RESPONSES BY COMMERCIAL BANKS OPERATING IN KENYA TO CHANGES IN THE ENVIRONMENT: A CASE OF NATIONAL BANK OF KENYA LIMITED

BY

MUSA ABSHIROW HERIN

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DECLARATION

This research project is my original work and has not been submitted for a degree course in this, or any other University.

Signed .... Date 01/03/2005

MUSA A. H

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

Signed .... Date 4/2/2005

PROF. EVANS AOSA
Supervisor, Faculty of Commerce
University of Nairobi.

DEDICATION

To my beloved mother and my entire family for the moral support.

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I would first and foremost, thank Al-Mighty Allah for giving the precious gift of life and strength to undertake this research.

My heartfelt gratitude goes to all the people who, in their special ways, have made this study a success.

I would like to thank my supervisor, Prof. E. Aosa whose guidance and encouragement was indeed invaluable.

To my fellow colleagues, the managers for their response to my questions.

ABSTRACT

The objectives of the study were to identify changes in the external environment affecting National Bank of Kenya and to establish the response of National Bank of Kenya to the changes in the competitive environment, and to document the relevant responses made by the bank.

In order to meet these objectives, the pertinent primary and secondary data was collected. Primary data was obtained from personal interviews with the respondents who were responsible for developing the strategic responses by NBK to its changing competitive situation.

The same research interviewees have also been overseeing the implementation of these responses. Secondary data was collected from various sources. The data was then analyzed qualitatively.

The study established that the changing competitive situation in the Kenyan banking industry has posed some challenges to NBK. These challenges arose from the changes in the business environment in terms of economic decline, liberalization; legislative changes, increasing level of education and technological advancements. The management of these changes has been made more difficult by the presence of all five forces that influence the competitive situation in an industry. These forces are barriers to entry, rivalry within the industry, threat of substitutes, power of buyers and power of suppliers (Porter, 1980).

According to the research findings, NBK has addressed its changing competitive situation through restructuring, marketing, information technology, re-capitalization and culture change among other responses. These have made NBK more competitive but have not adequately enabled the bank to fully match its environment.

However, most of the respondents believe that NBK has the necessary capability to effectively respond to its changing competitive environment.

This study was based on four major strategic response variables. A further study can, therefore, be carried out on the other responses that NBK has made to address its changing competitive situation. Alternatively, a cross-sectional survey covering the whole industry can be undertaken to determine the strategic responses by the banking industry. This would give an indication of the responses made by banks, in Kenya, to their changing competitive situation especially with the increasing growth, in the number and size, of the non-bank financial institutions. This, then, will allow for industry generalizations to be made.

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CHAPTER ONE: INTRODUCTION

1.1 BACKGROUND

Pearce and Robinson (1991) state that strategic response is the set of decisions and actions that result in the formulation and implementation of plans designed to achieve a firm's objectives. It is thus a reaction to what is happening in the environment of organizations. Porter (1980) points out that knowledge of the underlying sources of competitive pressure provides the groundwork for strategic agenda in action. When firms are faced by unfamiliar changes, they should revise their strategies to match the turbulence level (Ansoff and McDonnell, 1990).

Ansoff and McDonnell (1990) state that successful environment serving organizations, are open systems and use strategies that ensure continued organizational survival in the environment. They further state that a major escalation of environmental turbulence means a change from a familiar world of marketing and production to unfamiliar world of new technologies, new competitors, new consumer attitudes, new dimensions of social control and above all unprecedented questioning of the firms role in the society.

Organizations do not operate in a vacuum. They are environment dependent (Ansoff and McDonnell, 1990). They obtain their inputs from their environment and after transformation they discharge their outputs into the same environment (Porter, 1985). The organization's external environment consists of all the conditions and forces that affect its strategic options and defines its competitive situation (Pearce and Robinson, 1997). Therefore, for an organization to succeed in achieving its objectives, it must pay close attention to its external environment.

Aosa (1998) argues that strategy is creating a fit between the external characteristics and internal conditions of an organization to solve a strategic problem, which is a mismatch between the internal characteristics of an organization and its external environment. Consequently, organizations need to not only notice changes in their external environment, but also need to formulate strategies that match these changes. Failure to do so will result in a strategic problem, which is detrimental to the survival of the organization.

The Kenyan business environment has been undergoing drastic changes since the onset of liberalization in the early 1990s. Some of the changes include the accelerated implementation of economic reforms, the liberalization of the economy, discontinuation of price controls, privatization and commercialization of public sector and increased competition.

In this changing environment, organizations have constantly adapted their activities and internal configuration to reflect the new external realities. Failure to do this may put the future success of the organization in jeopardy (Aosa, 1998)

The environment in which Kenyan firms operate therefore became turbulent in the 1990s due to unfamiliar changes in the business environment that exerted heavy pressure on organizations to face competition (Government of Kenya, 1998).

From the above scenario, one can assert that external conditions have drastically changed in Kenya, hence continuously exerting new challenges on the organizations. This in turn creates pressure for organizations to respond to the new environmental reality. National bank of Kenya bearing the full brunt of environmental turbulence needs to have strategies in place to cope with the changes in the environment.

1.2 THE KENYAN BANKING INDUSTRY

There are forty-six bank and non-bank financial institutions, fifteen micro finance institutions and forty-eight foreign exchange bureaus with a total asset of Kshs.459.6 billion, (Central Bank of Kenya, 2003).

Thirty-five of the banks, most of which are small to medium sized, are locally owned. A few large banks dominate the industry most of which are foreign-owned, though some are partially locally owned. Six of the major banks are listed on the Nairobi Stock Exchange.

The commercial banks and non-banking financial institutions offer corporate and retail banking services but a small number, mainly comprising the larger banks, offer other services including investment banking. The Central Bank has on a few occasions put certain commercial banks under statutory management and some have resulted in closure. Some of the smaller banks have started to merge in a bid for survival as they are faced with an increase in commercial banks minimum paid up capital and high operational costs due to cut-throat competition from the bigger players, (Banking survey 2002). The banking sector is poised for significant product and market development that should result in further consolidation of the banking sector.

The Banking industry in Kenya is governed by the Companies Act, the Banking Act, the Central Bank of Kenya Act and the various prudential guidelines issued by the Central Bank of Kenya (CBK). The banking sector was liberalized in 1995 and exchange controls lifted.

