study Design was used.

3.2 Data Collection

The data required for this study was both primary and secondary. Primary data was collected using an interview guide. In-depth interviews were carried out with 3 top managers in Kenol/Kobil in charge of strategy and business development (Retail Manager, Business Development Manager, Marketing Manager) using the interview guide. The interview guide was used because, of its interactive nature as it helps one to go in-depth as the discussions were held. Tape recording of the interviews was not done. These manager interviewed was Public relations manager.

Secondary data consisted of Kenol/Kobil Financial Statements for 2005 found in the company website.

3.3 Data Analysis

The responses from the interviews were content analysed. After content analysis was done, specific issues about diversification were brought out. Qualitative analysis was used to analyse secondary data. Final responses were grouped together under themes that had emerged from the analysis.
CHAPTER FOUR: FINDINGS AND DISCUSSION

4.1 Introduction
This chapter presents the discussion on findings of the survey after analysis of the data collected. Overview of the interpretation of the results is also presented. Since most of the data collected were from interviews, this chapter is largely presented in narrative.

4.1.1 Profile
Kenya Oil Company Limited (Kenol) was founded and incorporated as a Private Limited Company in Kenya on May 13, 1959. It became a Public Company in September of the same year. The company's shares are quoted at the Nairobi Stock Exchange. Its head office is situated at ICEA building in Nairobi's Kenyatta Avenue. Kobil Petroleum Limited was established in 1984 after acquiring the assets of the then Mobil Oil in Kenya. It is a private company registered in the State of Delaware, USA.

In 1987, the two companies (Kenol and Kobil) entered a Joint Management Agreement. Kenol and Kobil trade under their individual brand names, and their overhead costs are shared pro-rata to the size of the business transacted under the terms of the Operating Agreement.

Kenol and Kobil head offices are situated in ICEA Building, Kenyatta Avenue, Nairobi. The two companies' market white and black oils, lubricants, liquefied petroleum gas (LPG) and other specialized petroleum-related products. The companies have oil processing agreements with the Kenya Petroleum
Refineries Limited (KPRL) for the refining of their products. They also import processed products to supplement the supplies generated from the crude oil processing. Transport of the processed products is undertaken by pipeline, rail and road. Each of the two companies has its own retail network and fixed assets, as well as separate customer accounts and supply contracts. The companies have a distribution and maintenance system covering the whole country, and have seven storage depots. Together, they command over 20% of the total inland market in Kenya.

Kenol and Kobil have over 185 service stations in Kenya, and are active suppliers to all sectors of the economy including aviation, agriculture, manufacturing, construction and transport. Kenol and Kobil are split into eight departments. These are Marketing and Fuel Business Development, Operations and Non-Fuel Business Development, Supply and Planning, Lubricants Business, and Finance, Accounting and Management Information Systems. Others are Aviation and International Sales, Administration and Human Resources, and General Management. All eight department heads, together with six other senior managers, form the two companies’ Management Team, whose combined experience in the oil industry exceeds 150 years.

The two companies have a strong regional presence within the Greater African Region. Kenol has established four subsidiaries, which trade under the Kobil brand. The subsidiaries are Kobil Uganda Limited, Kobil Tanzania Limited, Kobil Zambia Limited, Kobil Rwanda SARL and Kobil Ethiopia. The
combined number of service stations is over 260, with over 12 strategic storage and distribution facilities. The two companies employ over 350 staff directly, and over 4,500 indirectly through retail and distribution networks. Kenol and Kobil engage in trading activities in Eastern and Southern African countries including Uganda, Tanzania, Rwanda, Mozambique, Malawi, Ethiopia, and the Indian Ocean Islands.

Kenol also implemented a Group Employee Share Ownership Plan (ESOP) in 2003 thereby becoming the first indigenous African oil company outside of South Africa to introduce the ESOP concept. The ESOP, which was approved by the Capital Markets Authority, has as its objective the retention, motivation and reward of Kenol’s high quality staff. In total, 872,470 shares have been granted thus far with further branches becoming available for the year 2004.

4.1.2 Profitability
In 2005, as has been the trend over the years, the accounts reflected a continued growth of the organization, with a 20% growth in Gross Profit over the 2003/2004 financial year. Operating profit grew by 36% over the same period, from KShs.1.2 billion to KShs.1.6 billion.

