A STUDY OF RELATED DIVERSIFICATION WITHIN EAST AFRICA BUILDING SOCIETY.

BY

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DECLARATION

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

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

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DEDICATION

This study is dedicated to my dear wife Stella, daughters Mary and Mercy for their patience and understanding. Also to my parents Mum and Dad for their emphasis on education and to all others who have made me come up to this far end.

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First to Almighty God for all what he has done to me. Glory and Honour to Him now and forever. Secondly, I do owe special thanks to my Supervisor Mr.J.K Maalu for his constructive advice, guidance and support that led to the completion of this study. I am additionally grateful to the KAAD-Germany for their material support. The entire staff of EABS group and in particular the staff members of Mercantile Life and General Assurance Company for giving me the opportunity to become one of their own. To my beloved wife Stella and daughter Mary for their love, patience and understanding during those long hours I used to spend away from them. You were indeed supportive and cheerfully helped me through a multiple of ways. To mum and dad, thanks for your inspiration on education. Finally to all the colleagues and lecturers of the MBA program who I encountered. To all of you, may the blessing of the Almighty God be with you always!

ABSTRACT

This is a management research project which was carried out with three (3) key objectives, namely,

- To identify the extent of diversification within East Africa Building Society,
- The factors that influence the pursuit of the related diversification strategy
- Why the EABS wants to move to the main stream of banking.

It is a case study whose respondents comprised the Chief Executive of the EABS,the Chief Executives of its sister companies within the EABS holdings and the marketing managers. Primary data was collected using personal interview guide whereas secondary data was collected from the company's periodicals. Content analysis method was applied for the data analysis.

The research findings were that-:

It has diversified into both financial and real estate sectors. Reasons for these were due to support the parent firm's core objectives of mortgage financing and housing development.

The key factors which have influenced their pursuit of related diversification move were that they wanted to remain competitive and turn into "one stop shop" where they could satisfy all their customers' needs as well as maintain their relative market share. Also they wanted to share and transfer key resources within their SBUs, others cited included the synergy effects, firm's strategic intent, and to try to spread its risks as well as putting their excess financial resources into viable ventures.

Their move into the banking sector from their main stream mortgage sector is due to the competitive environment into which they are operating in. It was found out that EABS is registered under the Society's Act which has hindered it in terms of the clearing procedures at the central bank, a factor they now think they can overcome by entering into the banking sector and also due to the fact that their capital base has over grown and surpassed the central bank requirement. Also change of their target market, a fact they think can well be met by shifting to a commercial bank. Finally, insiders pointed out that they are actually divesturing one of its SBUs which has failed to perform to their expectation.

With these strategic moves, EABS is seen to have taken the necessary proactive strategy of related diversification which has in deed placed it in the upper hand in the entire mortgage industry in the country. Further, it was revealed that the EABS supports its sister companies especially in both finance and resources of which this has boosted their operations within their respective industries.

Recommendations for the policy and practice are that the centralised decision making process and the management style within the EABS Group were cited to have hindered the effectiveness of the single SBUs which need to be set free to compete effectively. It is also the high time the management of the EABS realised the importance of recruiting and maintaining high qualified staffs from all the races. Finally each of the SBUs should be allowed to set up a research and development departments to enable them read the market signals early in advance and set the necessary proactive strategies.

ABBREVIATIONS

EABS - East Africa Building Society

MGL - Mercantile Life and General Assurance Company Ltd.

GOK - Government of Kenya.

SBU - Strategic Business Unit.

CFC - Credit Finance Co-operation

FCS – First Chartered Securities

I&M - Investment and Mortgage

GA - General Accident Insurance Company Limited

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CHAPTER ONE: INTRODUCTION.

1.1 Background.

There is no firm which can afford every thing it would like to do. Resources need to be allocated in the most efficient form in order to guarantee maximum returns to all the stake holders. For this reason, there is the need of strategy. The essence of strategy is to allocate resources to those areas that have the greatest future potential (Jones 1973).A diversified firm's business portfolio needs to begin with a clear identification of its diversification strategy. Improving the long term financial performance of a diversified firm entails giving priority to investments in business with good to excellent prospects and investing minimally if at all in business with sub par prospects. Diversification strategy is said to take place whenever a firm changes the market it serves and or the technology it uses and or geographic location on which it does business.

Diversification Strategy involves the directions of development, which take the organisation away from its present markets and its present products at the same time. (Johnson and Scholes 2002). It is usually initiated when growth opportunities dwindle in the company's present business.

Diversification falls under two broad headings-:

Related and Unrelated diversification. Related diversification is development of a firm beyond the present product and market, but still within the broad confines of the 'industry' (that is, value chain) in which a company operates. Unrelated diversification is where the organisation moves beyond the confines of its current industry. Synergy is the most common reason for both related and unrelated diversification to happen. Potentially synergy can happen, when two or more products or services combine to complement each other to the extent that, the two services added together have an effect that they become stronger than the sum. The approach here is to venture into "any business in which we think we can make a profit". Firms pursuing unrelated diversification are often referred to as conglomerates.

On the other hand, related diversification involves diversifying into businesses whose *value chains* possess competitively valuable "strategic fits" within the value chain(s) of the present business (es). Capturing the "strategic fits" makes the related diversification a 2 + 2 = 5 phenomenon. This may involve sharing of sales force, advertising and distribution activities, exploiting closely related technologies, transferring know-how together with brand name and expertise from one business to another, reputation to a new product or service and finally acquiring new businesses to uniquely help firm's position in existing businesses.

1.2 The Mortgage industry in Kenya

Since independence from Britain in 1963, Kenya has enjoyed relative political and economic stability. It has one of the highest GDPs in the region. However, the country faces several challenges in its own housing structure. Most poor Kenyans want to have a home of their own. However, their ability to take the first step towards achieving this dream of acquiring a plot of land is extremely limited due to three interrelated factors-: high cost of available land, obstacles to affordable alternatives (such as communal ownership or subdividing), and strong controls on squatting. The existing financial services legislation and regulation in Kenya, whilst intended to ensure financial discipline, imposes unnecessary requirements.

Commercial banks are permitted to lend to developers over two to three years to allow them to get through the construction phase. Mortgage companies (EABS) and building societies are permitted to provide long-term mortgage loans to individuals to purchase units from developers or less commonly, to build their own complete units. The problem with these regulations is that it has reduced access to financial services, rather than protecting the interests of the public. This has had a net impact to the mortgage firms themselves who do not make profits, as they should be doing hence the need to adapt strategies geared at giving them profits.

1.3 History and status of the EABS

The prehistory of EABS dates back in 1959, when its founder Lalji Pandit set up a 'small saving society', which attracted funds from his close allies with an aim of building houses. The rapid urbanization and limited housing stock in Kenya places an enormous strain on an already stretched urban infrastructure, housing stock, and services, and resulting in the proliferation of informal housing settlements. Nairobi, Kenya's capital and largest city comprises of a quarter of the country's urban population hence the need of a permanent housing solution.

The housing facility being an important role in the economy has attracted a lot of interest from both the private sector through banks and other building societies and the Government through the Ministry of Lands and housing hence causing concern in the industry. EABS focuses on the provision of housing finance to the middle income people as evidenced by its upcoming estates such as the Fedha estate in Nairobi's southland and Lavington areas among others. It has three branches within the city centre whereas outside Nairobi it has established branches in the major towns such as in Thika, Kisumu, Eldoret and Mombasa.

The mortgage industry just like all other industries has not been spared by competition either and now different firms have thought to pursue different strategic responses to overcome competition and remain competitive. The firm has opted for related diversification strategy with an aim of overcoming competition. The related firms it has established and diversified into include-:

Mercantile life and General Assurance Company Limited (MGL), which is specifically an insurer, which offers insurance facility to the properties (General) and the Life especially for the mortgage holders plus other insurance products. Akiba Bank Limited well known for offering loans to raise the so called down payment to the mortgage borrowers as well as premium financing to the insurance firm. Kalapi Insurance Brokers which aims at giving specialised tailor made information to a range of the clientele who are interested in purchasing of the insurance products and finally the Tala

Investments and Fedha Management firms whose major aim is to manage basically the properties of EABS and invest them in a sound manner.

Fred (1989) did discuss some of the strategies a firm can use to respond to the increased turbulence in the environment. These include diversification and or intensive marketing among others. Thuo (2003) in his study on diversification strategy, case for Nation Media Group did note that diversification is not the only factor, which is responsible for the good performance of the individual strategic units, but there exists other factors, which are responsible for this. These factors are diverse and depend from one firm to another. It can thus be argued that different firms have the ability of achieving superior performances if they embark on different strategies, which their competitors seem not to have or are not better in them. The related diversification strategy, which the EABS has taken, is bound to place it at a far-reaching position unlike other firms, which have never thought of pursuing such a form of strategy.

1.4 Statement of the problem.

Today's dynamic markets and technologies have called into the question of the sustainability of the competitive advantage.

Under the pressure to improve quality, productivity and spread the risk, managers have embraced on different tools such as the Total Quality Management (TQM), Benchmarking and Re-engineering. These have led to dramatic operational improvements but as managers' push to improve on all the formats, they move further away from the viable competitive position. This calls for the adoption of a strategy, which can help the firm to attain and sustain a competitive advantage within its industry of operation.

Firms will tend to diversify in order to gain a competitive advantage and at the same time overcome the environmental turbulence. Related diversification, which is based on interrelationships when pursued, leads to greater added advantage (Porter, 1985). Any diversification move must pass the test of structural attractiveness and of course give the shareholders their value in the shortest time possible. Earlier studies have tended to emphasis on how different organisations have attained competitive advantage through application of different strategic options such as market differentiation, and strategic planning as highlighted in the likes of Kibiru (1999) and Hapisu (2003) respectively. Little has been brought up on the logic of related diversification as a strategy which firms may opt for in an attempt of remaining competitive.

Further, there has been a problem on the results of the earlier studies conducted which tend to emphasise on the cross sectional research design. Most recent researches are based on large manufacturing Kenyan firms leaving the single or the individual service firms hence this leads to the generalisation of the results derived there from. This then calls for the need to adapt the case study design that examines a one single study unit within the Kenyan service sector. This will eventually provide us with getting in-depth information about the subject matter of the study. It will also generate reasonably consistent and interpretable findings in this area of diversification.

Despite the various considerable academic efforts during the last decades on the areas of diversification, there are still many unanswered questions about how and whether related diversification strategy can lead to superior results as opposed to unrelated diversification. To add on, much has been written about focusing on the core competencies and responses which firms may opt for in an attempt to overcome the environmental turbulences. Diversification has offered few analytical techniques that can be used to attain competitive advantage or even overcome the environmental turbulence and those that have emerged lack breath and comprehensive. It is in justification of this that Costas Markides in the Harvard Business Review article argues that companies may overlook a significant growth opportunity by abandoning the diversification moves hence there is always a need to take it seriously.

Thuo (2003) recently highlighted the diversification strategy. The goal of this paper, however, is not to replicate him on his study with a different study period. It will cover a number of issues not addressed in his study, such as the factors that influence the diversification strategy which occupies a large place in the diversification literature (Chandler, 1962; Williamson, 1975). We will also focus our attention to the evolution of the firm's diversification posture, especially the relatedness of its constituent businesses. It is often argued that for diversification to create value, the firm must keep the relatedness (coherence) of its business high. It is in attempt to prevail the above noted problems that the study aimed to achieve the under noted objectives.