The CBK is responsible for formulating and implementing monetary policy and fostering the liquidity, solvency and proper functioning of the financial system. The CBK publishes information on Kenya's commercial banks and non-banking financial institutions.

The banks have come together under the Kenya Bankers Association (KBA), which serves as a lobby for the banks' interests and also addresses issues affecting its members. Ideally, financial reforms and a free market should spur the adoption of innovations that improve efficiency and provide a healthy balance between lending and deposit rates. However this was hampered due to a highly volatile macroeconomic environment that occurred after liberalization of interest rates causing closure of some institutions.

Banks looking for a safer investment in a period of high risk raised their interest rates on loans in tune with the government's move, thus beginning a trend that has now dominated the better part of the last 10 years. During this period, the spread between lending and deposit rates in Kenya's banking sector has remained very high. Savers have thus been discouraged from keeping their hard-earned cash in banks, because of the poor return on their deposits, while businesses have been starved of loans to keep them afloat.

This has had the knock-on effect of increasing financial transaction costs, reducing access to finance for potential borrowers, choking investment and contributing to the overall decline in Kenya's GDP which expanded by an estimated 0.9% in the year 2002(Central Bank Kenya, 2003).

Foreign Exchange Bureaus were introduced in 1995 with the primary objectives of providing healthy competition in the foreign exchange market in the liberalized financial sector. As at now there are 48 licensed and operational foreign exchange bureaus, 38 based in Nairobi, 7 in Mombasa and 1 each in Nakuru, Kisumu and Eldoret. Foreign exchange bureaus are permitted to buy and sell foreign currency in cash, and may also buy travelers' cheques, personal cheques and bank drafts. The overhead cost of foreign exchange bureaus are lower compared to the banks leading to favourable exchange rates and loss of business by banks.

During the year under review, the banking sector embraced the changes occurring in information technology. The banks which are front runners have already achieved branchless banking. The big banks expanded their networks of Automated Teller Machines (ATMs) while the small and medium size banks are exploring possibility of establishing shared ATMs. The use of credit, debit and charge cards has also expanded.

Several banks entered into the internet banking and established websites. However, internet banking is still at its infancy. A major constraint that banks have been facing in their endeavour to computerise and introduce other technology related products is the lack of modernization in telecommunications sector.

1.3 NATIONAL BANK OF KENYA LTD.

The bank was established in 1968 by an Act of Parliament to assist in Africanizing the economy. The government of Kenya who put up an initial capital of Kshs.5 million wholly owned it. The bank is among the largest commercial banks in the country, (Central Bank of Kenya, 2003). The size of the bank is important, as the capital base is important, to be able to fight competition and counter change. The Bank was licensed as per the banking act to carry out banking services. It started operating the first branch at Development house in 1968.

The bank's first public share issue was on 26th September 1994, which was oversubscribed. Its Head Office is located at National Bank Building on Harambee Avenue Nairobi. The bank has 23 branches and six agencies.

The branches were many but due to rationalization and restructuring, a number of them were merged and others closed down between 1999 and 2001. The branch network is important to fight competition.

The bank was wholly government owned until 1994 when it was privatized. The major shareholders of the bank are the Government of Kenya 22.5%, National Social Security Fund 48.05% and public 29.45%.

The bank has 23 branch network. The bank offers all the services and products offered by commercial banks but it is not clear which market segment they are targeting i.e. either corporate or retail. In the year 1999 National Bank of Kenya (NBK) recorded a record loss of Shs.3.4billion, which was the highest ever loss recorded by any financial institution in this country. This was as a result of huge unsecured loans in form of bad debts which was created by political loans due to Government influence.

As at 31st December 2002, the bank had accumulated losses amounting to Shs.5.55billion (2001-Shs.5.89billion) primarily due to significant portfolio of non-performing advances.

The continued profitability and return to satisfactory liquidity levels are dependent on recoveries of non-performing loans and advances and/or injection of additional capital which has threatened the liquidity and the survival of the bank as a viable financial institution.

The bank recorded a pre-tax profit of Kshs.390m in the year 2002 compared to a loss of kshs.322M in the previous year. Total operating income rose from Kshs.2.4 billion in 2001 to 3.4 billion in 2002. This was brought about by improvements in interest received from loans and advances representing a 57% growth. Provisioning for bad and doubtful debts outweighed savings in staff costs realized from restructuring of the bank.

1.4 THE STATEMENT OF THE PROBLEM

The 1990s have seen a lot of changes in the economy of Kenya. Most of these changes have mainly had to do with liberalization, globalization, technological advancement and a more enlightened consumer. The harsh economic conditions in Kenya have seriously affected the profitability and market share of companies (Government of Kenya, 1999). Many sectors of the economy witnessed stiff competition following liberalization. This has forced many companies to adopt changes to compete in the new turbulent environment.

The changes posed serious strategic threat to existing firms. Studies to confirm changes in the business environment in Kenya were done such as Bett (1995), Chune (1998, Kombo (1997), Abdullahi (2000), Warucu (2001) and Kandie (2001).

Local studies have been done in the banking industry in Kenya but there is no specific study done on the responses of National Bank to changes in her environment. This study is therefore meant to fill the void to study how National Bank has responded to the changes in her environment.

There have been turbulent changes in the environment of National Bank Kenya just like any other industry players. The organizations faced with environmental changes are expected to respond by adopting the appropriate responses. In changing environments, firms should cope with the change by adopting various strategies such as differentiation, focus, marketing mix variables, segmentation, positioning, strategic alliances, improvement in quality of products and services among others. Therefore NBK is equally expected to respond to those changes. It's not clear whether the bank responded to the changes and what strategies it is using to respond. This is what researcher set out to investigate in this study. What is the response of National Bank of Kenya to the changes in the competitive environment?

1.5 OBJECTIVES OF THE STUDY

The objective of the study is:-

To establish the response of National Bank of Kenya to the changes in the competitive environment.

1.6 SIGNIFICANCE OF THE STUDY

The study will be important to the following users:-

It will help managers in identifying what in the external environment affect their organizations and the possible responses to be adopted.

The Government may use it for formulating policies that relate to the economic forces prevailing in the country that put pressure on organizations and its citizens.