The growth in profitability has been realized despite a slight decline in sales volume due to a lower volume moved by the company’s trading desk. The results for the year have also been greatly affected by higher Finance Costs and Income Tax Expenses. Finance Costs were affected by an increase in interest rates in 2005, and a sharp increase of Crude and Product prices during the year, leading to increased borrowings. Exchange differences
resulting from translation of foreign currency asset and liabilities contributed in reducing the earning by over KShs 139 million compared with a gain of over Kshs 53 million in 2004.

Table 4.1 Profit and Loss Accounts for Kenol/Kobil 2005

| KENYA OIL COMPANY LIMITED. Financial Statements For the Year ended 30th September 2005 |
|-----------------------------------------------|--|---|
| KENYA OIL COMPANY LTD - 2005 ANNUAL GROUP RESULTS CONSOLIDATED PROFIT & LOSS ACCOUNT (AUDITED) FOR THE YEAR ENDED 30 SEPTEMBER 2005 | 2005 | 2004 |
| Sales (gross) | 41,744,973 | 34,478,830 |
| Sales (net) | 37,536,818 | 30,414,739 |
| Cost of sales | (34,753,886) | (28,090,022) |
| Gross profit | 2,782,932 | 2,324,717 |
| Other income | 29,486 | 39,808 |
| Distribution costs | (134,864) | (159,809) |
| Administrative expenses | (1,068,391) | (1,019,907) |
| Operating profit | 1,609,163 | 1,184,809 |
| Finance (costs)/income | (235,402) | 15,728 |
| Profit before income tax | 1,373,761 | 1,200,537 |
| Income tax | (457,883) | (362,053) |
| Profit for the year | 915,878 | 838,484 |
| Basic earnings(Ksh per share) | Ksh9.09 | KSh8.32 |
| Diluted earnings per share | Ksh9.92 | KSh8.20 |
| DIVIDENDS | | |
| Special Interim | NIL | 100,796 |
| Proposed final | 226,791 | 100,796 |
| | 226,791 | 201,592 |

Source: www.kenolkobil.com

4.1.3 Business Expansion

Kenol has signed an agreement to acquire 100 percent of Shell Rwanda SARL’s assets as a going concern. Shell Rwanda SARL operates among others, a retail network of 17 service stations and a terminal under long term lease from the Government in Kigali, with storage capacity of 16,000 M³, the
biggest in the country. Rwanda has been a viable market for Kenol since it established Kobil Rwanda SARL in 2002. The company has been an active player in the market, mainly concentrating on the Commercial, Reseller and Export markets. Kenol expects that this acquisition will help it consolidate its present position in the Great Lakes Region, including Burundi and the Democratic Republic of Congo.

Kenol's latest acquisition reflects the confidence the company has on the growth of its operations in the downstream petroleum business in Africa. Since 1999 when Kenol first launched an ambitious expansion programme and established its first subsidiary, Kobil Uganda Limited, the company has continued to seek growth through diversification, organic expansion and acquisitions.

Kenol/Kobil's Export Department sells petroleum products to markets outside Kenya. Below is a brief outline of the department's activities:

**TABLE 4: EXPORT DEPARTMENT'S ACTIVITIES**

<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sale Outlets:</strong></td>
<td>In Kenya, product is sourced and sales are made from Mombasa on the Indian Ocean Coast, Kisumu on Lake Victoria, and Eldoret in Western Kenya's Rift Valley. Outside Kenya, export sales are made from the company's subsidiaries in Uganda, Tanzania, Rwanda and Zambia.</td>
</tr>
<tr>
<td><strong>Transport:</strong></td>
<td>Products are delivered via road, rail and water.</td>
</tr>
<tr>
<td><strong>Destinations:</strong></td>
<td>K/K currently exports petroleum products to Uganda, Tanzania, Rwanda, Burundi, Sudan, Congo (both Eastern Congo and the Lubumbashi area), Zambia, Malawi and Mauritius.</td>
</tr>
<tr>
<td><strong>Castrol Lubes:</strong></td>
<td>Kobil holds the rights to distribute and sell Castrol brand lubricants in Uganda, Tanzania, Rwanda, Burundi and Eastern Congo</td>
</tr>
</tbody>
</table>

Source: www.kenolkobil.com
The company’s other subsidiaries, (as shown in the Map below) in addition to Kobil Rwanda and Kobil Uganda, are Kobil Tanzania, Kobil Zambia and Kobil Ethiopia. The latter was established this year, and strategies are in place to expand its operations. Kenol’s latest acquisition in Zambia will be brought up for formal approval in its forthcoming Annual General Meeting.

