STRATEGIC RESPONSES OF COMMERCIAL BANKS TO THE THREAT OF SUBSTITUTE PRODUCTS

BY

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DECLARATION

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

Signed.. Date..15th October 2003

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The project has been submitted for examination with my approval as the university supervisor.

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DEDICATION

"To Him who sits on the throne and to the Lamb be praise and honor, glory and power, wisdom and thanks forever and ever!"

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ABSTRACT

For a number of years, the banking sector in Kenya has been experiencing challenging times. Some of the challenges have been external - poor macro economic policies, and a hostile operating economic environment. Other factors include poor debt culture, a slow and cumbersome judicial process, the rein of political patronage and poor supervision by the regulatory body. Coupled with this there is the emergence of non-banking key players in the delivery of financial services targeting marginalized groups but also those seeking to close the gaps evident in the financial services provided by the commercial banks.

This study sought to identify the substitute products that the commercial banks in Kenya consider a threat, and the strategic responses that the commercial banks are using to counter this threat..

For the purpose of the study, all the commercial banks in the clearinghouse, forty-five at the time of the study, were included. However, only 15 of them responded, constituting a 33% response rate. The study was carried out by use of a questionnaire, which consisted of both open- ended and closed questions. The data collected was analyzed using the SPSS computer based statistical program and presented in tables and other descriptive statistics.

The study revealed that commercial banks in Kenya were concerned about the threat posed by treasury bills as an alternative to savings and investment products in the commercial banks. They were also concerned about the entry of money transfer organizations and the existence of long term financial providers.

The study revealed that to counter the threat of these substitutes, commercial banks were diversifying their product portfolio to include these products. They were also deliberately listening to the needs of their customers and packaging products that customers would find suitable for their needs. Some commercial banks were entering into strategic alliances with other service and product providers, to enhance customer retention, as the customers would perceive them as a one- stop- shop for financial services.

From these findings, it was recommended that commercial banks should monitor emerging competitors both in the financial and non financial sectors, and quick responses be formulated to counter the threats as they emerge. Commercial banks should also monitor global trends with a view to proactively managing emerging threats from substitute products emerging in the market. If need be the commercial banks will need to redefine their market segments to ensure continued profitability, which all respondents regarded as a very important factor for the organization.

CHAPTER ONE: INTRODUCTION

1.1 Background

Commercial banks, as all organizations, operate within the environment, and are environment dependent (Ansoff and McDonnell, 1990). The organization's environment consists of the conditions and forces that affect its strategic options and define its competitive situation (Pearce and Robinson, 1997). Organizations, in order to survive, have to pay close attention to the external environment. Failure to do so will affect the future survival of the organization.

Over the last 15 years, the banking industry, like all industries in the country, have been faced with various challenges arising from changes in the environment such as liberalization, a turbulent economy and government policies such as that enabling financial institutions to acquire bank status while retaining their other functions (Banking Act of Kenya, 1994).

The Market Intelligence Journal, Annual Edition 2003, states that the volatility of interest income and profit before tax accompanied by political and economic uncertainties relating to the last General Election held in December 2002 have resulted in a lackluster performance for Kenya's banking sector for the year 2002. It observed that the general economy continued to perform dismally with real GDP growth of 1.1% down from 1.2% the previous year.

Khubchandani (2000), in his description of a bank, quotes Sir John Paget's assertion that

> "No person or body corporate or otherwise can be a banker who does not take deposit accounts, take current accounts, issue and pay cheques and collect cheques crossed and uncrossed for his customer"

A banking company is defined a one which transacts the business of banking, that is accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable bv cheques, drafts, money order or otherwise (Khubchandani, 2000).

Strategy is described as creating a fit between the external characteristics and internal organizational conditions to solve a strategic problem. The problem occurs when there is a mismatch between the internal characteristics of an organization and the opportunities existing in the external environment.

Strategic responses, according to Pearce and Robinson (1991) are the set of decisions and actions that result in the formulation and implementation of plans designed to achieve a firms objectives. Strategic responses are part of competitive strategies that organizations develop in defining their goals and policies. They are reactions to what is happening in the environment of the organization. Porter (1980) observes that the knowledge of the underlying sources of competitive pressure provides the groundwork for strategic agenda in action. When organizations are faced with unfamiliar changes, they should revise their strategies to match the turbulence level (Ansoff and McDonnell, 1990). New technologies, new competition, new dimensions of social control and above all an unprecedented questioning of the organisation's role in the society define the unfamiliar world.

Strategic responses are concerned with the long-term strategy of an organization, involving high investments and embracing the organization as a whole. Other responses, for example that of one commercial bank to an announcement that another commercial bank is taking over partially paid loans, as was the recent offer by Standard Chartered Bank Kenya Ltd as advertised in the press in June 2003 (Daily Nation), may be ad hoc, involving a part or division of an organization.