The Scholars would use it for reference and further research in external forces affecting organizations operating in Kenya or any other country hence act as authority.

CHAPTER TWO : LITERATURE REVIEW

2.1 INTRODUCTION

The chapter addresses the concept of strategy, strategic management and the external environment of the organization. The concept of strategic management is important for the success of organizations. These issues influence the responses made by such organizations in managing the environments in which they operate.

2.2 THE CONCEPT OF STRATEGY

Ansoff (1965) defines strategy as the product market scope of a company. This refers to a decision of what to produce in what market. If the environment is stable, an organization can operate without changing its product-market focus. However, if the environment changes, this would require changes in the organization's product-market focus that is its strategy. Product-market focus relates to conditions of the external environment, which have to be incorporated into strategy. If the products the company is producing or the markets it is serving are not reflective of the demands of the external environment, then the company's efforts are futile.

Aosa (1992) states that strategy is creating a fit between the external characteristics and the internal conditions of an organization to solve a strategic problem. The strategic problem is a mismatch between the internal characteristics of an organization and its external environment. The matching is achieved through development of organization's core capabilities that are correlated to the external environment, enough to enable the exploitation of opportunities existing in the external environment and to minimize the impact of threats from the external environment.

Strategy is therefore required in order for an organization to obtain viable match between its external environment and its external capabilities. Organizations must also continuously and actively adapt the change to meet the demands of an ever-changing environment.

Porter (1996) asserts that strategy is creating a fit among company's activities. The success of a strategy depends on doing many things well – not just a few- and integrating them. If there is no fit among activities, there is no distinctive strategy and little sustainability. The company's activities include its effective interaction with the environment in that these activities are geared towards serving the external environment.

Peace and Robinson (1997) define strategy as large-scale, future oriented plans for interacting with the competitive environment to achieve company objectives. It is the company's 'game plan'. While it does not detail all future development of resources, it provides the framework for managerial decisions. A strategy reflects a company's awareness of how, where and when it should compete and for what purposes it should compete.
The underlying issue of this definition is that the main thrust of strategy is to achieve long term sustainable advantage over the other competitors of the organization in every business in which it participates. It recognizes that competitive advantage results from a thorough understanding of the external forces that impact on the organization.

Johnson and Scholes (1999) Identifies 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 changing environment to meet the needs of the market and fulfill stakeholders' expectations.' The organizational environment is always changing and for an organization to enhance its competitive advantage, it must reconfigure its resources to match the changes. The changes could be mild or turbulent but they must be matched accordingly by appropriate strategy. Failure to do this will result, according to this definition, in market needs not being met by the organization activities and resources.

Since resources are scarce, managers must decide which alternative strategies will benefit the firm most. For any organization to succeed, it will be necessary for top management, managers and employees to work as a team to achieve the company goals and objectives.

From our discussions, we note how inter-related the organizations and their external environments are. This is where the organization outputs are discharged and where inputs come from. We also note that the company must discharge those outputs that meet the needs of the external environment. This external environment is always changing, sometimes more turbulently than other times. Consequently, the company must not only configure its resources to meet these needs but must develop foresight, flexibility and speed in order to respond to these changes in a timely manner.

2.3 STRATEGIC MANAGEMENT

According to Hax and Majluf (1996), strategic management is the process by which organizations determine their purpose, objectives and desired levels of attainment, decide on the actions for achieving these objectives in an appropriate time scale, and frequently in a changing environment, implement the actions, using the appropriate resources, assess progress and results.

Since strategic management is a process, it means that a change in any component will affect several or all the other components.

The process of strategic management is defined at both the primary and secondary levels, which are corporate and business levels, respectively. Strategic management involves strategic analysis, strategic choice, strategic implementation and strategic evaluation and control (Johnson and Scholes, 1999).

Strategic analysis is concerned with understanding the strategic position of the organization in terms of its external environment, internal resources and competences, and the expectations and influence of stakeholders (Johnson and Scholes, 1999). At this stage the mission and vision of the organization are stated and the goals are set and objectives defined. An organization has to be concerned with the degree to which it is changed to achieve truly demanding goals that effectively meet the external environmental characteristics (Johnson and Scholes, 1999, Hax and Majluf, 1996). Strategic choice involves understanding the underlying bases guiding future strategy, generating strategic options for evaluation and selecting from among them (Pearce and Robinson, 1997; Johnson and Scholes, 1999). Here an organization is striving to achieve sustainable competitive advantage and therefore chooses a strategy that will help it succeed towards this goal.

The choice of strategy is crucial for it could make an organization either to succeed or fail and its consequences are long term and costly to reverse. The choice must also be compatible with stakeholders' expectations. It must also pay attention to the organization's resource capabilities and its environment (Johnson and Scholes, 1999).

Strategy implementation entails translation of strategy into organization's actions through organizational structure and design, resource planning, and the management of strategic change (Johnson and Scholes, 1999). In implementing strategy, the strategist must of necessity effect change in order to accommodate the new strategy, which is based upon the demands of the external environment.

Management of strategic change involves recognizing the need for altering the way things are in an organization, planning for the alteration by doing the correct analysis, setting change goals and designing the appropriate actions, moving the organization from the current state to the desired future state, and consolidating and stabilizing changes by changing the structure and process of the organization.

Strategic evaluation and control involves not only evaluating strategy for deviation from intended course, but also for flexibility towards responding to new challenges and determining the effectiveness and the pace of the implementation (Johnson and Scholes, 1999).

Organizational change should be a continuous thing as new ideas and challenges keep coming up. Strategy therefore must be flexible enough to accommodate these developments particularly the impact of the external environment and be in tune with the environment (Johnson and Scholes, 1999).

Strategic management therefore tries to ensure that opportunities are grasped, risks are acceptable, failure can be contained and success can be built upon and sustained (Hax and Majluf, 1996). These objectives cannot be realized while ignoring the external environment, is where the organization gets its resources and products and services will be released to.

These definitions, though offered by different authors over a period of time all emphasize the fact that strategic management is dynamic and is concerned with providing, and continuously adjusting the means by which organizations can effectively cope with the turbulent environmental changes. Therefore, strategic management is not only continuous process, but also dynamic.