4.2 Competitive Advantage through Diversification

During the year 2005, the company continued to face stiff competition in all the major business lines. The industry re-alignment brought with it new challenges. Despite these re-alignments, Kenol/Kobil continued to strategise with a view to protecting and expanding its market position in all sectors. The company managed to grow in most sectors, most notably in the Retail and Aviation Sectors. The company recognizes that Retail is a key business line, and has focused a lot of energy on its continued growth. The commercial segment has also maintained several key accounts that have contributed to higher sales volumes for the business. With a view to maximize shareholders value, the company continued to expand its investment portfolio with the aim of increasing profitability for the organization.

4.2.1 Long Term Strategic Issues

The company has purchased Shell’s entire assets in Rwanda. These include a network of 17 service stations and a Leased Terminal. Kenol/Kobil products and services portfolio continued to expand across the subsidiaries during the period under review, with the introduction of LPG brand and K-Gas in Rwanda and Burundi. The company also introduced Kobil lubricants in Tanzania, and have established new customers’ base for the lubricant products across the
region, a move that will improve profitability for the organization. The Non-Fuel Business has continued to generate extra resources for the organization, and the company has sought to grow this business line through introduction of new services and products, while expanding existing ones.

Kenol/Kobil has continued to expand its facilities in tandem with the strategy of seeking growth and new markets for its products. During the 2005 financial year, the company commenced construction of an LPG filling plant in Industrial Area, Nairobi. The project has been completed and commissioned. Developing the LPG business line has been the companies’ strategy for the last two years and with the new Filling Plant in Nairobi, it believes it can make substantial progress in achieving the goal of becoming a major player in the LPG market.

Other strategies Kenol, together with its sister company Kobil Petroleum Limited, has undertaken to increase its presence in the African Continent is the establishment of the African Trading Desk. It is the responsibility of the African Trading Desk to develop new mid-stream trading markets in African countries. The African Trading Desk has won tenders to supply petroleum products in several African countries, the most significant of which is Mozambique. Kenol and Kobil are now eyeing diverse markets including Malawi, Sudan, Ethiopia, Mauritius and Zimbabwe.
4.3 Strategies Communication for Successful Diversification

The company has put in place long term strategies including strategic communication, financial strategy, strategy for resource acquisition, deployment and subsidiaries and new activities.

4.3.1 Diversification Strategy

The Kenol/Kobil Group has been actively involved in the sale of bulk petroleum products in crude oil and refined form. The company calls this concept Trading.

From the volume of business generated from trading activities, Kenol/Kobil established an African Trading Desk to enhance this business line, in 2002. The Desk has been actively trading in East, Central and Southern Africa, and the Indian Ocean Islands. Countries so far covered are Kenya, Uganda, Tanzania, Mozambique, Sudan, Ethiopia, Malawi, Mauritius and Zambia. To this end, there are strong ties with governments, government bodies, oil companies and storage companies within this region.

As the reach of the trading activities continues to grow, the company has also developed a strong Supply source through ties with state oil producers and refiners as well as with equity producers, in the Arab Gulf region.

4.3.2 Financial Strategy

Kenol/Kobil embarks on careful management of inventories to ensure that they are able to meet their Customers' requirements at all times. The company has also established a dynamic financial base with strong ties with
several first-class European International Banks that enable it to meet whatever amounts of crude oil and product purchases that may be required.

With expansion and growth comes the necessity to fund the Group’s increased working capital requirements. The Commercial Paper programme is meant to fulfil these needs.