The banking act of 1994 gave other financial institutions the option to convert into banks. According to the Central Bank of Kenya information bulletin on their website (see appendix 1), this saw 20 such institutions convert into banks, this being mainly attributable to the high profits seen in the industry, as well as the strategic positioning for their core products through their complementary nature to banking products. Some of the core products of these institutions are long-term finance, mortgage financing and leasing arrangements. Capital product companies have also entered into agreements with financial institutions making it possible to purchase these without finance from the banks. These include motor vehicle companies such as D T Dobie who have an arrangement with NIC Bank to finance a percentage of the cost of vehicles to buyers subject to credit appraisal. This has had an effect of increasing competition in the banking industry.

In addition to the new entrants in the market who have heightened the competition for consumer and large deposits, increasing competition is also resulting from the fact that non-depository and non-financial institutions are beginning to offer services directly substitutable for those provided by commercial banks (Eisenbeis, 1984). Such 'institutions' offering substitute products include insurance companies, micro-finance organizations, hire purchase firms, Savings and Credit Societies (SACCOs), mortgage companies, foreign exchange bureaus, funds transfer organization such as Western Union and credit card issuers. Informal sources of finance include micro finance companies, NGOs, fund raising events (harambees), family and friends. According to *Marketing Intelligence*, Annual Special Edition 2003,Micro-Finance institutions and SACCOs are emerging as key players in the delivery of financial services, particularly to marginalized groups, yet they do not operate under an effective regulatory framework such as that of the commercial banks. The competition for their target market is therefore not on a level-playing field with the commercial banks, as it is tilted in favour of the micro – finance institutions.

Mintzberg and Quinn (1991), define substitutes as those products that appear different but can perform the same function as another product. Substitutes place limits on prices and on the profits that a segment can earn. A company has to monitor the price trends of substitutes closely. If there are advances in technology or competition increases in these substitute industries, prices and profits in the segment are likely to fall.

Pearce and Robinson (1997) assert that the degree of competitiveness is manifested not only in other players, but rather other competitive forces exist that go well beyond the established combatants in a particular industry. Porter (1980) identifies five forces that affect the level of competition in an industry. He states that the rules of competition are embodied in the entry of new competitors, the threat of substitutes, the bargaining power of suppliers and the rivalry among the existing competitors. Gathoga (2001) identified the key competitive factors affecting commercial banks in Kenya as increasing competition and the threat of substitutes. According to Pearce and Robinson (1991), 'a serious concern of any business is the threat of a substitute product in which buyers can meet their original need'. Banks therefore have to reposition themselves to counter the threat of substitute products in the economy, and this will require a strategic approach in order to ensure their survival and continued profitability.

1.2 Research Problem

Commercial banks are all those institutions that are involved in accepting deposits and lending money to the public with the use of cheques. They retain a given amount of their capital base at the Central Bank of Kenya. They lend money, for short periods of time, usually five years and less. It is difficult to visualize how an economy would operate and survive without the crucial service offered by banks.

In spite of the important role that commercial banks are playing in the economy, substitute products now threaten their survival. Substitute products emerged from a gap created due to some market segments not being adequately serviced by the commercial banks due to the nature of their products and the regulatory framework that defines the operations of commercial banks, for example, their term loans are five years or less. These substitute products seek to provide alternative sources of foreign exchange, alternative investments and alternative sources of finance. Borrowers seeking longer-term loans must look elsewhere, for example, to mortgage companies. Other substitute examples are foreign exchange bureaus, insurance investment policies such as the twenty-year education plan, and hire purchase which enables the consumer the use of an item while payment are made in installments. Mortgage companies have in turn developed products such as savings accounts, checking accounts and flexible terms of repayments as an alternative to bank products. (Daily Nation, August 17, 2003). Co-operative societies, "merry-go-rounds" and other informal sources of financing have emerged due to the imposition of a minimum lending criteria, and high interest rates charged by commercial banks. Foreign exchange bureaus were licensed after the deregulation of the foreign exchange act. This was meant to decontrol the rates from the Central Bank and allow the forces of demand and supply to determine the rates of different currencies. Foreign exchange bureaus operate on a smaller spread than that of commercial banks, and they target the traveler in the provision of foreign exchange currencies. Some encash cheques for their clients with whom they have special arrangements.

The amendments in the banking act in 1994, licensing of micro finance institutions, and the introduction of non-traditional sources of raising capital such as commercial paper, substitute products, both from financial institutions and non-financial institutions are also posing a formidable threat to their survival of commercial banks.