2.4 EXTERNAL ENVIRONMENT AND THE ORGANIZATION

An organization's external environments are all those conditions and forces that affect its strategic options and define its competitive situation. Porter (1985) sees this connection as an input-throughput-output process, where inputs are received from the environment, processed by the organization, and released back into the environment. What is released back can only be consumed by the environment if it fits the environmental requirements and needs.

Consequently if a firm is to control its growth, change and development, it must seek to control the forces, which provide the opportunities for growth and change and those, which pose threats and demand response. Not only must managers be aware of environmental forces and environmental change, but they must also manage the organization's resources to take advantage of opportunities and counter threats (Thompson 1997).

Thompson (1997) sees the external environment as consisting of three aspects. These are the external stakeholders; the changing political, economic, social and technological forces and the organization's response to the environmental forces. The external environment comprises of the remote environment, the industry and the operating environment, each of which has a global and domestic aspect.

Shipper and White (1988) refer to the external environment as having multiple facets, three of the major ones being the degree of market competitiveness, the rate of technological innovation and the variability of economic fluctuations that affect the industry. The above factors are the major facets of the external environment, which the strategist must not only be aware of, but also incorporate in his/her strategy.

According to Porter (1985), change is inevitable in the history of any organization. Organizations exist in an environment. They are environment-dependent. They look to the external environment for resource inputs. Once inputs are transformed into outputs (products and services), these are again absorbed by the environment. If the environment of organizations changes significantly, this will create pressure for change within the affected organizations. The organizations have to adapt their internal operations to reflect the new external realities.

He says that organizations that do not adapt change to keep pace with the changing environment are likely to suffer and become irrelevant. They will lose their reason for existence.

For a number of years now, the external environment of organizations allover the world had been described as turbulent and has been changing constantly and in a discontinuous way.

This means organizations have to continuously change to keep pace with this fast changing environment.

According to Porter (1980), environments can change (uncertainty of environment), new organizations enter and exit, and the supply of resources becomes more or less scarce. When environments change (become uncertain), organizations face the prospect either of not surviving or of changing their activities in response to these factors.

Therefore, to survive and become effective, an organization must be capable of making adaptations to the changing situations. It is due to these continuous changes that organizations need more powerful management process like strategic management to cope successfully.

Porter (1985) placed the dynamic relationship between enterprise strategy and industry structure at the centre of his concept of 'competitive strategy'. He presented the possibility of 'selecting' a strategy based on a well-defined 'position' in the economic market place backed-up by 'analysis' rather than 'prescription'.

An organization is an open system which interacts and relies on their environment, for obtaining essential inputs and for the discharge of their outputs.

The inputs include people, materials, information and finance. These inputs are organized and activated so as to convert human skills and raw materials into products, services and other outputs which are discharged into the environment. For this purpose, closed systems on the other hand are completely self-supporting and thus do not interact with their environment (Cole, 1990).

Pearce and Robinson (1991) arguing on the same line state that a host of external factors influence a firm's choice of direction and action, and ultimately, its organizational structure and internal processes. They argued that these factors, which constitute the external environment, fall into remote, industry and operating environment.

The remote environment comprises factors that originate beyond, and usually irrespective of, any single firm's operating situation concerning economic, political, technological and ecological factors. Accordingly, the environment presents firms with opportunities, threats and constraints but rarely does a single firm exert any meaningful reciprocal influence.

The writings of Ansoff (1965) and Andrews (1971) on the need for organizations to interact with their environment were instrumental in triggering off the adoption of corporate planning by business firms before the environment became turbulent in the early 1970s.

The essence of formulating competitive strategy is relating a company to its environment.

Although the relevant environment is very broad, encompassing social as well as economic forces, the key aspect of the firm's environment is the industry in which it competes. Industry structure guides the strategies available to the firm (Porter, 1980).

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 INTRODUCTION

Since the aims of the study were to identify the challenges that faced NBK and to document the relevant strategic responses made, a case study approach was chosen. This chapter outlines the overall methodology that was used to carry out the study. The pertinent primary and secondary data were then collected to meet the objectives of the study. The research design, data collection methods and data analysis is discussed in this chapter.

3.2 RESEARCH DESIGN

The research problem posed can best be studied using the case study method.

This method gives an in-depth account of the challenges NBK is facing in a competitive environment and in-depth account on how the company has been responding to the challenges.

The advantages of using a case study include enabling an in-depth understanding of the behavior pattern of the concerned unit, facilitating intensive study of concerned unit which is not possible with different methods and possibility of obtaining the inside facts from the experienced employees. In addition, the use of the case study method enriches generalized knowledge and makes it possible for the researcher to use one or more methods depending upon the prevalent circumstances e.g. in-depth interviews, questionnaires, etc.

3.3 DATA COLLECTION

The researcher interviewed the Chief Executive Officer (C.E.O.) of the Bank and all the Heads of Departments. The heads of departments who are experienced in their specific functional areas gave the relevant information pertaining to the bank and its environment, while the CEO gave a general over-view of the bank's strategic responses to her environment and the way forward.

The first respondent to be interviewed was the Chief Executive Officer who facilitated observation of the overall picture of the bank. The other respondents interviewed were the Director Finance, Chief Managers: - Credit, Human Resources, Marketing, Operations, Information Technology, Internal Audit and Legal were interviewed after the CEO so that they can provide specific data in their departments.

A part from the CEO, all other respondents were interviewed specially on the challenges and responses adopted by the respective departments.

3.4 DATA ANALYSIS

The data analysis sought to establish the strategic responses applied by NBK to her changing environment. The data was analyzed using content analysis.

According to (Mugenda and Mugenda, 1999) content analysis is the systematic qualitative description of the composition of the objects or materials of the study. In other words, it involves observation and detailed description of objects, items or things that comprise the study.

The information gathered was analyzed using the same technique which involves logical grouping of the information gathered to enable the researcher apply qualitative analysis, compiling results and interpretations.

CHAPTER FOUR: DATA ANALYSIS AND INTERPRETATION

4.1 INTRODUCTION

The collected data has been analyzed and interpreted in line with the aims of the study .The chapter outlines the respondent's profiles, challenges facing National Bank of Kenya, strategic responses by the bank and strategic Fit.