1.5 Objectives of the study.

Basically the study aimed to attain the following three key objective:-

To determine the extent of diversification strategy within the EABS. Investigate the factors that have influenced the pursuit of the related diversification Strategy and establish why EABS wants to move to the main stream of banking from the mortgage stream.

1.6 Importance of the study

This study will be important to the following groups of people-: The stakeholders and more so the shareholders especially in pursuit of their investment plan and also in determination of which SBUs to promote and or support on one side and those to divestiture on the other side. The managers who are already in the organisation will find the study to be useful as they strive to attain the competitive advantage of their individual firms while holding in mind their corporate objectives.

To the scholars and academia interested in the business studies. It will act as an important source of knowledge and additional information and stimulate a further research study in the responses and even replication of the same in an attempt to overcome the limitations and questions, which were encountered herein.

CHAPTER TWO: LITERATURE REVIEW.

2.1 Diversification Strategy

Diversification as one of the competitive strategies a firm may opt for refers to directions of development, which take the organisation from its present markets and its present products at the same time. (Johnson and Scholes 2002). It addresses two basic strategic questions, namely, *which product markets* should the firm enter and *how should the company enter* these products to avoid failure and maximise returns. It is a corporate level strategy, which is based on the task of crafting, and implementing action plans to improve on the attractiveness and competitive strategies of a company's business unit portfolio. Further, it is seen as a means of widening a firm's stock of assets and skills by expanding the perimeter of value action, which it participates in. Best diversification is one, which reinforces the firms existing resources and strengths as well as creating the basis for new ones (Porter, 1996).

It involves taking steps such as what moves to use to enter new businesses, initiate actions to boost combined performance of businesses, find ways to capture synergy among related business units and establish investment priorities and steer resources into most attractive business units. Kasters (1993) observed that diversification is seen to be a negative strategy for the diversifiers are known to be always running away from one thing to another which they believe in the long run will lead to a competitive advantage.

Research on the diversification-performance link suggests several pitfalls we should try to avoid. One is the effect of firm's industry affiliation on diversification. It is known that firms in different industries have different propensities to diversify due to various industry traits (e.g. Lemelin, 1982;

Montgomery and Hariharan, 1991). Montgomery (1985) shows that such industry-level heterogeneity in diversification behaviour obscures the effects of diversification and industry on performance. In addition, research on the diversification discount, such as Campa and Kedia (2002) and Villalonga (2004a), demonstrates that treating diversification as exogenous in the analysis of firm value is misleading because there are factors affecting firm value and diversification simultaneously. There is no reason to expect that our analysis is immune to this endogeneity problem.

Analysing the Kenyan examples, there are evidences that the key performing organisations have tended to diversify in the related areas. For example, the First Chartered Securities Group (FCS), which has diversified into insurance, reinsurance, brokerage and banking businesses has turned out to be the leading financial provider in the country. Further, the CFC group has also danced to the same tune by diversifying into related areas as evidenced in the insurance, financial services, bank and of course the CMC motor assemblers. This has in turn given them a strong financial base as evidenced by the purchase of the Giant Alico Kenya Life fund. The EABS'S major competitor, which is Investment and Mortgage (I &M) has not been left behind as evidenced by the setting of Insurance company, the General Accident (G.A) and Investment Insurance Brokers.

Organisations are thus cautioned to take into considerations all the environmental factors within their operations and attempt to adapt their activities and internal configuration to reflect the new external realities. One may wonder on to why a firm may think of or opt to pursue the diversification strategy in general.

(Ansoff and McDonnell 1990) responds to this by suggesting three key reasons for doing this. This includes-: Their objectives cannot be achieved by continuing to operate in the existing markets. Also there appears to be greater opportunities presented to the firm in the new markets areas than they accrue from its existing activities. Finally a business tends to have excess financial resources beyond those necessary to satisfy its expansion plans in its existing plans hence it sees it fit to invest these resources in new markets rather than retaining them in liquid cash.

Various problems have been cited to the diversification options, which are taken by different firms as noted by Johnson and Scholes (2002). These include among others-: Lack of the firms having a clear set up diversification strategy. This is attributed to the fact that a lot of firms have tended to pick up strategic management just on the way and they do not have established departments for pursuing it. Moreover, most of them tend to pursue the related diversification strategy because their competitors have done so. Thus they tend to imitate their competitor's strategy but when it comes to implementation part, they fail terribly.

Further, Management more often than not appears to be somehow optimistic in respect of its ability to manage varied interests or insufficiently well prepared for the differences between the new venture that it undertakes and the condition on its principal market. In this regard, the managers will tend to stick to the status quo and will not give full attention to the new ventures as proposed by the parent or the holding firm. Moreover, the management are a bit over-optimistic regarding the rate at which the diversified interest will generate profits. There also occur problems of adopting uncritical, passive attitudes to the management of the varied interests. While diversification is fine as the matter of abstract principle, it can result in so many different eggs in one basket that nothing really significant is hatched out of them (Johnson and Scholes 2002).

The above experiences do suggest that companies undertaking diversification should only do so only in the context of explicit policy regarding what the objectives of such a strategy should be. Peterson and Watermann (1982) suggested that companies should try to 'stick to the knitting' as they pursue their diversification strategy.

2.2 Types of diversification

Johnson and Scholes (2002) have highlighted the different diversification options available for most organisations. They include-: Strategies for entering new industries, related diversification strategies, unrelated diversification strategies, divestiture and liquidation strategies, corporate turn around, retrenchment and restructuring strategies and of course the multinational diversification strategies. For the purposes of this project, we shall only discuss the related diversification strategy.

2.3 Related Diversification Strategy.

Related diversification refers to where the firm develops beyond its present products and markets but still within the confines of its industry. Chandler (1962) noted that firms with product or market orientation tended to diversify into related products and related markets whereas those with technological orientation moved into diverse products and markets with related technology. Closely associated with this is the unrelated diversification which refers to diversifying into businesses with *no* meaningful value chain relationships and *no* unifying strategic theme.

Two notable issues of the related diversification are linked and constrained diversification. The constrained diversification refers to the case where the firm diversifies into industries that are all related through its core business serving as the main provider of sharable resources. Honda's diversification from motorcycles into automobiles and other products, such marine engines and generators, is a prime example. On the other hand, in the linked diversification, a firm increases its industry scope sequentially, leveraging resources acquired through the process of diversification, not necessarily those the firm had in the core at the onset of diversification. Canon is a good example. It is argued that in related diversification there is the possibility of resource sharing, however, is not limitless.

From the foregoing, it is clear that the effectiveness of resource sharing increases with the similarity of industries a firm has in its business portfolio. Reasons as to why a firm may opt to pursue the related diversification strategy are many but the most ones could be because of control of supplies quality and quantity, markets, access of information, building on the core competencies, spreading of risks and of course resource utilisation. It is the industry competition that indeed forms the basis for the persuasion of any diversification strategy (Porter, 1985). Porter adds that the business potential and the valuable type of relatedness in diversification is a crucial component of overcoming key entry barriers.

2.4 Competitive Strategy

Competitive strategy in diversification concerns itself on how to create competitive advantage in each of the SBU. It is normally governed by two (2) key questions. Namely, what business should the corporate be in and how should the corporate manage them? Competitions occur in the SBUs. The competitive strategy should aim at nurturing the success of each SBU as it strives to add value to the SBU by providing tangible benefits that offset the inherent costs of lost independence and shareholders by diversifying in a way that is difficult to replicate (Porter, 1996)

Competitive advantage of a firm refers to the ability to perform in one or more ways than those, which the competitors cannot or will not match (Kotler 1997). Porter (1980) adds that competitive advantage refers to creating a position in the market industry that can be sustainable in a long time. Sustainable competitive advantage is achieved by continuously developing the existing and new capabilities in the response to a rapidly changing environment. The issue of gaining a competitive advantage through the related diversification strategy is seen in the evaluation of how to add capacity to further the objectives of the firm in order to improve its competitive position or market share and avoid industry over capacity. Organisations will tend to take various strategies aimed at giving them an added advantage in all what they do.

The early literature on diversification asserts that diversified firms can employ a number of mechanisms to create and exploit market power advantages, tools that are largely unavailable to their more focused counterparts (Caves, 1981; McCutcheon, 1991; Scherer, 1980; Sobel, 1984). Whereas related diversification in itself is not a sure guarantee of gaining competitive advantage, a firm may decide to pursue it for the synergy effects. This in mind then may be one among the reasons why firms may attain a competitive advantage in their industries compared to their competitors who have not thought of pursuing a related diversification at all.

2.5 The Measurement of the Competitive Advantage.

Some notable factors that indicate the various strengths of the SBUs and market attractiveness and also their strength compared with their competitors include-:

The market share and the competitive position which that particular SBU tends to enjoy. The sales force and the marketing team of the particular SBU. Its financial resources coupled with strong managerial competence. There follows of course the manufacturing, distribution and the research and development within a given firm. Not forgetting the key indicators of any market attractiveness such as the market size, market growth and the cyclically of the industry's' Competitive structure and barriers of entry. Industry profitability, technology and of course the inflation and workforce available. All these might be summarised by what Pearce and Robinson (1997) term as the Porter's five forces of the industry model.

Johnson and Scholes (2002) pointed out that this can be achieved by considering issues such as-: The competitive environment in which the firm operates, the principle products which are valued by the customers, whether the business have those competencies which allow to deliver the desired competitive strategy and are they likely to offer sustainable advantage or can they be imitated? Finally are the constitutions placed upon the choice of the competitive strategy?

2.6 The Strategic Business Units to enter into.

The Strategic Business Unit refers to a distinct business within the holding company that exercises a full mandate of its operations and on which the parent company has set up some autonomy. (Johnson and Scholes 2002). It is supported in its initial years of operation by the parent company. In our case the EABS acts as the parent company while firms like the MGL, Akiba Bank, Kalapi Insurance Brokers and the Fedha Management acts as its Strategic Business Units. Wise diversification has its core as the search for the ways to build value and a sustained competitive advantage across the multiple business units. Too much diversification tends to diffuse a firm's focus. Rumelt (1974) in his writings discussed this and found out that companies that diversified into related business perfected in their dominant business and outperformed the others who pursued unrelated or conglomerated modes. It is in line with these that business executives will thrive to pursue the related diversification strategy.

2.7 The Role of Parent Relationship to the SBUs.

Key questions that a corporate strategy should address as pointed out by Johnson and Scholes (1997) are-: What is the strategic role of the corporate centre? This is basically concerned with how the corporate adds value to the business. It is strongly supported by the fact that the corporate parent is able to exercise better control and be more efficient at the resource allocation than the financial markets. In addition to these, they also have more assess to the internal information within their business that is not available to the external financial market analysts.

In a different article Andrew Campbell, Michael Goold and Marcus Alex (1992) have pointed out that the parenting framework should be able to deal with questions such as what kind of business should a company own and what parenting approach will give them the best performances from these businesses? They add that firms have their best chance of being successful at diversification if they capitalise on the existing relationship between their SBUs by having them transfer skills and share activities.

Further, their decisions should basically be based on the terms of the allocation of resources, increasing or decreasing investments or changing of the management in cases of the poor performances. There should also be a benefit from the transfer of management and there must be synergies between the businesses in terms of the common usage of resources and so on. A well-managed firm should thus be able to add value to its Strategic Business Units. There exists different ways into which the corporate centre is claimed to add value as outlined by Johnson and Scholes (2002).