With the establishment of a Trading Desk, the Group has begun tapping into new markets. As a result, the Group’s net sales have grown from Kshs 8.7 billion in 2001 to Kshs 30.4 billion in 2004. The Group’s growth has resulted in the need for an increase in working capital requirements as shown in the table below. Because of the Group’s high growth, it has become necessary to fund this growth both in terms of long-term capital and short-term capital needs.

While the internally generated funds are set aside to fund long-term capital investments (acquisitions and capital expenditure), the Commercial Paper programme is designed to fund the Group’s short-term capital needs.

The following table depicts growth in sales and short-term capital requirements for the Group for the last four years:

<table>
<thead>
<tr>
<th>TABLE 5: GROWTH IN SALES AND SHORT-TERM CAPITAL REQUIREMENTS</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Net sales</td>
</tr>
<tr>
<td>Working Capital</td>
</tr>
<tr>
<td>after external</td>
</tr>
<tr>
<td>funding</td>
</tr>
<tr>
<td>External funding</td>
</tr>
<tr>
<td>• Commercial</td>
</tr>
<tr>
<td>paper</td>
</tr>
<tr>
<td>• Overdraft</td>
</tr>
<tr>
<td>facilities</td>
</tr>
<tr>
<td>Total working</td>
</tr>
<tr>
<td>capital</td>
</tr>
</tbody>
</table>

Source: www.kenolkobil.com
The cash flow projection for 2005 showed that the Group needed to raise short-term funding of between Kshs 60 million and Kshs 880 million from month to month. These funds are needed to support the growing level of sales. Kenol intends to utilize the Kshs 1 billion Commercial Paper facility to meet these projected working capital needs and support the Group's vision of being a major player in Africa. In addition, the company has a team of experienced professionals who are constantly in touch with ship owners and broking houses for competitive freight packages.

4.3.3 Resource Acquisition and Deployment

The Kenol/Kobil Group has achieved significant growth in recent years both through internal growth and acquisition of companies. The table below summarizes the company's progress over the last 14 years in developing its network:

<table>
<thead>
<tr>
<th>Network growth</th>
<th>Number of stations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kenya</td>
<td>41</td>
</tr>
<tr>
<td>Uganda</td>
<td>-</td>
</tr>
<tr>
<td>Tanzania</td>
<td>-</td>
</tr>
<tr>
<td>Zambia</td>
<td>-</td>
</tr>
<tr>
<td>Rwanda</td>
<td>-</td>
</tr>
<tr>
<td>Total</td>
<td>41</td>
</tr>
</tbody>
</table>

Source: www.kenolkobil.com

4.3.4 Subsidiaries and New Activities

Subsidiaries and new acquisitions are discussed below.

a. Kobil Uganda Limited

Although trading under the Kobil brand, Kenol owns 100% shares in Kobil Uganda Ltd. After five years of operations in Uganda, the Company already
has fifty two (52) service stations and a depot in Kampala. The Company's operations account for an estimated 12% of the local market share. Kobil Uganda sales are mainly in the retail sector. The business has been profitable and is expected to expand in the next financial year with a view to opening eight additional retail outlets in 2005.

b. Kobil Tanzania Limited

Kobil Tanzania Limited (KTL) is also a wholly owned subsidiary of Kenol. KTL started operations in May 2001 and currently operates 15 service stations in Tanzania and is well poised for growth. There are plans to open another three service stations in 2005. Kobil Tanzania currently controls a 5.6% share of the local market. The Company is currently selling large quantities of both fuel and lubricants. The Tanzanian petroleum industry, though very competitive, is a strategic market place for the Group as it is the fastest growing economy in East Africa.

c. Kobil Zambia Limited (formerly Jovenna Zambia Ltd)

Kenol acquired a 100% interest in Jovenna Zambia in March 2002 before renaming it as Kobil Zambia in 2003. Kobil Zambia has been operating in Zambia for two years and currently has depot facilities in Lusaka and Ndola. The company has a network of 15 service stations having opened a new one in 2004. In line with the impressive growth here, plans were underway to open three more stations in 2005. Management expected to increase the Company's market share to over 10% in 2005 from 8% in 2004. The market,
which is dominated by multinational companies, is stable, profitable and well organized due to government supervision.

d. Kobil Rwanda SARL

Kobil Rwanda is the latest addition to the Kenol Group. This subsidiary, which is 100% owned by Kenol, was incorporated in May 2002 with the aim of covering the eastern part of central African markets of Rwanda, Burundi and Eastern Congo. The Company has already established one service station and within two years gained an impressive 30% market share of the wholesale fuel market in the country. Inspired by this phenomenal growth Kobil Rwanda planned to expand its presence in Rwanda in 2005. Kobil Rwanda also sells lubricants, fuel oil and bitumen in the region. With the petroleum industry being well regulated, the operating environment in Rwanda is expected to remain stable.