4.2 THE RESPONDENTS' PROFILES

The respondents in this case study are part of the top management of National Bank of Kenya and have been involved in the formulation of strategic responses that were being studied - Restructuring, Information Technology, Marketing, Re-capitalization and culture changes and are charged with the implementation of these responses. Most of the respondents have held senior management positions at NBK for over five years. The rest were new entrants both from within and outside the banking industry. Thus, their contribution to the strategic responses of NBK to the changing competitive situation facing the bank is drawn from a broad reservoir of experience and Knowledge.

4.3 CHALLENGES FACING NATIONAL BANK OF KENYA

4.3.1 Changing In Business Environment

There have been a number of changes in the business environment in Kenya, within the last 10 years that have resulted in a changing competitive situation, and have posed various challenges to NBK.

The respondents identified five major macro-environmental changes that have occurred in the business environment in Kenya, which have made an impact on NBK. These are economic decline, liberalization, legislative changes, increasing level of education, and technological advancements.

The economic recession has resulted in fewer business opportunities for NBK's clients. Consequently, the level of deposits has gone down while the ability of the bank's customers to borrow and service their loans has declined. The latter has been one of the reasons for the high level of non-performing loans at NBK. This has resulted in a worsening level of profitability, with NBK declaring a substantial loss of Kshs. 6.5 Billion over the last 3 years ending Dec. 1999. In addition, the respondents stated that due to the economic decline in the country, the bank had to rationalize its branches by merging some of the branches and closing others.

Liberalization of the Kenyan economy has led to an increase in the number of financial institutions. Furthermore, the privatization policies adopted by the government have resulted in the loss of preciously guaranteed businesses that were being offered to organizations such as NBK where the government and parastatals had large shareholdings. Such businesses now have to be won by competing effectively through efficiency and customs satisfaction.

Legislative changes have led to a reduction of interest margins at NBK especially with the emergence of the Central Bank Amendment Act (2000) that sets limits on interest rates. In addition, some smaller commercial banks have merged and have become a major threat to the Big-Five banks, which include NBK. Such mergers were occasioned by the increase in the minimum capital requirement for commercial banks of Kshs. 500 Million (The Kenyan Banker, 2000). Furthermore, the conversion of non-banking financial institutions into commercial banks, as well as the increasing number of micro-finance institutions and cooperative societies, has intensified the competition facing commercial banks. Consequently, there has been a reduction in the income generated by NBK, both from interest and commission charges.

The increasing level of education and awareness among Kenyans has led to the emergence of a more informed/demanding clientele.

NBK has had to undertake market segmentation and the development of a variety of products to satisfy the constantly changing needs of the bank's target markets. Hogendoom (2000) advised Kenyan banks, such as NBK, to be more innovative so as to be able to profitably interface the products on offer with the appropriate delivery channels for their chosen market segments.

Technological advancements have resulted in the concepts of one-branch banks, home banking as well as internet banking. NBK, therefore, is in the process of phasing out its legacy IT system and replacing these with open system that will provide more convenient banking services based on the highlighted concepts.

The current ongoing installation of Automatic Teller Machines by NBK in various delivery points, including supermarkets, has been driven by customers' need for convenience banking, 24 hours a day. However, these technological innovations are not only expensive to adopt, but also involve a high rate of obsolescence. In addition, they rely on telecommunication efficiency, which is yet to be realized in Kenya.

There is increased use of information technology at National Bank of Kenya. The bank now uses computers in all aspects of their operations. It appears that the race for computerization is on and National bank of Kenya doesn't want to be left behind.

Actually the bank has embarked on centralization programs, which will see all the branches, inter linked by the end of 2004. Hence one branch banking.

Banks looking for a safer investment in a period of high risk raised their interest rates on loans in tune with the government's move, thus beginning a trend that has now dominated the better part of the last 10 years. During this period, the spread between lending and deposit rates in Kenya's banking sector has remained very high.

Savers have thus been discouraged from keeping their hard-earned cash in banks, because of the poor return on their deposits, while businesses have been starved of loans to keep them afloat. This has had the knock-on effect of increasing financial transaction costs, reducing access to finance for potential borrowers, choking investment and contributing to the overall decline in Kenya's Gross Domestic Product (GDP).

In the 1980's the economy started deteriorating leading to a period of stagnation and loss making. The 1980's saw a computerization explosion in the banking industry. This was due to the increased power of computers at affordable price. The banks of course pioneered by multinational banks took up the concept of one-branch bank, which relied on centralization of the banks operations.

This was a threat to National Bank therefore they had to change its operating systems. With increased competition in the banking industry the customers bargaining power become more powerful and demand for efficient and reasonable priced services.

The government interference and the politically correct powerful individuals did not spare National Bank. Management was appointed on personal and political consideration, with no consideration for professionalism. Risk management did not exist at all and loans could be released on a telephone call without any collateral. This resulted a huge non-performing debt portfolio (list of shame) current staggering 14.8 billion with the resulting drag on performance and existence of the bank. This was another powerful driver of need for change.

In order to offset a further deterioration on the bank the treasury appointed a seasoned banker Mr. Reuben Marambii as the Managing Director of the bank in 1999.

4.3.2 Competitive Situation in the Banking industry

Five forces influence the competitive situation in any industry. These are barriers to entry. Rivalry in the industry, threat of substitutes, power of buyers, and power of suppliers (Porter, 1980). All these forces are at play in the banking industry in Kenya.

The respondents' assessment of the intensity of these forces is presented in the table below.

Intensity of Competitive Forces in the Banking Industry

	Very Low				**Very High**
Barriers to entry			2	1	3
Rivalry in Industry			1	1	4
Threat of Substitutes			2		4
Power of buyers		1	3	1	1
Power of Suppliers		1	4	1	0

NB The respondents were asked to rate the competitive forces in a likert scale of 1-5:-

1- is very low, 2- is low 3- is high 4- is quite high and 5- is very high

Source: Research Results

On the basis of the response in the above table, it is evident that barriers to entry in the banking industry, such as the minimum capital requirement of Kshs 500 million for commercial banks, are quite high. The respondents added that this was one of the reasons for increase in the number of non-bank financial institutions such as micro-finance companies and cooperative societies, which offer products that, are good substitutions to those offered by banks.