These are through-: Improving efficiency in their operations in order to enhance good returns to the stakeholders. Provision of expertise and services not available within the smaller units known to them. They also offer investments particularly during the early days of the new ventures. On the other hand they foster innovation through the management of knowledge creation process. Over and above they control risks, which the smaller Strategic Business Units inevitably run into and thus ease their problems created by the variety and the variability of demands from the costs. Finally they do set up standards, assess performance of individual SBUs and strive to improve their performances.

Hamel and Prahalad (1987) did highlight the importance of the corporate holding firm having a clear strategic intent. They argued that it helps to galvanise motivation and enthusiasm throughout its other businesses by providing a sense of destiny and discovery. In this regard, all the SBUs are strongly advised to try to follow or even abide to the corporate roles objectives and even support it in order to ensure that there is maximum return to their shareholders. Further, they are also advised to shun away from the activities that can cause or create conflict within them. The rationality of a corporate centre of a firm is that it adds value through its monitoring, protecting co-ordination and guidance roles, which it offers to the SBUs and especially if they are related. Performance increases as firms shift from single business strategies to related diversification, but performance decreases as firms change from related diversification to unrelated diversification.

The proponents of having a corporate centre do argue that it indeed leads to destruction of the business value and that businesses would be better off on their own and subject to the market mechanisms (Johnson and Scholes 2002). They pose the following arguments-: Adds costs within the bureaucratic mechanisms and hierarchies that delay decisions by creating a bureaucratic fog that hinders market responsiveness. Moreover, it is also not clear that the costs of these levels of management above the SBUs are offset by the benefits they provide. In addition, they buffer the executives in these businesses from the realities of financial markets by providing 'financial safety net' that is; the executives are not truly answerable for the performances of their business. Diversity and size of some corporations makes it very difficult to see what they are all about. Managers are challenged in that they seem to view the corporate centre as a vehicle for the empire building in which they only tend to grow the number and size of business for their personal motives.

Then, there follows the question of what is the logic of the portfolio into which the corporate firm enters into? There is also the question of control style and whether it is the most appropriate or not? Finally there comes up the question of whether related diversification, which the corporate parent enters into, is superior to unrelated diversification.

2.8 The Resource Allocation in the SBUs.

The resources within the SBUs need to be allocated in the most efficient manner in order to enhance competitiveness. The central theme in resources allocation rests on the way to capture the benefits of sharing. This works out perfectly well in the case of related Diversification. Costs should be shared within the SBUs and skills should also be transferred into the businesses with strategic fit. The primary issue in this controversy arises from concerns that related firms may not be able to exploit fully the relatedness designed into the portfolio of businesses. Markides and Williamson (1994) refer to this as "exaggerated relatedness," suggesting a "mirage effect" when assessing apparent similarities between business units. They argue that related diversifiers will outperform their unrelated counterparts only to the degree that they are able to exploit relatedness "to create and accumulate *new* strategic assets more quickly and cheaply than competitors" (Markides and Williamson, 1994: 150). Simply amortizing existing assets via economies of scope the popular centrepiece of relatedness theory will yield short-term benefits at best. In the words of Shakespeare: "All that glisters is not gold." In addition to these concerns, Nayyar (1992) points out that the activities that are necessary to exploit relatedness lead to costs that partially blunt the benefits of that strategy.

For example, the benefits of relatedness require a significant degree of co-operation among the involved business units. From a transaction costs perspective (Jones and Hill, 1988; Williamson, 1985), this cannot be achieved without intrafirm exchanges, which lead to inefficiencies resulting from governance costs (arising from co-ordination and integration demands), incentive degradation (as a result of agency effects), and bureaucratic distortions. Nayyar (1992) also mentions impediments to relatedness exploitation that result from a lack of communication between units, problems of allocating joint costs, incentive distortions generated from the intra firm competition.

Johnson and Scholes (2002) observes that while strategic fit relationships can occur throughout the activity costs chain, they mostly fall into one of the three broad categories-: Market related fits, operating fit and the management fit. Market related fit occurs when the activity costs chain of different businesses overlap such that the products are used by the same customers, distributed similarly thus leading to great economics of scale coupled with the ability to transfer firms reputation into other products.

Operating fit on the other hand occurs when there is potential for cost sharing or skill transfer. They arise due to the ability to do things jointly rather than independently. Finally the management fit is pronounced in areas where the different SBUs are said to compose comparable types of entrepreneurial and administration styles thus allowing a managerial know how in one of the businesses to be transferred to another business. Competitive advantage achieved through these strategic fits among the different SBUs adds to the performance of the individual firms. It is this extra source of competitive advantage that allows any firm which has decided to diversify to use a 2+2=5 effect on shareholder value.

2.9 The conceptual model.

Diversified firms will only appear to make sense if the managers in them can guarantee to their shareholders the worthiness of having taken the diversification strategy. This is normally noted if they can prove that there is an added advantage of pursuing the diversification strategy, which they choose to pursue as opposed to not taking it or any other form of strategy. In an attempt to realize our goal the following issues need to be investigated-:

The role of the parent in a diversified firm and whether it adds or removes value within its SBUs. We shall also look at the extent of relatedness of the SBUs into which the parent firm enters into. It is believed that in related SBUs there are high chances of resource sharing and transfer of competences and therefore this could also be examined in details. Finally we shall also analyse the extent of rivalry among the SBUs and it is in regard to this that we shall be able to examine which ones to support and the ones to divestiture. It is believed that these are the key pillars of the study and it is only in attempt to establish the way in which they influence the success of a diversified firm that a well conceptual framework shall be developed.

2.10 Related Studies

The recently completed studies on the organisations have had interesting results. Firms are constantly cautioned to match their capabilities to environmental requirements. Success therefore calls for a proactive approach to the business (Pearce and Robinson (1997). Kandie (2001) studied the strategic responses by the Telcom (K) in a competitive world. He found out that financial constraint and the lack of managerial empowerment had considerably limited the capacity to respond to the environment. Mutua (2004) on his study on the Responses of University of Nairobi to the environmental changes concluded that the greatest challenge was the competition the institution was facing from the other local institutions. Thuo (2003) on his study in the diversification strategy in the Nation Media Group concluded that diversification was in deed a success irrespective of which area they entered into.

From the highlights of the above studies, it is clearly demonstrated that as the environment which the organisations operate in keep on changing, firms will be forced to adopt the strategies which work to overcome the overall turbulence as they place themselves within a competitive edge in their industry of operation. All in all, it should be noted that environmental changes are not necessary for the worst. When proactive strategies are put in place such as the diversification strategy, they offer an exclusive basic investment opportunity and reinvestment climate. Firms like the EABS and others who have opted to pursue the related diversification strategy may give us a hint on whether such a move has any positive impacts towards its performance in the ever-turbulent environment or not.

CHAPTER THREE: RESEARCH METHODOLOGY.

3.1 Research Design

Due to the nature of the research problem, which proved itself more to be a qualitative type, it was studied by the use of the case study research design. A case study refers to a research design that is used when the why and the how questions are being posed, the researcher has got little control of the events and it focuses on the contemporary phenomenon with a real life context.

It has been proposed to yield significant results as highlighted by the likes of Thuo (2003) in the diversification strategy within the Nation Media Group. Further this being a qualitative research method its findings can best be analysed by the use of the case study method.

3.2 Data Collection.

The study used multi sources of data. Both primary and secondary data were applied. The primarily data was collected by carrying out both structured and unstructured form of interview to the two (2) categories of people.

First, through the personal in depth interview with the Managing Director of the EABS guided by the open ended interview guide (Appendix I). In addition the Chief Executive Officers (CEO) of each SBU were interviewed. It was believed that these are the people who are involved in the decision-making process within the firm and thus what they offered was considered to be of great importance to the study. Further, the marketing heads of the SBUs were also interviewed in an attempt to get a feel of how they go about the implementing the strategy as directed by the top management team.

Due to the nature of the study which is qualitative in nature, the unstructured interview guided by open ended question was adopted with an aim of probing to get to know the key advantages the firm possess by having opted for the related diversification strategy.

Secondary data on the other side was collected from the firms' archives and the library material as authorised by the management. The financial statements of the EABS were considered in details to gauge the financial status of the firm together with those of its sister companies and of course the recent periodicals, which had some publication on the EABS or any of its subsidiaries.

3.3 Data Analysis.

The nature of data collected was qualitative in nature. This required the researcher to carry out an ongoing and iterative (non linear process) analysis. The interim analysis was carried out which involved the cyclical process of collecting and analysing data during the research. When all was done the researcher proceeded to use the conceptual content analysis.

Content analysis which the researcher used is a technique of making inferences by systematically and objectively identifying specified characteristics of messages and using the same approach to relate to trends. Researcher brings out the theme of study as highlighted from the context of what he collects. It deals with who says what, to whom, why, to what extend and with what effects. Analysis such as the literature criticisms, interpretations and even thematic coding were carried out in order to authentise and come up with a more comprehensive report. The approach applied was found to be conducive enough for it had been used in the similar studies by Thuo (2003) and Ongaro (2004).

The qualitative method was also used to uncover and understand what lies behind a phenomenon under the study. It assisted more in gaining quite some fresh material even in what was thought to be unknown.

CHAPTER FOUR: FINDINGS AND DISCUSSIONS.

4.1 Introduction.

This chapter presents the findings of the data collected and its discussions. The study revolved around three key objectives viz-:

a) The extent of diversification within the EABS

b) The factors that have influenced the pursuit of the related diversification strategy within the EABS.

c) The reasons as to why the EABS wants to move from the main stream of mortgage to the banking stream.

4.2 The organisational profile

EABS has highly diversified into both the financial sector and mortgage sectors as noted by the firms it has established.

The researcher found as at inception (1959) the firm strictly operated under the housing development and mortgage financing sectors and only diversified within the real estate sectors. Its market capitalization stood at Kshs.50,000,000/=. This made it to be the strongest building society within the region occupying virtually 80% on the market share of the building societies within the whole economy (Appendix 111 a).

In a view of diversifying further it set up branches in the major towns in Kenya which include - Mombasa, Eldoret, Thika and Kisumu . The twin roles of Mortgage financier and real estate developer by EABS itself and its affiliate property companies have no doubt made it to act as a one stop shop for both commercial and residential property for the potential owners. There is also the broader sectoral specialization that brings together the diverse but intertwined expertise for the purposes of synergy creation.

4.3 The extent of related diversification

EABS had diversified both in financial and mortgage sectors. Their subsidiary firms had increased in number as we tended to the turn of century with the following firms operating within the umbrella body. (See Table 1)

The extent of Diversification within the EABS

(Table 1)

DIVISION/SUBSIDIARY COMPANY	PRODUCT/ SERVICE OFFERED	YEAR OF ESTABLISHMENT
a) FINANCIAL SECTOR		
1.MGL	Insurance policies (Both Life and General)	April 1993
2.Akiba Bank	Banking services	January 1994
3.Kalapi	Insurance broker and advisory	January 1987
4.Fedha investments and managements	Investment decisions and real estate services	January 1963
b) **MORTGAGE SECTOR**		
1. Rajmuk limited	Real estate services within Nairobi	January 1978
2. Sea view Diani villas	Real estate services in the coastal region	January 1980
3.Tala investments ltd	Real Estate services outside Nairobi except coastal region.	January 1980
4. Emperor holdings Ltd	Real estate services for prime commercial premises within the Nairobi's Central Business District area	January 1985

Figure 1: Source: EABS Company Profile.

Mercantile life & General Assurance Company.