4.4 Competitive Diversification Strategies

Kenol is active in the major sectors of the economy, such as transport, energy, agriculture, tourism, construction, aviation and marine. The Company markets a wide range of petroleum products, such as Gasoline, Diesel, Kerosene, Jet A1, all Bitumen products, fuel oil products, industrial diesel oil and liquefied petroleum gas. The Company also markets lubricants covering a wide range of activities such as motoring, manufacturing, and marine.

In December 2001, Kenol launched its own brand of lubricants, which are now available countrywide. In response to the growing volumes, Kenol established
a lubricants division in July 2003 to cater to this market. The division is responsible for the development, supply and sale of the Kenol brand of lubricants that now account for 11.2% of market share of the total lubricants sold in the Kenyan market. The lubricants are also sold in neighbouring countries through the Kenol subsidiaries. Kenol lubricants are blended locally to meet lubrication needs in the automotive, industrial, marine, and aviation segments, conforming to American Petroleum Institute (API) standards and exceeding the performance levels required by original equipment manufacturers. Kenol is among the few oil companies to be awarded the ISO 9001: 2000 certification for its lubricants business segment. K-Gas is Kenol Group’s Liquefied Petroleum Gas (‘LPG’) brand and was launched in 2002.

The growth of K-gas can be attributed to its focus on consumer needs. Before K-gas was launched, extensive consumer research was conducted both locally and internationally. This research showed that consumers worldwide had three basic desires when using Liquefied Petroleum Gas: safety, availability and value for money. K-gas addressed these issues and as a result has posted impressive growth figures. K-gas now has over 100,000 cylinders with the end consumer. It also boasts of a 10% retail market share, all achieved in less than two years.

The group has obtained ISO 9001:2000 certifications for the following activities: refining, blending, storage, distribution and marketing of petroleum products, lubricants and specialties. Plans are now underway to get ISO 9001:2000 certifications for the LPG business line.
Kenol was the first oil company to introduce low sulphur diesel to the Kenyan market. Low sulphur diesel has half the sulphur content of regular diesel. It is far more environmentally friendly than regular diesel. By reducing the sulphur levels, this brand of fuel increases a vehicle’s engine life as well as its efficiency. Indeed, Toyota Kenya have recommended low sulphur diesel for its diesel engines. Further, unlike the unleaded fuel that is also in the market, low sulphur diesel is compatible with all diesel engines without any need for customization.

Currently, low sulphur diesel is available in Mombasa, Nairobi, Naivasha, Nakuru, Eldoret, Kericho, Kapsabet and Kisumu. Low sulphur diesel comprises 30% of Kenol's diesel sales. With increased market awareness and more distribution points, this figure is set to rise rapidly. Plans are already underway to further reduce the level of sulphur in the low sulphur diesel. Kenol also plans to introduce new products in the near future. Kenol has a depot at Sagana in the Mt. Kenya region. The Company also works with KPC and other oil companies in Mombasa, Nakuru, Eldoret, Kisumu and Nairobi. A dry goods storage depot is located at Ruaraka in Nairobi. The Aviation sector consumers are served through the Nairobi Refuelling Services and Mombasa Refuelling Services.

Over the last few years, the Company has developed and financed convenience stores, restaurants and other non-fuel businesses as part of its network. These businesses are managed by independent third parties, freeing
up Kenol's resources and management time while enhancing income through revenue sharing agreements. In addition, the Company charges license fees to Dealers for the service stations and other activities carried out on the premises.