Rivalry amongst the banks is considered high. However, the power of suppliers in this case the respondents considered (banks) and the power of the buyers (bank customers) as being generally equal, hence, no group can dictate the terms of service.

4.4 STRATEGIC RESPONSES

National Bank of Kenya has been responding viciously to the environmental changes that have influenced its competitive situation. Some of the strategic responses include: - Information Technology Strategy, Restructuring, Marketing, Cultural changes and re-capitalization.

4.4.1 Restructuring

Over the last five years, NBK has undertaken corporate restructuring, with the process taking a faster speed in the last three years. Both internal and external expertise has been used in the restructuring process.

The restructuring process has mainly been in the form of:-
Cost cutting and control through automation, modernization, reorganization and staff retrenchment; mounting cultural change programmes to develop sales and profits oriented culture necessitated by the inherent government/ parastatals' culture of inefficiency and lack of customer care; Retrenching redundant staff and recruiting skilled and well-trained staff to improve on speed and efficiency.

Towards the end of the year 2000 the first phase of the planned staff rationalization programme was completed when 97 employees of all cadres left the bank under Special Retirement Scheme. Each retiree qualified for a monthly pension with effect from 2001. Together with those who left under normal attrition, the establishment was reduced by 12% to 980 staff.

The restructuring also involved: Training and deploying relationship managers for parastatal markets based on the sub segments. It also involved training of staff in the retail network on front office delivery skills and for the head office retail support staff in product design; Assessing training effectiveness in relation to business objectives in a competitive environment. Automation of back and front office processes to avoid duplication and enhance efficiency.

The bank also embarked on vigorous recovery of bad debts through the use of internal and external legal experts; rationalization of branches through closure/mergers based on profitability; disposal of non-core businesses e.g. the closure of KENYAC; outsourcing of non-core services such as system maintenance, physical delivery and administrative services. The bank also reviewed tariffs to make its' products competitive and avoiding over reliance on interest income. There was also the need to change the banks image from a government bank to a customer focused private entity which they have since done.

According to the respondents, these forms of restructuring were chosen because they were considered appropriate for attainment of a number of the objectives of NBK. The poor financial performance of NBK has intensified the need for better income-generation and reduction of costs.

In addition, the bank's goal of becoming more customer-focused necessitated the provision of faster and better services while maintaining a workforce that is not only efficient but also lean in terms of staff costs. The Bank is aggressively recovering debts through the use of writing the concerned letters with warnings of criminal proceedings and through publishing of their names in the newspapers in what was popularly known as list of shame and to a certain extent some money have been recovered through the aggressiveness.

The bank had to cost control and the restructuring of the bank have started bearing fruits with operating expenses down by 18% from 2.2 billion to 1.8 billion. Provision for bad and doubtful debts of Kshs.1.5 billion was made compared to Kshs.2.7 billion in 1999. Subject to completion of negotiations and prosecution for recovery for certain non-performing debts one can foresee possible scaling down of provisioning in the near future leading to profitability in the last two years.

The staff rationalization was aimed at reducing the costs on salaried staff and generally reducing overhead costs of the bank. This was achieved through scrutinized procurement procedures of all tenders on the bank; reduce waste through avoiding unnecessary purchasing in all the bank branches and the headquarters. This went a long way in reducing cost and boosted on service delivery and provision of quality service by the bank.

The bank in an effort to rationalize and restructure its services merged some of its branches and closed others, which were not bringing enough revenue to the bank. This ensured that non-economic ones were closed and those near others were merged. This ensured that the bank reduced operational costs in running its branches and ensuring that the services are improved as customers became more enlightened and demanding due to increased competition in the business environment.

With bad debts having dodged the bank for many years, provident credit assessment is being carried out so that past mistakes is not repeated.

With Provident Credit Assessment in place, the bank credit policy was more provident and the risk management will ensure that such credit payment will be repayable within expected payback period and will fetch enough interest, as the risk management of the bank will be ensured to be closely maintained.

Given that the bank has some government shares will ensure that they use government machinery to its advantage and will get occasional financial support redemption from the treasury.

4.4.2 Marketing

There have been strategic changes in marketing at National Bank within the last 5 years. Market segments have been redefined and the marketing function being reorganized into retail and corporate divisions.

The bank is putting a lot of emphasis on improving customer service. A lot of money is being spent on physical renovations; staff training and other activities intended to improve customer service. The main motivation behind the improvement in customer service is increased competition.

National bank of Kenya is now segmenting its market and carefully selecting its customers. There is a realization that competing across the board may not be the best way forward. The idea is to select target customers and give them high quality service. Some banks are moving up-market to target corporate customers and high net worth individuals while others are focusing on small and/or medium savers. This trend is expected to continue.

The bank is undertaking very aggressive marketing. This is taking the form of: -

Pricing-There is competitive pricing of products, products-Innovative, new products are being introduced in the market, Promotion-National bank is actively advertising its products as well as building its corporate image, distribution-the bank is rationalizing its branch networks to better reach its customers.

The market positioning of National bank can be compared to the other big banks if one considers two dimensions, namely product diversity and customer focus. The bank offers the market a full range of banking products.

Financial institutions are competing fiercely to improve customer service.

National bank of Kenya is also aggressively improving its services to customers. Some activities adopted by NBK to improve customer service include: -

Developing and implementing customer service departments and counters, Increased use of new information technology, appointment of vibrant professional marketing team, continuous training of staff, centralization of its operations i.e. Branchless banking, re-furbishment of its banking halls.

Introduction of new customer tailored products e.g. salaried personal loan, which is given to employed customers without any collateral and the new NBK Visa Electron Debit Card, which can also be used as an ATM card anywhere in the world.

In a bid to ensure that the bank has the ability to transfer money quickly from several collection points and from different geographical locations the bank has responded through branchless banking.

The general enhancement of marketing strategies ensured that the bank used marketing strategies to market its products and develop its markets and the aggressiveness involved made the bank to maintain its market share and to beat competition.
The bank ensured easy access to tailored credit and trade finances facilities at negotiable interest rates and fees by its clientele. This was done through specialized professional services and the products suggested are products tailored to specific needs and this is delivered through account relationship managers situated at corporate centers of expertise.

Despite the above efforts most of the respondent felt that the bank is not doing enough marketing of its services especially through print and electronic media. They felt that the bank is concentrating on personal selling by its staff.