This was established in early 1990s with an aim of capturing the whole of the clientele who were enjoying mortgage facilities from the EABS. This they offered perfectly through the mortgage protection facility which ensures that each and every mortgage beneficiary is insured against the same amount of money. In addition the EABS was still expanding in its housing development and their apartments were already complete units. The insurer captured this by provision of the property insurance.

The research revealed that the firm progressed very well since its inception until late last year when its growth started dwindling (appendix iii (b). However, despite the rough times the firm seemed to undergo it is still considered as the star of the whole EABS Holding in that it has a good growth. The financial backing from EABS has actually boosted its market share in that it was rated amongst the top ten insurance firms in terms of financial stability (Daily Nation 23rd April 2005- pg 26). This indeed agrees with the philosophy that the corporate centre adds value through the monitoring, protecting, coordination and guidance roles which it offers to its SBUs.

Financial stability is considered to be one of the critical success factors within the insurance sector and the financial fraternity as a whole for it gauges which company can pay their claims without any difficulties.(Daily Nation 27th July 2005-Pg27). Because of this, the firm has been able to stand alone and it was noted that the group has just maintained its share of capital towards this firm. It was revealed that the shareholders of the EAB'S were indeed impressed with the MGL's performance.

Akiba Bank Ltd.

It was formerly founded as Akiba Loans and Savings Limited and it changed its name to Akiba Bank in January 1994. It was specifically set up to ensure or support the bancassurance strategy. Bancassurance refers to a form of strategy developed by organisations specifically the banks, insurance firms or even brokers which aims at linking the different financial services offered by these firms and the distribution of the insurance products by the banks. The main products distributed under this strategy are the life insurance policies, property insurances and the mortgage protection. The research revealed that the strategy was indeed operational and this had boosted the client base of both the bank and insurance firm.

Despite the success of this strategy which works well within the group, it was noted that the bank did not perform well for the past two (2) years. A fact which led to the decrease in the share holding by the parent company from 49% to 25% (Appendix III). Insiders pointed out that this might also be the reason as to why it will be acquired by EABS to form the EABS Bank. In a diversified firm portfolio, it became eminent that Akiba Bank had turned out to be the dog which calls out for divestiture strategy as the research reveals.

It was further highlighted that the divestiture move in this regard worked out in an attempt to uphold the philosophy that a diversified firm should only invest minimally if at all in the SBUs which have indicated or have only shown sub par prospects.

Kalapi Insurance Brokers

This was originally formed in 1987 to handle the group's businesses by holding valuable profits within the group as opposed to ceding every thing to the other insurance companies. It was originally set up as Fedha Insurance agents whose basic aim was to channel all the insurance matters to MGL. However, as the environment turned turbulent, they realised that for them to satisfy and offer smart and quality service to their clients, they needed to open up and serve a wide clientele within the insurance industry.

This necessitated their change of name from Insurance Agents to Brokers who are authorised to present as many intermediaries and underwriters as they wish. In this regard Kalapi has increased its market share and now it's termed among the best performing insurance brokers within the industry.

It now serves all the insurance requirements for the potential clients to MGL which of course it awards the first priority with an aim of supporting the bancassurane strategy and to the rest of the insurance companies by offering advisory services to the clients. By so doing, it supports the marketing and distributions efforts of the entire EABS Group.

Fedha Investments and Managements

This was set up in 1963 with the key role of managing the commercial properties of EABS and actually manage the Fedha towers building, Emporer Plaza, Westminister including the Union towers building in terms of rent collection, maintenance and education of clients and tenants Management. They also involve themselves in the investment decision of the EABS especially in terms of property development. In this regard they are best known to offer or act as consultants of the group. They oversee the operations of the other real estates firms within the group.

The researcher through the interview of the Head of the marketing department of one of the SBUs established that there were other firms within the group which were mandated to perform the real estate functions(Table 1). This include-:

Rajmuk limited.

This is a real estate management firm set up by the group to oversee the value of the properties, buy and sell the same, within the region of Nairobi and its environments. They do the detective counselling and coordination works until the clients' needs are met. In this regard, they too act as the distribution channels of the EABS Housing products.

Sea View Diani Villas limited

This is also a real estate firm whose key operations are centred in the coastal region. They oversee the EABS housings development within the coastal region and also markets the same for the group. It is also mandated with the maintenance and collection of rent for the EABS at the coast.

Tala Investments.

This is an investment firm which was founded in 1980.Aims at investing in the outer sides of Nairobi especially in Machakos district. In so doing, it caters for the firm in ensuring that its profits are invested in a sound and viable ways.

In so doing it was revealed that the various real estate firms of the group were enjoying some tax relief due to the fact that they acted to promote the core business of their parent firm.

From the foregoing above, EABS was noted to be one of the strongest mortgage firm in the country which has diversified in the areas of both finance and mortgage sector. The Financial statements revealed that it is a strong firm whose capital base had surpassed the Central Bank's minimum requirement.

The management of EABS have no doubt of its survival in the next century or so. It is this extra capital base which supports its SBUs and especially during the time of financial handicaps.

4.4 Reasons for the pursuit of the related diversification.

There exists various facts as to why a firm may choose the related diversification strategy. The research revealed that EABS choose to diversify in the related areas due to the under noted five (5) key reasons-:

Excess financial resources.

It was revealed that since its establishment, the EABS continued to make abnormal profits. It was because of this fact that the shareholders decided to invest these abnormal profits into viable ventures. This they did by opening up other firms within their industry hence ended up diversifying into the related areas. Also it was decided that the establishment of these other firms could lead to them having an extra super abnormal profits than before. This indeed proved right to the shareholders as revealed from the financial statements. (Appendix III).

To ensure that there is optimum use of resources.

This was cited as one of the key reason why the firm opted to diversify within the related area. Key resources which the researcher found were been shared included the human, technological and capital resources. It was discovered that all the firms under the Group were centrally located in one building. Further, management was also noted to be shared including the directors who doubled up to be the Chief Executive Officers of the different SBUs within the group.

Further the marketing and distribution functions were also noted to be shared in a sense that virtually all the clients of the entire group were noted to be intertwined in all the various SBUs as revealed in figure 1. The SBUs were seen to be highly dependent on the core businesses of the EABS and virtually 90% of the SBUs products were related to the core business of the parent firm. Also the entire clientele of the group were in one way or another interrelated in that they virtually relied in at least one of the SBUs in an attempt to attain their goal. This seemed to agree with the philosophy that the SBUs have to strive to support the objectives of their parent firm.

Spread of risk.

Mortgage industry is known to be very risk. It requires one to set up precautionary measures due to its long term conditions which are characterised by uncertainty in the economy. In this regard, EABS realised this and they reacted by setting up related businesses which could support them should it be affected. It was noted that the problem of mortgage firms originates from the fact that housing been amongst the basic needs, not all people can afford to acquire one for themselves in the urban set up and especially in our economy which is characterised by low consumer purchasing power.

It is because of this, that even those who manage to acquire it especially through the mortgage only a few manage to abide by its conditions. As the financial statements revealed, the non performing mortgage loans formed the bulk of their risk.

Further, the financial support it accords to towards its SBUs (Akiba) were noted to be unfavourable but by adopting the proactive strategy of related diversification ,this has been actually off set by the abnormal profits which they continue to reap from the other SBUs especially MGL(Appendix iii-b) .

Synergy effects.

It is in support of the idea to spread their risk that they also realised that the net effects can be more than the already existing businesses. In this regard, the research showed out that EABS had increased its capital base more than four times since it set up its related businesses. The underlying conviction is that diversification should be able to bring growth and subsequent secure health and growing returns for the share holders and at the same time secure strong future through the increased efficiency of capital use, increase in market share, utilization of excess capacity and above all economies of scale.

The Group's strategic intent.

The vision of the EABS been to become a predominate leader in the financial circles, it was highlighted from the research that this necessitated its pursuit of the related diversification in that in wanted to have a share in each of the financial sectors within the economy especially in banking, insurance and mortgage circles. A fact it has realised since each of the SBUs are known to have a considerable share within their sectors of operation.

Other factors leading to related diversification as cited by SBUs CEOs was to ensure that the group turns out to be a one stop shop for all its clients who happen to visit their offices. In this regard, it was highlighted that all the SBUs are located within the same premises as their parent firm.

4.5 The reasons for the EABS to shift to Banking Sector

EABS's core business has for a long time been in housing development and mortgage financing. However, early this year they changed their focus and actually declared that they wanted to move away from mortgage financing to full-time banking. The researcher established that there existed three (3) Key reasons as to why the EABS thought to move to the banking sector.

Legal aspects

EABS just as its name suggests it's a building society established under the Building Society's Act. The building society act stipulates that all the account holders are actually owners of the society. This then implies that the management have no obligation at all to pass any resolution pertaining to the society's issues without a due approval by the members. It is this fact that has indeed affected most of the building societies in our country. The firms in these industry have in turn reacted by converting from been building societies to banks. A notable example has been Equity building society which converted to Equity commercial bank (Daily Nation 23rd March 2004).

It was also revealed from the research that key reasons to move into the banking act were actually in an attempt to overcome the stipulations laid in the Building society's Act by the Central Bank. The clearing house at the Central bank takes more time to clear building society's transaction unlike those of the bank. It was because of the threats which banks were causing to the building societies that they decided to change to the banking sector.

Target Market.

It was also established that most of its clientele had changed from middle income based to small scale households who demanded personalised service. This could only be met by refocusing their activities to actually match those of a medium sized commercial bank. It is due to this fact that the EABS Group now wants to move to the banking sector to capitalise and at the same time retain their clients.

Further due to the harsh economic conditions prevailing in the country, most of their huge finances under their mortgage facilities were not going to their targeted group. Instead, of keeping funds idle for a long time, they opted to develop personalised loans to assist to reach their target market. A fact which could only be realised by changing the name which has for long time be known to offer mortgage facilities to a name the clientele could trust as be able to offer loans.