The Company has entered into a partnership agreement with Java House Ltd which specializes in high quality coffee. Under the partnership agreement, Java House Ltd. pays license fees to Kobil for the use of its premises, other ancillary facilities and parking space. In return, the coffee house has granted exclusive rights to Kenol/Kobil meaning that Java House Ltd cannot enter into a similar arrangement with another oil company. There are further plans to open a new store within Nairobi's Central Business District. In addition to this, there is a similar agreement with the Kengeles restaurant group. As the two establishments have different market niches, there is no conflict between Kengeles & Java Coffee House.

In line with management's strategy of increasing its non-fuel based business, Kenol has also entered into a partnership with Triple A pharmacy. Currently there are two pharmacies at Kenol premises: at Gigiri and on Thika Road with plans to introduce one more in 2005.

The Company has also signed a Distribution Agreement with Safaricom to distribute products such as mobile phones, connection services, and scratch cards. These products and services are available through Kenol's service stations. In Uganda, there is a similar arrangement with mobile provider MTN.
In addition to these, Kenol has a Distribution Agreement with Holt Lloyd International (UK) to market and distribute Car Care and Fuel additive products in East Africa.

4.5 Political Environment and Response to Change

Kenol/kobil is a fast mover. In 2003 Kenol had an average market share of 8.74%, 7.76% and 8.80% in the Kenyan retail, commercial and inland market sectors respectively. In the 9 months to 30 September 2004, these market shares figures had moved to 6.20%, 9.92% and 9.20% respectively. The reduction in the retail market share is attributable to the temporary closure of some petrol stations in 2003 in response to difficult trading conditions. Kenol has however significantly improved its market share in the commercial sector after winning several tenders during the year.
CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary
The Kenol/Kobil Group has embraced geographic diversification as its core strategy. It pursues acquisition as an entry strategy in the region and countries where it is operating. Currently, apart from Kenya, the company has subsidiaries in Kobil Uganda Limited, Kobil Tanzania Limited, Kobil Zambia Limited, Kobil Rwanda SARL and Kobil Ethiopia. Within Kenya, Kenol/Kobil pursues geographic diversification by making presence in all the regions and major towns in the country.

In business expansion strategy, pursued as part of geographic diversification, the company has been an active player in the market, mainly concentrating on the Commercial, Reseller and Export markets. Kenol's latest acquisition reflects the confidence the company has on the growth of its operations in the downstream petroleum business in Africa and is an indication that the strategy pursued by the company is successful.

Other strategies Kenol, together with its sister company Kobil Petroleum Limited, have used to increase their presence in the African Continent is the establishment of the African Trading Desk. Kenol and Kobil are now eyeing diverse markets including Malawi, Sudan, Ethiopia, Mauritius and Zimbabwe. This gives the company a strong back up to compete in the areas of operation. Its Trading concept is a powerful diversification strategy.
Acquisition of the companies and subsidiaries require a very strong financial base. The strength in finance enables the Company to succeed in its geographic diversification especially given that the major competitors are multinational companies with a lot of financial muscle. Because of the Group’s high growth, it has become necessary to fund this growth both in terms of long-term capital and short-term capital needs.

In response to the growing volumes in the market, Kenol established a lubricants division in July 2003 to cater to this market. This is a twin diversification strategy both in product and geography. Quality, being an integral part of competitiveness in the international market has also been emphasized by the company by acquiring ISO 9001: 2000 certification for its lubricants business segment.

5.2 Conclusion

The objectives of this study were: To determine whether Kenol/Kobil has attained competitive advantage through geographic diversification, to determine the factors used by Kenol/Kobil in pursuit of its geographic diversification strategy, and to determine factors considered by Kenol/Kobil in selecting geographic areas to diversify into.

All the three objectives the study sought to meet were achieved. It is evident from the study that Kenol/Kobil has been able to increase its market share both locally and regionally through acquisitions of rival companies. In Kenya, it has increased its market share to 20%. It has also acquired Shell in Rwanda.
and is successful in Tanzania. The factors considered in diversifying include the possibility of dominating and the state of competition in those areas. It also considers financial capabilities of the company in meeting the objectives it has set for itself. The unique Trading strategy used to support its expansion by providing alternative financing is the most successful and ingenious strategy considered by the company.

5.3 Limitations of the Study
Being a case study, it was not easy to get the information required to complete this study. It took a very long time to finally convince the company to give an interview on the issue, which they consider to be part of company secrets.