4.4.3 Information Technology

Modernization of the computer system designed to cut costs, improves delivery to customers, is progressing according to schedule. The entire NBK network will be computerized by December 2004. Already Nairobi, Mombasa, Kisumu and Nakuru branches are inter-linked. Hence branchless banking. The Automated Teller Machines (ATM's) will upgrade the Bank to higher plateau of branchless banking and 24 hour services to the customers.

In the last 5 years, NBK has been making changes in its information technology (IT) systems in response to its changing competitive situation.
The respondents noted that the major change in IT at NBK is the phasing out of the legacy IBS systems that are mainframe based and replacing these with open standard systems. These would facilitate better interconnectivity of the bank's branch network as well as with its clients.

The Bank embarked on the modernization of its computer system in 1995 when they bought 11 branches of Standard Chartered Bank which was on a different system i.e. Bankmaster. A decision was made to role out Bankmaster to the entire NBK branch network to replace the aged Wang-IBS system.

In 2001-2004, the implementation had begun with the centralization of its Mombasa and Nairobi Branches with the installation of ATMs' in those regions. The bank is serious about centralizing its branch operations by the end 2004 and installing ATM's all over the country.

Other IT responses to NBK's changing competitive situation include short-term upgrades of the systems to take advantage of technological innovations, provision of home banking, referred to as BankDirect, to most of the bank's corporate customers, centralization of the bank's clearing system both inter-branch and inter-bank.

In addition, there is increased installation of Automatic Teller Machines (ATM) in various delivery points, including supermarkets, linkage with international payment systems such as the society for Worldwide Inter-bank Financial Transfers (SWIFT) and the provision of intranet to enhance efficiency of communication within the bank.

The above changes, according to the respondents, were aimed at achieving three main objectives. One of these was the need to improve customer service through amore convenient and faster access to bank services, for instance, the provision of Bank Direct to the corporate clients and the 24-hour access to ATM services by the retail customers.

Another objective was to enhance record keeping and ease of data retrieval within the bank. The enhancement of internal communication, for faster decision-making, was the main reason for the installation of the intra-net access.

The above responses were, and continue to be, implemented on a phased approach. The respondents also noted that the centralization of the bank's clearing system and the linkage with the SWIFT system had been completed. The bank is also in the process of linking the SWIFT system to its core banking system to enhance efficiency in its customer care.

While making these changes, NBK has faced some constraints. According to the respondents, IT changes involve substantial costs in terms of software, hardware, and qualified personnel. The poor financial performance of NBK has limited the extent of investment in IT adaptations that would have enabled the bank to enhance its competitive position much earlier in time.

Technological innovations rely on telecommunication efficiency, however, the existing communication infrastructure in Kenya is poor and, thus, it hampers the full realization of the benefits of technological improvements. The respondents added that the field of information technology is highly dynamic.

As a result, what may be seen as a satisfactory IT adaptation today will soon be considered obsolete even before the full benefits have been realized.

Some of the bank's IT systems were pre-packaged. As a result, the respondents noted that there was heavy reliance by NBK on vendor support that was not always readily available. In a bid to overcome the above challenges, NBK has, according to the respondents, been reviewing its contractual relationships with the IT vendors. This has enabled the bank to have some of the terms of service to be adjusted, temporarily, to cater for the it's currently needs.

In addition, NBK has invested in the training of its IT staff and in the acquisition of expertise from outside the bank. This has been done to ease the heavy reliance on vendor support.

The respondents also identified that, in order to enhance the speed and reliability of telecommunication, NBK has been exploring the use of satellite communication. However, this has not yet been achieved but a lot of progress has been made towards its attainment.

Despite these challenges, the respondents considered the IT adaptations to have achieved their objectives to a large extent.

However, half of the respondents considered the bank's IT responses as lagging behind those of its major competitors who form part of the Big-Five banks in Kenya, while the remaining half were of the opinion that these adaptations adequately meet the needs of both the bank and its customers. The bank, in its efforts to revitalize its provision of service introduced new accounts.

The personalized accounts coupled with Automated Teller Machines (ATM's) made people to stick with the bank.

Information Technology resulted to configured and deployed systems for centralized databases and processing, it will also lead to online information access and retrieval together with real time information processing.

This led to a centralized database with signatures mandates and photos appearing on the screen to enable the user vet the transaction.

4.4.4 Culture Change

The culture inherent in government institutions or parastatals should end and embrace a serious business culture experienced in the private sector.

Better communication across the bank has been enhanced, with upward communication being encouraged. The staff, for instance, is now able to directly communicate with, and get response from any one member of the top management.

The establishment of the bank's intra-net has enhanced this. The annual end of year party has been introduced which enables representatives from all cadres in the bank meet openly discuss issues that affect all various categories of staff and management.

Following the restructuring of the bank, a strategy and change management division was created. Both internal and external forces have influenced the necessity for a culture shift at NBK.

An additional objective of the culture change was to facilitate the shedding-off of the quasi-parastatal tag and assuming a culture that portrays the fact that NBK is a commercial business that is customer-focused. Thus, one of the reasons for the culture shift was to "transform the bank into business profit making venture" as already emphasized by the Managing Director Mr. Reuben Marambii.

4.4.5 Re-Capitalization.

Over and above their core capital, some banks have what is called supplementary capital to boost the capital base. The combination of core capital and supplementary capital is what is referred to as Total Capital. The Bank was heavily reliant on supplementary capital of Kshs.5.9 billion while its core capital is negative Ksh4.2 billion.

These are in the form of long-term loans from the government and the National Social Security Fund (NSSF), which was converted into share capital.

The bank's capital base was eroded by the long period of loss-making which was caused by heavy provision for the huge bad-debt loan portfolio resulting from political loans.

The Bank's re-capitalization process was salvaged by its major share holders i.e. NSSF, the government and National Hospital Insurance Fund (NHIF) by converting its long-term deposit to share capital.

The bank is also aggressively recovering outstanding debt which is increasing its retained earnings by making profits in the last 2 years which puts the bank in the right path of re-capitalization.

Before its re-capitalization program, the Bank was not adequately capitalized in relation to its liabilities. The bank was run on depositors' funds making it insolvent. The Bank was not meeting any of the statutory requirements, but only remained in business due to the government and CBK support which allowed it to over-draw its account. All these are now in the past. The bank is out of the woods and is on the right track to recovery.