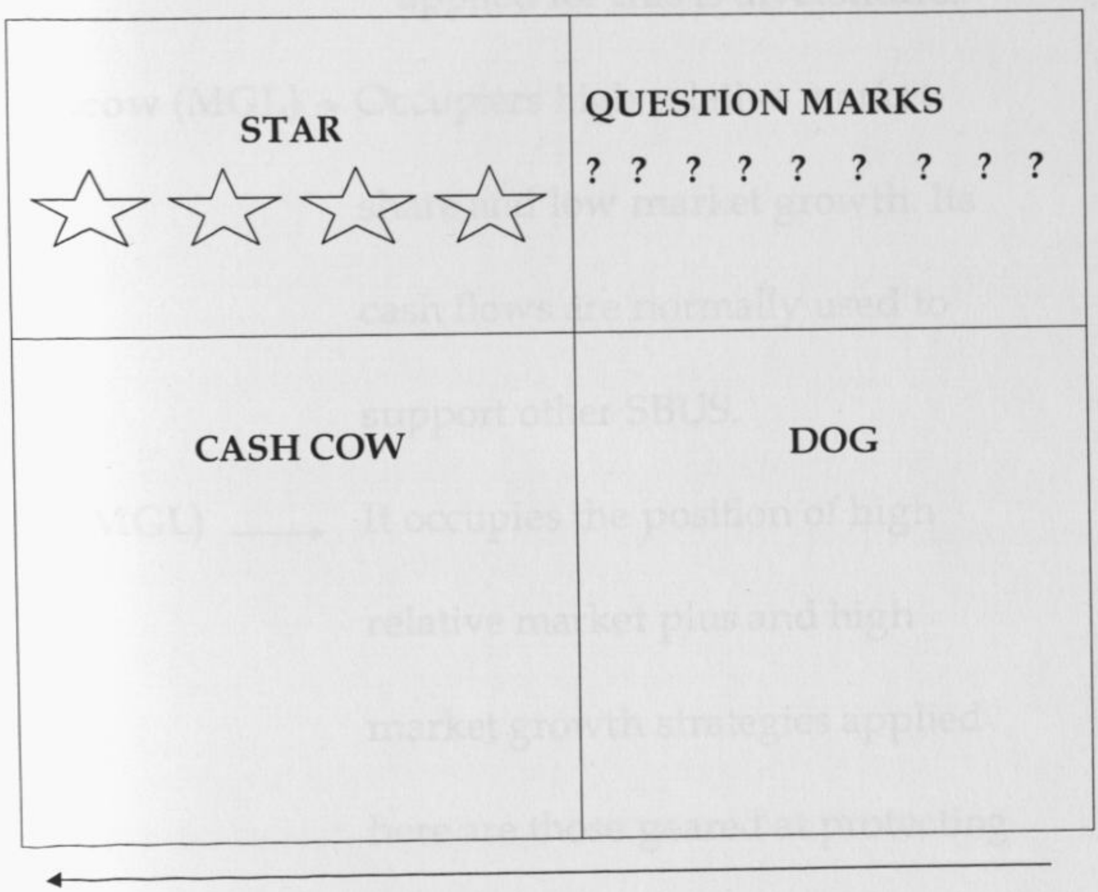
Divestiture Reasons.

The different SBUs within the diversified firm actually falls under the following four categories in terms of their relative market share and market growth -: stars, cash cow, a dog and question marks. (Figure 1) It became eminent from the research that one of its key SBU (Akiba Bank) was just but milking cash flows from the other SBUs. In this regard it continued to operate while still making losses until the shareholders decided to close it.

However, Akiba having operated as a bank, they could not just decide to close it down or shut it up due to the public image. They decided that it merges with the parent firm to form the EABS bank. A move meant to create a good public image to the entire clientele of the EABS group. The financial statements revealed that the EABS had decreased its capital share to a considerable size simply because of the performance of the Akiba bank which did not go well with the share holders.

Figure 1

A BCG (Boston Consulting Group) matrix of a diversified firm



Relative Market Share

Source: Pearce N Robinson (1997)

Dog: (Akiba Bank)→This occupies a relative low market share and low market growth. The strategy to be applied for this is diverstiture.

Cashcow (MGL) → Occupiers high relative market share and low market growth. Its cash flows are normally used to support other SBUS.

Star (MGL) → It occupies the position of high relative market plus and high market growth strategies applied here are those geared at protecting or sustaining its market positions.

Question Marks → (EABS Bank) – Occupies a position of high market growth but low market share.

4.6 The Mortgage Industry

EABS though originally formed under the mortgage sector, it has a wide area of businesses within the financial sectors. Entry into these related areas of businesses are aimed at ensuring that it fully utilizes its capabilities and competences whereas maintaining its key competences.

EABS though it had set up certain precautionary measures by opting for the related diversification strategy, it still felt that it could be better of by converting into a commercial Bank. This process is in progress and by the year end, it will have being concluded (The Financial Standard, Tuesday March 22nd 2005). It is expected that once EABS converts to bank, it will solidify its position among middle-level banks that have become popular with small and medium sized enterprises whose needs are not well catered for by the big commercial banks. It was also noted that since EABS diversified into the related areas, its market capitalisation had be affected by its SBUs especially by the fact that it continued to support even the few SBUs which were doing drastically poorly. The financial statements revealed that its growth had been increasing at a very low rate but still at a recommendable rate within the industry. It was also noted to be the strongest building society in the country.

The customers' perspective was that the move into the related diversification was indeed a positive one. The idea was liked by many for they now see themselves operating or associating themselves with a very financially sound organisation. They also cited up that most of their needs were being satisfied at a 'one stop shop'. That is as portrayed in figure 2 and Table 2 respectively.

Figure 2:

The clientele of EABS

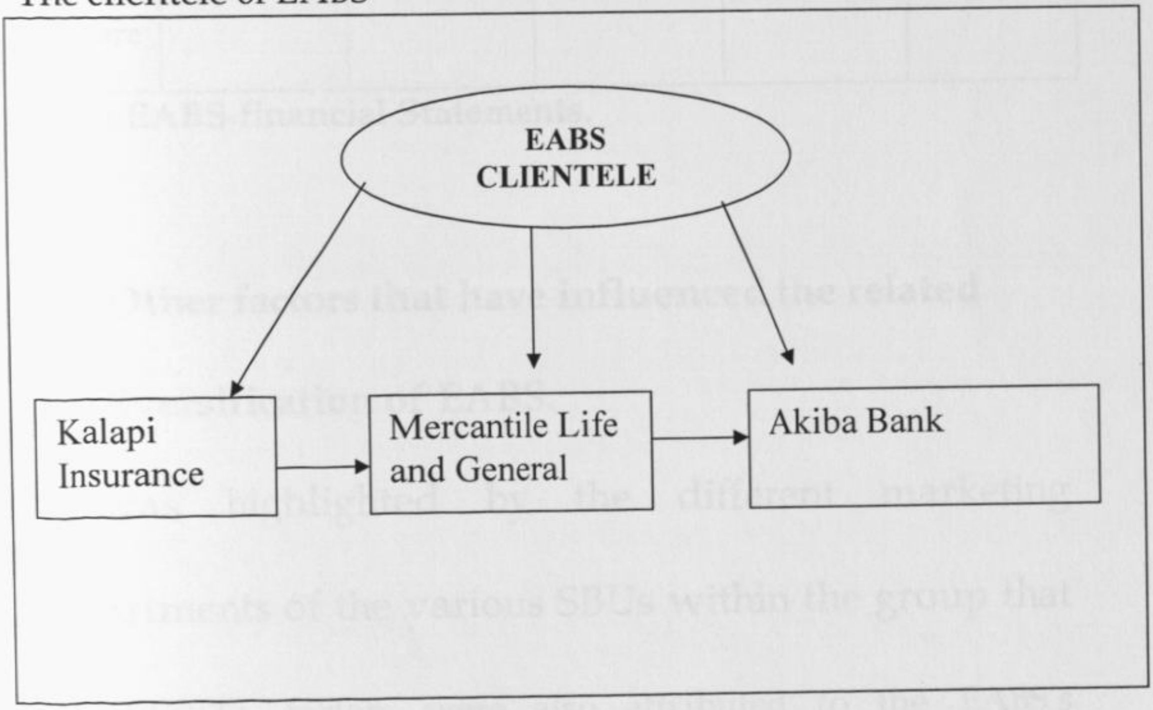


Table 2

The financial growth of EABS.

Profit after tax	2000 Kshs.000	2001 Kshs.000	2002 Kshs.000	2003 Kshs.000	2004 Kshs.000
	25,668	34,122	16,788	(78,677)	50,367
Dividend per share	8,500	2,400	1,400	(9,650)	-

Source: EABS-financial Statements.

4.7 Other factors that have influenced the related diversification of EABS.

It was highlighted by the different marketing departments of the various SBUs within the group that the PESTEL factors were also attributed to the EABS's diversification strategy.

The country's political environment had indeed contributed to the success of EABS. The fact that the political atmosphere in the country has been stable was pointed out to be the reason as to why they have opted to diversify only in Kenya compared to opening offices in the foreign country which are politically unstable. This was due to the fact that they understood the rules of the game well in Kenya. However, it was revealed that they could capitalise on diversifying regionally but opening branches in the Kenya's major towns. More over, its SBUs have also followed suit and set up branches within those towns where the parent firm has operated.

The depressed economy and the declining consumer power in the country for the last decade have had diverse effects on the firm. This has left their products (Developed houses) unoccupied for long time. Consumers have just opted for cheaper financial modes of which this has had some impact on its market share. It is because of this they thought to introduce Easy loans and even change their target market from middle level class to lower level classes. They have also embarked on a full scale advertising campaign geared at winning the small scale low level income earners.

Social factors had highly contributed to the high performance levels of EABS in a sense that they apply ethnocentric Management style. This has seen them appoint various CEOs only from an Asian community. Further, the research found out that Asian employees are remunerated differently compared to their Africans counterparts. This has demoralised most of the employees within the firm. Moreover, most of their major clients were from the Asian community. Above all the demise of their founder had started to have biting effects in a sense that most of their supporters pulled out their businesses from the entire group.

The technology aspect placed it in the upper hand especially in its operations. This has boosted their operation in that services are being conducted online, a move which has increased their clientele base. It was highlighted that most of its businesses could be conducted online plus it could link well with the SBUs.

The legal aspect has played a major role in that it has enabled EABS to rethink on its core business by moving from the building society's act to banking act which will give them more powers and flexibility in their businesses hence enhance their competitive edge. This was necessitated by the fact that the turbulence environment in which it operates in requires firms to capitalise on working harder and harder in order to sustain its competitive advantage.

CHAPTER FIVE: CONCLUSIONS.

5.1 Summary and Conclusions

The chapter presents a summary of the research project whose objectives were to determine -: The extent of diversification within the EABS. The factors that have influenced the pursuit of the related diversification strategy and the reasons as to why they want to move from their main stream of mortgage to the banking stream.

The firm has responded strategically and operationally. Strategic responses being those long-term issues aimed at directing a firm into a competitive edge, they embrace on the whole organisation. Operational responses on the other hand are those departmental issues of any organisation aimed at achieving and supporting the strategic responses. They act as the implementation phase of the strategic responses.

Due to the diversification strategy which the firm had embarked on, it had grown both in market share and returns . It was noted that it was rated among the best and strong financial base of B++. Respondents concurred that EABS had faced stiff competition within its industry but it had managed to overcome them due to the proactive move of diversifying extensively into the mortgage and financial sectors. Some of its SBUs were rated to be the key performing organisations within their respective industries due to the financial backing they were receiving from their parent firm.

It had thrived all these years due to its strategic approach of diversification. The various SBUs it has set up have not only increased its capabilities but have enabled it even to survive during the depressed economic times. It was noted that the SBUs continued to share resources especially the management, technological and more so the IT and even the distribution channels. This has in turn given them a positive image in that their clientele always wish to associate themselves with a group which they count as stable and having the ability to satisfy virtually all their needs.

It was highlighted that they wish to move to the banking sector in order to be able to compete effectively and also enhance service provisions as guided by the banking Act contrary to the building society's act which has impended greatly on its operation. Observers have pointed out that by moving to the banking sector it will merge with one of its key SBUs of which in actual sense it shall be divestituring the SBU for it has all along operated by the support it has continued to receive from the other SBUs. This in turn agrees with the philosophy of that the SBUs of the diversified firm actually enjoy the support of their parent firm or even from the other SBUs.

It can therefore be concluded that the related diversification strategy of the EABS has given them a competitive advantage compared to the other mortgage financing and housing development firms which have never opted for related diversification. It is in justification of suistaing their competitive advantage that they now wish to move into the banking sector and actually close one of its SBUs which is not performing up to the expectation. All these strategic moves will definitely give them an upper hand in their industry of operation.

5.2 Limitation of the study.

The research focussed only on one firm within the entire mortgage industry thus failing to capture the responses and effects of diversification in the entire mortgage sector.