5.4 Recommendations for further study
It is recommended that more detailed study be undertaken on the limitations and challenges faced by companies diversifying geographically across international borders.
REFERENCES


Bennett, R. ((1999) **Corporate Strategy**. Financial Times Print Management London


Chepkwony, J. (2001) **Strategic Responses of Oil Firms Kenya to Challenges of Increased Competition in the Industry**, Unpublished MBA Project Paper, University of Nairobi


Daily Nation, **Wednesday, July 18, 2002**. Nation Profits Up By 78 P.C.


Drucker P. F. (1955) **The Practice of Management**, Heinemann


http://www.hbsworkingknowledge.hbs.edu

International Migration Volume 41, Issue 3, Page 155-185, Sep 2003


Salter, MS And W. Weinhold (1979) *Diversification Through Acquisition*: Free Press New York


www.bkpub.com

Www.blackwell-synergy.com/servlet/useragent?func=showHome
APPENDIX 1: INTERVIEW GUIDE

PART A

Introduction
1) Name and location of the firm
2) Size (Number of employees, Number of plants, Number of Outlets, Names of countries operating)
3) Ownership structure (sole proprietor, partnership, franchise, chain, subsidiary)
4) Most recent gross revenues available, net profits, market share, growth rate
5) Primary products/services of the firm
6) Secondary products/services of the firm
7) Firm's relevant geographic market for primary and secondary lines
8) Firms relevant demographic market for primary and secondary lines
9) Firm's share of market in primary and secondary lines
10) Additional information relevant to describing the business and its market

PART B

Identify whether Kenol/Kobil has achieved Competitive Advantage through geographic diversification in relation to other oil companies.

1. Competitive Stance. Where does the company fall?

   Why is it so?

2. Identify the firm's principal inter-firm rivals and strategic group(s)
3. Describe competitive strategies within the strategic group
4. Describe the structural forces, which drive competition.
5. Describe environmental factors impacting competition?
6. Identify long-term strategic issues affecting:
   a. Industry attractiveness / long term profit potential
   b. Nature or structure of competition or core technologies
7. In concluding this part, identify where the long-term profit potential exists in the industry?
8. Identify the strategic potentials in the industry's future?

PART C
Identify the diversification strategies used by Kenol/Kobil.

1) Strategic Communication

   How are strategic intent, mission, vision, business strategies, and corporate strategies, functional and operational strategies communicated?

2) Financial Position/Financial Strategy

   What is current position relative to industry potentials? Specify financial inhibitors, warning signals, and weaknesses.

3) Resource Acquisitions and Deployment

   Identify inputs that are critical industry potential? How well is the firm positioned to acquire and exploit those inputs?

4) Functional Capacity

   Does the design of work, structure of authority, human capital management, and information systems contribute towards your geographic diversification strategy?

5) Innovation Capacity
What are the sources of innovation within the firm? What inhibits these sources from contributing to competitive advantage?

PART D
Identify the factors that Kenol/Kobil uses in selecting geographic areas to diversify into

1) Competitive Strategies in geographic diversification
   What are they? How have they evolved? Are they working toward competitive advantage?

2) Political Environment
   Does the political environment internal or external to the firm enhance or inhibit your competitive? How?

3) Response to Change
   How well does the firm mobilize for change? How well does it integrate change? Adjust to instability and crisis?

12. CONCLUSION
What is overall plan of action the firm has for gaining and sustaining competitive advantage, and for seizing strategic potentials?

Thank you very much for your time and cooperation
APPENDIX 2: SECONDARY DATA SOURCES FOR THE CASE STUDY

1. Company's Annual Reports
2. Petroleum Institute Of East Africa
3. Capital Markets Authority Annual Reports
4. Shareholder Meeting Notices
5. Internet Address of the Company
6. Regional Performance Reports
7. GoK Economic Surveys
8. Ministry of Economic Planning Reports
9. Ministry of Energy Annual Reports
10. Analysis of the Industry by Brokerage Firms
11. Business Week (Business Information)
12. Unpublished Research Reports, University of Nairobi
13. Kenol/Kobil Online Http/: KenolKobil.co.ke
14. Nairobi Stock Exchange
15. Internet Address of other oil Companies