The respondents felt that the Bank has learnt from its past mistake and with the current professional management will never make the same mistakes. The management is focused on clearing the deficit retained earning accounts so that the bank can once again start paying dividends to its loyal share-holders.

4.5 STRATEGIC FIT

According to the respondents, the strategic responses made by NBK to adapt to its changing competitive situation are inadequate. They attributed this inadequacy to the NBK's current poor performance in a dynamic competitive environment.
The respondents also stated that NBK should undertake more proactive initiative and less reactive responses to facilitate the management of its environment.

The respondents emphasized that it is important at corporate level to assess the attractiveness and performance of the various products offered by National bank of Kenya. This way it is possible to identify the best products and those ones that are loss making.

Most of the respondents, however, were confident that NBK does possess the necessary capability to adopt strategies that can enable it to effectively match the changes in the environment in which it operates. It was also established from the study that NBK could enhance its capability by getting a strategic partner that offers complementary services and also has a large capital reserves to boost the bank's financial resource base.

CHAPTER FIVE: SUMMARY, RECOMMENDATIONS, LIMITATIONS AND SUGGESTIONS FOR FURTHER RESEARCH

5.1 SUMMARY OF FINDINGS

5.1.1 Challenges Posted To NBK By The Changing Competitive Environment

There have been many changes in Kenyan economy in the last decade. The major environmental factors that have had an effect on the banking industry, NBK in particular are economic decline, liberalization, legislative changes, increasing level of education, and technological advancements.

The above changes have contributed to the intense competition in the banking industry especially through the wide availability of substitute products as seen in the case of Forex bureaus as well as the increase in the rivalry within the industry. As a result, NBK has had to take measures to counter the impact of such forces.

5.1.2 Responses Of Nbk To Its Changing Competitive Environment

NBK has addressed its changing competitive situation by formulating and implementing strategic responses that include restructuring, marketing, Information Technology, culture change and re-capitalization. The respondents response have no doubt, improved the bank's competitiveness.

However, the study indicated that there is still the need for more strategic actions that need to be undertaken by NBK in order to enable the bank to fully match the environment in which it operates. Further, the study also established that NBK have the necessary capability to adopt the strategies that would facilitate effective response by the bank to its changing competitive environment.

5.2 RECOMMENDATIONS

The environments in which organizations operate is turbulent and force organizations to have strategic responses which are well developed and appropriately adopted, are powerful tools for acquiring and sustaining a competitive advantage. Such weapons have to be constantly adapted, or even transformed to achieve the desired advantage.

In view of the above, I suggest that NBK should become more proactive rather than reactive in managing its changing competitive situation.

This can be achieved by formulating and implementing strategic initiative that would pre-empt any anticipated adverse changes in its dynamic environment.

In addition, I recommend that the bank should continue to possibly merge or close some branches in order to improve services of the bank to its customers.

This will ensure that the existing branches are cost effective in terms of the right number of staff and serve efficiently the customers

The bank should get the major shareholders to re-capitalize by selling new shares to them.

Continue investing in technology for improved efficiency and effectiveness, reduction of government shares and speeding privatization, to facilitate mergers or strategic partner/alliances.

The bank should aggressively market its product through the print and electronic media in order to attract more business and build its public confidence and improve its image.

The bank should consider selling off its bad-loans portfolio to debt collecting organizations so that it can start afresh with good-books.

It should continue with prudent credit assessment and risk management. This will ensure that cases of bad debts are avoided.

This makes the bank to evaluate the credits the bank offers is prudently matched with the payback period well known.

The bank should always conduct market research and be able to develop new products to ensure that the bank is in tune with turbulent business environment. This will ensure that the bank becomes proactive in continuous marketing research.

The bank should reduce costs in order to increase revenues that can be used to enhance the provision of quality service that will increase profits and better image.

Aggressively recover debts. The bank should persistently follow-up those who have not paid back loans given to them by threatening them with prosecution and publishing their names in the Daily Papers.

Staff training and development should be increased by strictly rationalizing the needs of the organization to enhance the service delivery by the bank.

5.3 LIMITATION OF THE STUDY

Given that the study was a case study, it could not give a general picture of the banking industry in Kenya.

5.4 SUGGESTIONS FOR FURTHER RESEARCH

The study recommends further research on response of companies to changes in the business environment. Not only in the banking industry but also other sectors. Further study will bring insights in the area of the study.

Cross-sectional survey covering the whole industry can be undertaken. This will allow for industry generalizations to be made.

Alternatively comparative study between indigenous bank like NBK and a multinational bank like standard chattered bank or Barclays can be carried out to see if there exists any difference in their strategies.

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APPENDICES

APPENDIX 1

LETTER OF INTRODUCTION

July 2003

Dear Respondent,

<u>MBA RESEARCH PROJECT</u>

This questionnaire is designed to gather information on the effects of environmental changes and the strategic responses used by National Bank of Kenya.

This study is being carried out for a management project paper as a requirement in partial fulfillment of the degree of Master in Business Administration, University of Nairobi

Your responses will be treated strictly confidential and in no instance will your name be mentioned in the report.

Your cooperation will be highly appreciated.

Yours Sincerely

Musa Adan	Prof. E. Aosa
MBA STUDENT	**SUPERVISOR**

APPENDIX 2

QUESTIONNAIRE

Please answer the following questions.

SECTION A: CHALLENGES FACING NATIONAL BANK OF KENYA LTD.

Please describe the changes that have taken place, within the last 10 years, in the business environment, which have affected NBK.

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What challenges have these changes posed to NBK?

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SECTION B: STRATEGIC RESPONSES

Please explain in detail how you have responded to the challenges identified.

Are there any other responses that NBK has made as a result of The changing competitive situation facing the bank?

Are there any challenges that you have not responded to and why?

What are you intending to do in the future about the challenges that you have not responded to?

Do you consider the bank's strategic responses to competition adequate?

What else do you feel NBK should do to stay competitive?

What areas have improved in the company?

In your assessment, does NBK currently possess the necessary capability to adopt aggressive strategies to match the external environment changes?

If not, please indicate the possible means by which the bank acquires these capabilities.