As at the time of research the EABS group was still mourning the departure of their founder. Responses released were not from the founder himself but from the CEOs who deemed to be very green in the diversification concept. His responses were based on what the founder used to say. Also most CEOs refused to release information expressing that it could be leaked to the competitors a fact which led the Researcher to interview their deputies.

5.3 Recommendation for further research.

A study could be carried out to establish factors that influence related diversification within a different firm in a different industry or in the whole of mortgage industry has a whole.

Further, some housing development and mortgage firms have not diversified in any way leave alone with taking or opting for the related diversification, yet they have continued to outshine their counterparts. A research into the factors behind this should be carried out.

Finally the study focussed only in one firm within service industry, a similar study of the same could be carried out in manufacturing, agricultural or even construction industries to understand fully whether related diversification supersedes unrelated diversification.

5.4 Recommendations for policy and practice.

From the findings of the research the following issues need to be addressed-:

EABS should decentralise its control style and change the management style which has been said to hinder the operations of a free market economy. It is believed that this will drive them to higher levels of the competitive advantage which they already have and especially among its SBUs. Recruitments of the key personnel of the organisation should be guided by the free market forces and all in all they should try to avoid the ethnocentric style of management especially during these turbulent economic times.

It is also the high time that the group realised the importance of establishing a research and development departments within its SBUs, which will abreast the firm on the developments and market signals within the dynamic environment of its operation. The firm should embrace strategic thinking in its businesses guided by a clear vision and mission a fact which lacked in all the SBUs. It was noted that it was only their founder who seemed to have the company's vision. This should be clearly expressed and possibly well documented to avoid the issue of knowledge gap.

It was further noted that the organisation and its SBUs was characterised by very high labour turnovers, a fact which the firm should address by offering competitive remuneration packages in order to retain and maintain the highly qualified staff who in turn will enhance the competitive advantage of the firm. Insiders pointed out that most of the employees who leave the organisation end up joining the competitor organisations.

Finally the group should be sensitive to the economic conditions prevailing in the country and more so to the forces of demand and supply and try to set up affordable prices for the mortgage borrowers in order to increase its market share and growth. This is a move which they are slowly trying to achieve by changing their target market to the middle small scale households.

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APPENDICES.

APPENDIX I

INTERVIEW GUIDE

Part I:

TO BE ANSWERED BY THE CEO, -EABS.

A) Organisation Profile.

1.Which year was the organisation established……………………………………………

2.What was the core business when the organisation was started……………….…………..

3.What is the ownership of the organisation-: Private( ) or Public( ) . Please tick.

4. (a) Does your organisation have a Vision and Mission statements?

Yes ( ) No ( ).

(b) Please state them

Vision Statement………………………………………………………

Mission Statement…………………………………………………..

5.What is the current size of the organisation in terms of staff numbers?……..…

6.Generally what is the business turnover for the last three years?(Kshs.)

2002…………… 2003……………….. 2004……………….

7. Do you have a marketing or business development department in your organisation? Yes ( ) or No ( )

8. What is the rate of product or service innovation in your organisation?

(a) 1-2 per year?.......... 3-5 per year? ……… None? ……

(b) Do they always succeed in the market or not?

Please explain…………………………….

…………………………

B) The Diversification Scope.

1.What led to choice of the diversification Strategy that you are pursuing?

……………………………………………………………………………

2.To what areas of business and or markets have you grown since the company was started? …………….

3.Which of the above business do you regard as your core?………………………………..…

4.Kindly list chronologically the order of your Sister or Associate firms in terms of growth and Market Share

……………………..

………………………

5. (a) Is there some environmental factors e.g. government Regulations or social which have enhanced your diversification? YES( ) OR NO ( ).

(b) Please name at least three……………………………………….

C. The Scope of Related Diversification

1. Why did your organisation think of moving into related diversification?

 ……………………………………………………………………………

2.Do you consider yourself better off than your competitors by having diversified into related areas?

 ……………………………………………………

3. What are the key resources which you share with your sister companies? ……………

4.Do they add value to the firm as a whole?

5.How do your competitors view you now that you are diversified into these related areas of business?

 ………………………………………………

6.What Measures do you have in place to ensure that your Competitors do not copy your Resources and Capabilities?.................................

7.Do you wish to diversify outside the related areas you have already diversified into?

....

Why? ....

D) Parent Role.

1. Do you have any intentions of opening a branch in the foreign countries? Yes ( ) or No ( )

Why?......................................

2.Does each of your Associate firms operate independently? YES( ) or NO ( )

3.What Specific Roles does the Parent firm play towards the SBUs?..

4.(a) In your opinion do you think they enhance the

competitive advantage

or not? ....

(b) Why? ....

6. Comment on the ability of each firm as part of the group?

7.Give a general comment on the related Diversification Strategy

That you have taken ....

8. Has it been a success or not?

Comment ....

PART II

<u>TO BE ANSWERED BY THE Chief Executive Officers (CEOs) OF THE SBUs</u>

1.What are some of the key advantages of been associated with the group?

....

....

2. What are some of the disadvantages associated by been part of the group?

....

....

3. What is your market share compared to other firms in the same industry?

....

4.In your opinion HAS the parent firm played any role in increasing or decreasing your Market share? ....

WHY? ....

5.How do you rate yourself in terms of relative market share and growth? ....

6.What are some of the resources which you share with your sister companies?..

....

....

7.How do you view the other sister companies in terms of working for the group together With yourselves?

....

8.Do you make decision independently?

Yes ( ) or No ( )

Why? ....

9.Suppose the parent firm was to close down some of its subsidiaries, do you think you could survive? ....

WHY? ....

10.What is your general comment on the businesses under the EABS in terms of Maintaining the Corporate image.

Tuesday, 24 May 2005

The Managing Director.

East Africa Building Society (EABS)

Fedha Towers

NAIROBI

Dear Sir,

Re: Request to carry out a Research in your firm.

I wish to refer to the above and offer my request for the same. Sir, I am a postgraduate student at the University of Nairobi pursuing a Masters Degree in Business Administration (MBA). As part of the partial fulfilment of the requirements of its award, I am required to write and submit a Research Project paper.

The success of your firm in the application of the competitive Strategies within the Mortgage industry has been of great concern and interest. It is because of this that my topic of concern will be-: **"A study of the related diversification strategy within the EABS**

The results of the Research shall be used purely for academic purposes and no name will be mentioned anywhere in the report. Further, the final copy of the report shall be availed to your selves on request.

Your co-operation will be highly appreciated.

Yours Faithfully,

Philip M.Mwau

A Brief on East African Building Society

East African Building Society was established in 1959 by Mr.L.J.Pandit and has a track record spanning over a period of 44 years. It focuses on the provision of housing finance to the middle income housing market. It has also expanded into property development and has successfully developed and sold many properties. It forms part of the LP Holdings Ltd., the flagship company and has majority shareholding in Akiba Bank Ltd., and Mercantile Insurance and General Assurance Company Ltd. It has a professionally strong Management Team, which runs the Society, headed by the Managing Director, Mr.Raj Pandit.

East African Building Society has reflected a very high profitability and Asset Base in the recent past, in spite of the unfavourable credit environment and excess liquidity in the Kenyan Market. The Society recorded an impressive after tax profit of Kshs.64 million and an asset base of Kshs.5.6 billion in the year 2002. According to the unaudited results for the year 2003, the Society's after tax profits are in the range of Kshs.200 million and the Assets total to Kshs.6.2 billion. The Society also has several income generating Investment properties worth Kshs. 900 million.

In view of the fact that Building Societies are now allowed to make other type of loans, EABS has plans to target the micro-finance and retail market as well and has already launched Flexi loan products to individuals. The proposal to launch Debit Cards and ATM are also in the pipeline. Given the existing client base, the Society has tremendous opportunity to move forward in the near future, with the launching of new products.

An international Rating Agency, Global Credit Rating Co(GCR) has accorded EABS with long term domestic Kenyan shilling rate of BBB- (triple B minus),which was placed on positive rating outlook and a short term rating of A2.the short term rating of A2 is defined as "Good certainty of timely payment with good liquidity factors and sound company fundamentals."

EAST AFRICAN BUILDING SOCIETY

ANNUAL REPORT AND FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2004

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CORPORATE INFORMATION

DIRECTORS

LJ Pandit FCIBS, FKIM, FBIM	(Chairman – deceased 13th January 2005)
NPG Warren	(Appointed as Chairman on 31st March 2005)
Hon AA Moody Awori MP	
HA Damji ATII	
RL Pandit CPA (K)	(Managing Director)
DL Pandit	
DB Mehta	(Appointed Executive Director 31st March 2005)

SECRETARY

RM Ngui CPS (K)

ADVOCATES

Daly and Figgis
Lonrho House
Standard Street
Nairobi

Shapley Barrett and Company
Prudential Assurance Building
Wabera Street
Nairobi

Bowyer, Mahihu and Company
Rex House
Moi Avenue
Mombasa

Rajni Somaia
Oginga Odinga Road
Kisumu

AUDITORS

PricewaterhouseCoopers
Certified Public Accountants
The Rahimtulla Tower
Upper Hill Road
Nairobi

BANKERS

Akiba Bank Limited
Co-operative Bank of Kenya Ltd
Barclays Bank of Kenya Limited

CHAIRMAN'S STATEMENT

I take pleasure in presenting the Society's annual report and financial statements for the year ended 31 December 2004.

However, it is with deep regret and personal sadness that I report the death of the founder of the Society and our Chairman, Mr. L J Pandit after a short illness. The late Lalit Pandit was an inspiration to the industry and a guiding force that added huge value to the Society and the EABS group of companies. His sense of ethics and moral stance was a touchstone and his guidance will be missed. He has left a strong foundation for the management and shareholders to build on.

Year 2004 – A year of Consolidation

The Kenyan economy grew slightly as real GDP increased to 2.6% per annum, while the inflation rate continued to increase on the back of oil and food stuff price pressures. Interest rates remained low during the first half of the year, but rose quickly as the government responded to the increase in money supply. The Kenya Shilling showed stability against major international currencies and indeed closed the year on a high note on the back of aid flows, which was quite commendable.

At East African Building Society, it was a year of consolidation. During the year, the Society reduced its investment in Akiba Bank Limited to 25%.

EABS rated highly by Global Credit Rating Agency

EABS is proud to announce that once again, the International Rating Agency, Global Credit Rating Company Limited, has accorded EABS an excellent short term rating of A3 and Long Term Rating of BB+. We are one of the very few Kenyan financial institutions to have achieved such a rating.

EABS Performance

The Society showed considerable progress during the year and recorded a pre tax profit of Kshs.81.7 million. As at 31 December 2004, the Society's assets amounted to Kshs.5.6 billion (2003: 6 billion) and Customer's deposits amounted to Kshs.4.5 billion (2003: 5 billion). The decrease in deposits is mainly due to the reason that the Society discharged many of its expensive deposits during the year 2004, in view of the low Treasury bill rate that prevailed until the third quarter of last year. The liquidity position of the Society continued to remain strong with investments of Kshs.729 million in Government securities available for sale and Kshs. 440 million in deposits with reputable commercial banks and financial institutions.

The loans and advances portfolio as at year-end was Kshs.1.14 billion and recorded a slight decrease of Kshs.125 million over the previous year. The portfolio continues to be efficiently managed with a well-defined policy on lending and strict pursuit of arrears. Various management committees meet at regular intervals to ensure greater scrutiny in all required areas for continuous improvement. The Easy Loan product, launched in the year 2003 is also growing well, with disbursements of over Kshs.40 million during the year.

The Society's reserves at the end of the year stood at Kshs.600 million. Revision to International Accounting Standards 39 (revised 2003) required that movements in fair value of Treasury Bonds be shown as an adjustment to equity. As a result, the Society had to restate its profits for year 2003, in order to ensure that previous year's figures are comparable. The Society also early adopted International Accounting Standard 28, which required that investment in associate companies be accounted for using equity method. The fair value of Fedha Towers, valued by Lloyd Masika Limited, Registered Valuers, was Kshs.988.7 million, as reflected in the financial statements.

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The Society entered into an agency agreement with Diamond Trust of Kenya Limited and has successfully launched the Western Union Money Transfer Services in all its branches. The E-pass book project is also nearing completion and is ready to be implemented soon.

The Society's financial position remained strong during the year and the overall performance in all sections of business operations, satisfactory.

Other Investments

During the year, the Society reduced its investment in Akiba Bank Limited from 49.1% to 25%. The Society also has investments in Mercantile Life and General Assurance Company Limited, and Acacia Fund Limited, a company managed by Aureos Kenya Managers Limited.

Housing Development

The Society is happy to announce that in the first phase of Fedha Apartments, now called Parkview Apartments, 54 out of the 84 apartments have already been sold. The Society is at advanced stage of negotiations and will soon commence the construction of the second phase of Parkview Apartments.

Staff

Our staff members continue to benefit from both external and in house training courses made available to them throughout the year.

Marketing

The Society continues to support Kenya sporting activities, by sponsoring golf 'monthly mugs' and a variety of other events. Support also continues to be given to a number of charitable organisations and needy individuals.

Year 2005

The Boards of East African Building Society and Akiba Bank Limited have resolved to merge in 2005 to form EABS Bank Limited. An application has been made to the Central Bank of Kenya. This will be subject to all necessary legal and regulatory approvals. The merged Bank, EABS Bank Limited, is expected to do well in a competitive banking environment. The activities of mortgage lending and property development will continue.

Conclusion

In conclusion, I would like to thank the management and all members of staff for their loyal service during the past year.

I would also like to thank my fellow directors for their support and advice during the year, which is much appreciated.

NEVILLE PG WARREN
CHAIRMAN

MERCANTILE LIFE AND GENERAL

	2002 MERCANTILE LIFE & GENERAL	2003 MERCANTILE LIFE & GENERAL	2004 MERCANTILE LIFE & GENERAL
OPERATIONAL EFFICIENCY			
Gross premium income	846,984	2,130,320	1,196,764
Outside Kenya Business			
% growth over 2000	315.02	848.72	359.65
Market share	#DIV/0!	#DIV/0!	#DIV/0!
Net premium income	690,744	1,483,425	652,254
% growth over 2000	512.78	1069.15	407.33
% of gross premium income	81.55	69.63	54.50
Expenses of management	183,690	351,249	151,706
% growth over 2000	189.72	509.14	114.64
% of gross premium income	21.69	16.49	12.68
% of net premium income	26.59	23.68	23.26
Commission	133,275	89,320	31,880
% of gross premium income	15.74	4.19	2.66
% of net premium income	19.29	6.02	4.89
Claims incurred	417,413	1,041,109	408,852
% of net premium earned	57.69	72.94	67.65
Underwriting Profit(Loss)	(10,831)	(54,339)	11,946
% of net premium earned	(1.50)	(3.81)	1.98
Investment Income	137,505	103,025	191,363
% of total investments	5.34	13.50	10.11
Operating profit	126,674	48,686	203,310
FINANCIAL STATUS			
Equity	180,000	222,592	200,000
revenue reserves	402,079	21,381	359,913
Capital reserves	1,174,046	857,265	189,029
TOTAL SHAREHOLDERS FUNDS	1,756,125	1,101,238	748,942
% return on SHF	4.77	3.09	21.80
Total investments	2,574,278	763,333	1,892,507
Technical reserves	975,972	1,190,121	1,361,444
% Net premium income	141	80	209
Debtors	174,034	326,610	163,097
Days outstanding	75	56	50
GROSS PREMIUM PRODUCT MIX			
Fire	21.64%	22.58%	28.95%
Engineering	2.67%	3.73%	12.30%
Motor	35.80%	34.63%	31.95%
Marine & transit	6.93%	10.47%	5.90%
Accident	32.97%	28.59%	20.91%
Shareholders funds as % of Net premium income	254	74	115
SHF + Technical reserves as % of net premium income	396	154	324
Gross premium income 2000	204,083	224,546	260,367
Outside Kenya Business		1.35%	
Market share 2000	#DIV/0!	126,881	#DIV/0!
Net premium income 2000	112,723	57,663	128,565
Expenses of Management 2000	63,403	1,427,339	70,679
Net earned premium 2001	723,547	34,080	604,384
Profit after tax 2001	83,817	2,529,874	163,265
Total Assets 2001	3,038,164		2,362,315
		7.45%	
SHARES	21.17%	92.46%	5.70%
FIXED INCOME	10.85%	-	62.31%
REAL PROPERTY	50.19%	0.09%	31.98%
SUBSIDIARIES	17.79%	100.00%	-
TOTAL INVESTMENT	100.00%		100.00%
		30.17%	
Total investment/Total assets	84.73%	1.92%	80.11%
Returns/Total Assets	4.17%		8.61%

The directors submit their report together with the audited financial statements for the year ended 31 December 2004, which disclose the state of affairs of the Society.

PRINCIPAL ACTIVITIES

The Society takes deposits from the public and various institutions and provides mortgages to customers. The Society is also involved in housing development.

RESULTS AND DIVIDEND

The profit for the year of Shs 50,357,000 (2003: loss Shs 78,677,000) has been added to retained earnings. The directors do not propose a dividend for the year.

DIRECTORS

The directors who held office during the year and to the date of this report were:

LP Pandit FCIS, FKIM, FBIM	(Chairman – deceased 13th January 2005)
NPG Warren	(Appointed as Chairman on 31st March 2005)
RL Pandit CPA (K)	(Managing Director)
HA Damji ATII	
Hon AA Moody Awori MP	
DL Pandit	
DB Mehta	(Appointed as Executive Director on 31st March 2005)

AUDITORS

The Society's auditors, PricewaterhouseCoopers, have indicated their willingness to continue in office as auditors.

By order of the Board

SECRETARY

31 March 2005

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	2002	2003	2004
	MERCANTILE LIFE & GENERAL	MERCANTILE LIFE & GENERAL	MERCANTILE LIFE & GENERAL
SHARE CAPITAL PAID UP	100,000,000	100,000,000	150,000,000
RESERVES			
REVENUE RESERVES	28,468,000	25,110,000	19,727,000
CAPITAL RESERVES	-	0	-
TOTAL RESERVES	28,468,000	25,110,000	19,727,000
PAID UP CAPITAL & RESERVES	**128,468,000**	**125,110,000**	**169,727,000**
TOTAL FIXED ASSETS	**5,701,000**	**5,315,000**	**3,278,000**
INVESTMENTS			
EQUITY	1,046,000	578,000	1,520,000
GOVT. PAPER	244,150,000	205,800,000	38,928,000
DEPOSITS & OTHER DEBT SECURITIES	59,280,000	73,000,000	277,271,000
REAL PROPERTIES	-	0	-
INVESTMENT IN SUBSIDIARIES	-	0	-
TOTAL INVESTMENTS	**304,476,000**	**279,378,000**	**317,719,000**
CURRENT ASSETS			
BANK BALANCES & CASH	1,442,000	3,545,000	806,000
TAX RECOVERABLE	2,641,000	2,374,000	5,237,000
PREMIUMS O/S	69,925,000	54,912,000	55,775,000
AMOUNTS FROM BODIES ENGAGED IN INSURANCE BUSINESS	9,498,000	0	6,504,000
SUNDRY DEBTORS	2,224,000	4,666,000	11,396,000
OTHERS	-	0	-
TOTAL CURRENT ASSETS	**85,730,000**	**65,497,000**	**79,718,000**
TOTAL ASSETS	**395,907,000**	**350,190,000**	**400,715,000**
LIABILITIES			
UNEARNED PREMIUM RESERVE	53,300,000	49,929,000	48,304,000
O/S CLAIMS PROVISIONS	141,245,000	118,951,000	132,044,000
TOTAL U/W PROVISIONS	**194,545,000**	**168,880,000**	**180,348,000**
CURRENT LIABILITIES			
TAXATION	1,841,000	1,453,000	
DIVIDENDS	6,250,000	5,000,000	3,750,000
DUE TO BODIES RELATED IN INSURANCE BUSINESS	52,432,000	39,470,000	38,072,000
SUNDRY CREDITORS	12,371,000	10,277,000	8,818,000
OTHERS	-	0	-
TOTAL CURRENT LIABILITIES	**72,894,000**	**56,200,000**	**50,640,000**
TOTAL LIABILITIES	**267,439,000**	**225,080,000**	**230,988,000**
DIFF. BTWN TOTAL ASSETS AND TOTAL LIABILITIES	**128,468,000**	**125,110,000**	**169,727,000**
	OK	OK	OK

	2002	2003	2004
	MERCANTILE LIFE & GENERAL	MERCANTILE LIFE & GENERAL	MERCANTILE LIFE & GENERAL
SHARE CAPITAL PAID UP	100,000,000	100,000,000	150,000,000
RESERVES			
REVENUE RESERVES	28,468,000	25,110,000	19,727,000
CAPITAL RESERVES	-	0	-
TOTAL RESERVES	28,468,000	25,110,000	19,727,000
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GOVT. PAPER	244,150,000	205,800,000	38,928,000
DEPOSITS & OTHER DEBT SECURITIES	59,280,000	73,000,000	277,271,000
REAL PROPERTIES	-	0	-
INVESTMENT IN SUBSIDIARIES	-	0	-
TOTAL INVESTMENTS	**304,476,000**	**279,378,000**	**317,719,000**
CURRENT ASSETS			
BANK BALANCES & CASH	1,442,000	3,545,000	806,000
TAX RECOVERABLE	2,641,000	2,374,000	5,237,000
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AMOUNTS FROM BODIES ENGAGED IN INSURANCE BUSINESS	9,498,000	0	6,504,000
SUNDRY DEBTORS	2,224,000	4,666,000	11,396,000
OTHERS	-	0	-
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DUE TO BODIES RELATED IN INSURANCE BUSINESS	52,432,000	39,470,000	38,072,000
SUNDRY CREDITORS	12,371,000	10,277,000	8,818,000
OTHERS	-	0	-
TOTAL CURRENT LIABILITIES	**72,894,000**	**56,200,000**	**50,640,000**
TOTAL LIABILITIES	**267,439,000**	**225,080,000**	**230,988,000**
DIFF. BTWN TOTAL ASSETS AND TOTAL LIABILITIES	**128,468,000**	**125,110,000**	**169,727,000**
	OK	OK	OK

	2002	2003	2004
	MERCANTILE LIFE & GENERAL	**MERCANTILE LIFE & GENERAL**	**MERCANTILE LIFE & GENERAL**
GROSS PREMIUM	260,367,000	204,083,000	280,344,930
LESS: REINSURANCES	131,802,000	91,360,000	150,930,930
NET PREMIUM WRITTEN	128,565,000	112,723,000	129,414,000
UNEARNED PREMIUM B/F	49,929,000	49,341,000	43,933,000
UNEARNED PREMIUM C/F	53,300,000	49,929,000	48,304,000
NET EARNED PREMIUMS	**125,194,000**	**112,135,000**	**125,043,000**
TOTAL CLAIMS INCURRED	**73,729,000**	**63,563,000**	**65,826,000**
COMMISSIONS	3,573,000	4,436,000	2,620,000
EXPENSES OF MANAGEMENT	70,679,000	63,404,000	67,011,000
TOTAL EXPENSES	**74,252,000**	**67,840,000**	**69,631,000**
BALANCE BEING UNDERWRITING PROFIT/(LOSS)	**(22,787,000)**	**(19,268,000)**	**(10,414,000)**
INVESTMENT INCOME	37,333,000	30,889,000	21,647,000
PROFIT ON DISPOSAL OF FIXED ASSETS	-	0	-
TOTAL INCOME	**37,333,000**	**30,889,000**	**21,647,000**
EXPENSES NOT CHARGED TO REVENUE ACCOUNTS	-	0	
PROFIT BEFORE TAXATION	14,546,000	11,621,000	11,233,000
TAXATION	4,938,000	786,000	3,603,000
PROFIT AFTER TAXATION	**9,608,000**	**10,835,000**	**7,630,000**
UNAPPROPRIATED PROFIT B/F	25,110,000	19,275,000	38,847,000
PROFIT AFTER TAXATION	9,608,000	10,835,000	7,630,000
PROFIT AVAILABLE FOR APPROPRIATION	34,718,000	30,110,000	46,477,000
BONUS SHARE ISSUE			
PROPOSED DIVIDEND (GROSS)	6,250,000	5,000,000	3,750,000
OTHER	-	0	25,000,000
	6,250,000	5,000,000	28,750,000
UNAPPROPRIATED PROFIT C/F	**28,468,000**	**25,110,000**	**17,727,000**

	2002	2003	2004
	MERCANTILE LIFE & GENERAL	MERCANTILE LIFE & GENERAL	MERCANTILE LIFE & GENERAL
GROSS PREMIUM	260,367,000	204,083,000	280,344,930
LESS: REINSURANCES	131,802,000	91,360,000	150,930,930
NET PREMIUM WRITTEN	128,565,000	112,723,000	129,414,000
UNEARNED PREMIUM B/F	49,929,000	49,341,000	43,933,000
UNEARNED PREMIUM C/F	53,300,000	49,929,000	48,304,000
NET EARNED PREMIUMS	**125,194,000**	**112,135,000**	**125,043,000**
TOTAL CLAIMS INCURRED	**73,729,000**	**63,563,000**	**65,826,000**
COMMISSIONS	3,573,000	4,436,000	2,620,000
EXPENSES OF MANAGEMENT	70,679,000	63,404,000	67,011,000
TOTAL EXPENSES	**74,252,000**	**67,840,000**	**69,631,000**
BALANCE BEING UNDERWRITING PROFIT/(LOSS)	**(22,787,000)**	**(19,268,000)**	**(10,414,000)**
INVESTMENT INCOME	37,333,000	30,889,000	21,647,000
PROFIT ON DISPOSAL OF FIXED ASSETS	-	0	-
TOTAL INCOME	**37,333,000**	**30,889,000**	**21,647,000**
EXPENSES NOT CHARGED TO REVENUE ACCOUNTS	-	0	-
PROFIT BEFORE TAXATION	14,546,000	11,621,000	11,233,000
TAXATION	4,938,000	786,000	3,603,000
PROFIT AFTER TAXATION	**9,608,000**	**10,835,000**	**7,630,000**
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	6,250,000	5,000,000	28,750,000
UNAPPROPRIATED PROFIT C/F	**28,468,000**	**25,110,000**	**17,727,000**

(1)

REPORT OF THE INDEPENDENT AUDITORS TO THE MEMBERS OF AKIBA BANK LIMITED

We have audited the financial statements of Akiba Bank Limited for the year ended 31 December 2004 set out on pages 5 to 31.

Respective responsibilities of directors and auditors

The directors are responsible for the preparation of financial statements as described on page 3. Our responsibility is to express an independent opinion on the financial statements based on our audit.

Basis of opinion

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform our audit to obtain reasonable assurance that the financial statements are free from material misstatement. An audit includes an examination, on a test basis, of evidence supporting the amounts and disclosures in the financial statements. It also includes an assessment of the accounting policies used and significant estimates made by the directors, as well as an evaluation of the overall presentation of the financial statements.

We have obtained all the information and explanations that to the best of our knowledge and belief were necessary for the purposes of our audit and believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion proper books of account have been kept and the financial statements give a true and fair view of the state of the financial affairs of the company at 31 December 2004 and of its loss and cash flows for the year then ended in accordance with International Financial Reporting Standards and the Kenyan Companies Act.

Certified Public Accountants
Nairobi

23 March 2005

Profit and loss account

	Notes	2004 Shs'000	2003 Shs'000
Interest income	1	292,767	384,920
Interest expense	2	(134,455)	(182,789)
Net interest income		158,312	202,131
Fee and commission income		88,991	68,912
Foreign exchange income		25,392	5,468
Realised losses on disposal of available-for – sale investment securities		(11,594)	-
Other operating income		7,177	8,069
		109,966	82,449
Operating income		268,278	284,580
Impairment losses on loans and advances	14	(153,289)	(876,869)
Other operating expenses	3	(177,180)	(186,378)
Loss before income tax		(62,191)	(778,667)
Income tax credit	5	19,945	229,453
Loss for the year		(42,246)	(549,214)
		Shs	Shs
Loss per share (Shs per share) - basic and diluted	6	(8.45)	(109.84)
		Shs'000	Shs'000

Balance sheet

	Notes	2004 Shs'000	2003 Shs'000
ASSETS			
Cash and balances with Central Bank of Kenya	8	302,086	281,881
Government securities	9	601,667	489,823
Deposits and balances due from banking institutions	10	253,584	344,773
Other assets	11	311,627	172,456
Investment in associate	12	2,250	2,250
Unquoted investments	13	92,474	92,993
Loans and advances to customers	14	2,306,902	2,468,699
Current income tax		8,939	8,939
Computer software	15	23,402	31,203
Leasehold improvements and equipment	16	48,789	52,653
Deferred income tax asset	21	258,217	220,507
Total assets		4,209,937	4,166,177
LIABILITIES			
Customer deposits	17	3,059,600	2,970,183
Deposits and balances due to banking institutions	18	132,000	174,406
Borrowings	19	194,074	228,300
Other liabilities	20	220,720	106,047
Total liabilities		3,606,394	3,478,936
SHAREHOLDERS' EQUITY			
Share capital	22	1,100,000	1,100,000
Accumulated losses		(502,539)	(460,293)
Revaluation reserve		6,082	47,534
Total shareholders' equity		603,543	687,241
Total equity and liabilities		4,209,937	4,166,177

The financial statements on pages 6 to 32 were approved for issue by the board of directors on 23 March 2005 and signed on its behalf by:

N P G Warren – Chairman

D L Pandit – Managing Director

R Ngui – Secretary

H A Damji - Director

Statement of changes in equity

	Notes	Share capital Shs'000	Retained earnings/ (accumulated losses) Shs'000	Revaluation reserve Shs'000	Proposed dividends Shs'000	Total Shs'000
Year ended 31 December 2003						
At start of year						
-as previously reported		500,000	119,409	-	500	619,909
-effect of adopting IAS 39 (revised 2003)	24	-	(30,488)	30,488	-	-
As restated		500,000	88,921	30,488	500	619,909
Issue of share capital		600,000	-	-	-	600,000
-Changes in fair value of available for sale investments		-	-	17,046	-	17,046
Loss for the year		-	(549,214)	-	-	(549,214)
Dividends:						
- final for 2002 paid		-	-	-	(500)	(500)
At end of year		1,100,000	(460,293)	47,534	-	687,241
Year ended 31 December 2004						
At start of year						
- as previously reported		1,100,000	(410,889)	-	-	689,111
- effect of adopting IAS 39 (revised 2003)	24	-	(49,404)	47,534	-	(1,870)
As restated		1,100,000	(460,293)	47,534	-	687,241
Changes in fair value of available-for-sale investments		-	-	(49,568)	-	(49,568)
losses realised						

Cash flow statement

	Notes	2004 Shs'000	2003 Shs'000
Cash flows from operating activities			
Interest receipts		293,471	384,920
Interest payments		(129,499)	(182,789)
Net fee and commission receipts		88,991	68,912
Other income received		32,569	12,249
Payments to employees and suppliers		(156,810)	(160,305)
Income tax paid		-	(8,317)
Cash flows from operating activities before changes in operating assets and liabilities		128,722	114,670
Changes in operating assets and liabilities:			
- cash reserve requirement	31	(18,701)	56,725
- loans and advances		8,440	(417,882)
- other assets		(139,171)	(29,156)
- customer deposits		84,461	291,179
- other liabilities		114,673	42,251
Net cash generated from/ (used in) operating activities		178,424	57,787
Cash flows from investing activities			
Dividends received		3,437	645
Purchase of leasehold improvements and equipment	16	(11,216)	(10,725)
Proceeds from sale of leasehold improvements and equipment		2,183	37,033
Proceeds from sale of foreclosed property		3,979	-
Purchase of unquoted equity shares		-	(3,750)
Purchase of government securities		(231,444)	(192,668)
Net cash (used in)/ from investing activities		(233,061)	(169,465)
Cash flows from financing activities			
Dividends paid		-	(500)
Net repayments of short term borrowings		(35,193)	(2,700)
Proceeds from issue of preference shares		-	600,000
Net cash from financing activities		(35,193)	596,800
Net increase in cash and cash equivalents		(89,830)	485,122
Cash and cash equivalents at start of year		335,132	(149,990)
Cash and cash equivalents at end of year	31	245,482	335,132

Accounting policies

The principal accounting policies adopted in the preparation of these financial statements are set out below. These polices have been consistently applied to all years presented unless otherwise stated.

(a) Basis of preparation

The financial statements are prepared in compliance with International Financial Reporting Standards (IFRS). In 2004 the bank early adopted IAS 32 - Financial instruments :disclosure and presentation (revised 2003) and IAS 39 - Financial instruments: recognition and measurement (revised 2003). The financial statements are presented in the functional currency, Kenya Shillings (Shs) rounded to the nearest thousand ,and prepared under the historical cost convention, as modified by the revaluation of available-for-sale investment securities and derivatives.

The preparation of financial statements in conformity with IFRS requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on the directors' best knowledge of current events and actions, actual results ultimately may differ from those estimates.

(b) Interest income and expense

Interest income and expense are recognised in the profit and loss account for all interest bearing instruments on an accrual basis using the effective yield method based on the actual purchase price. Interest income includes coupons earned on fixed income investment and trading securities and accrued discount and premium on treasury bills and other discounted instruments. When loans and advances become doubtful of collection, they are written down to their recoverable amounts and interest income is thereafter recognised based on the rate of interest that was used to discount the future cash flows for the purpose of measuring the recoverable amount.

(c) Translation of foreign currencies

Transactions in foreign currencies during the year are converted into Kenya Shillings at rates ruling at the transaction dates. Assets and liabilities at the balance sheet date which are expressed in foreign currencies are translated into Kenya Shillings at rates ruling at that date. The resulting differences from conversion and translation are dealt with in the profit and loss account in the year in which they arise.

(d) Investments in associates

Investments in associates are accounted for using the equity method. They are initially