The concept of substitutes lurks in the background (Gathoga, 2001 identified substitute as one of two key factors that are a threat to commercial banks, whilst *Market Intelligence*, 2003 has drawn attention to the discomfort that micro – finance institutions are causing to the banking industry) and whilst there is concern as these are seen to erode potential profits of commercial banks, no study was found that has empirically investigated the Kenyan context. The only studies found were Shimba, 1993 (who looked at aspects of planning in the financial sector. This was aimed at documenting strategic planning processes within the financial sector in Kenya. This study did not focus on any of Porter's models), Bett, 1992(studied the financial performance in the banking sector, using accounting measures to gauge performance), Ndegwa, 1996 (set out to assess the quality of service in commercial banks and financial institutions) and Gathoga 2001 (who sought to analyze how commercial banks were responding to the turbulent environmental changes). Some studies in the United States of America found that substitutes were emerging from non-banking sectors such as retailers, manufacturers and other non-traditional competitors such as travel agencies, all of which are not categorized under the regulatory requirements of commercial banks (Eisenbeis, 1981, and Rosenblum, 1983). However, these studies were carried out in a different environment from Kenya, with different environmental dynamics, and whilst there may be lessons to be learned, not all may be applicable or relevant to the Kenyan context.

The commercial banks are significant in the Kenyan economy, to virtually all the sectors. Many banks have collapsed, been salvaged by the Central bank or merged with others due to increasing competition, apart from other factors such as mismanagement. According to the Central Bank of Kenya information website, some of those that have collapsed include Reliance Bank Ltd, Ari Bank Corp and Trust Bank while those that have merged include

National Industrial Credit and AM Bank into National Industrial Credit Bank, Giro Bank and Commerce Bank Ltd to form Giro Commercial Bank Ltd (see appendix 3 for the complete list). It was therefore important to find out the strategic responses of commercial banks in Kenya to the threat of substitute products.

Bank products are generally homogeneous and competition is centered on service. However increased competition is also resulting from the fact that non-depository and non-financial institutions are beginning to offer services directly substitutable for those provided by banks (Eisenbeis, 1981). Money market mutual funds and insurance companies enable investors to earn interest on balances. In the USA, Merrill Lynch has implemented a plan using VISA card and checks issued through a bank to permit a customer to draw funds against an interest bearing margin account that even includes an overdraft arrangement. The survival of commercial banks in Kenya will to a large extent depend on strategies they adopt towards the threat of substitute products.

The current study is concerned with commercial banks and their strategic responses to the threat of substitutes in particular. The question being addressed is " what strategic responses are commercial banks using towards the threat of substitute products in the industry?"

1.3 Research objectives

1. To identify the major substitute products that are a threat to commercial banks in Kenya
2. To determine the strategic responses of the commercial banks to the threat of substitutes

1.4 Importance of the study

The study will benefit all commercial banks as it is expected to establish the adequacy of their responses in the face of increased competition from substitute products. The findings are expected to help the commercial banks identify any strategic gaps in their strategic responses and which they could adopt in order to counter the threat of substitutes.

The study will also be of interest to government agencies and policy makers in the development of policy frameworks. Apart from contributing to the existing literature in the field, academicians will find it useful as a basis for further research.

1.5 Structure of the report

The report for the research is divided into 5 chapters. Chapter one highlights the background of the research, the research problem and the objectives of the research. In chapter two the pertinent literature is dealt with. The third chapter deals with the methodology of the research highlighting the population of interest, the data collection method and the data analysis method. Chapter four presents the data analysis and findings of the study. The concluding chapter presents summary discussions and conclusions of the study, limitations of the study and recommendations for further research, and the managerial implications of the study.

CHAPTER TWO: LITERATURE REVIEW

This section covers literature that is relevant to the study. The literature is derived from texts, journals and past research done.

2.1 Literature on substitutes

According to Porter (1985), the state of competition in an industry depends on five basic competitive forces He identifies these as the threat of new entrants, the threat of substitute products/services, bargaining power of the buyers, bargaining power of suppliers and rivalry among existing firms. According to Porter, all firms in an industry are competing with firms producing substitute products. Substitute products offer an alternative to buyers. Pearce and Robinson (1997) contend that the strongest competitive forces or force determines the profitability of an industry and so are of greatest importance in strategy formulation. Gathoga (2001) identified these in commercial banks in Kenya as increasing competition and the threat of substitutes.

Mintzberg and Quinn (1991), define substitutes as those products that appear different but can perform the same function as another product adding, "Unless it can upgrade the quality of the product or differentiate it somehow... the industry will suffer in earnings and probably growth". Porter (1985) continues to explain substitution as the process by which one product or service supplants another in the performing of a particular function or functions for a buyer. Since the same principles apply to the buyer choice, substitution applies equally to products and processes Porter states; "Substitutes limit the potential returns of an industry by placing a ceiling on the prices firms in the industry can profitably charge." Assuming that switching costs are low, substitutes may have a strong effect on demand in an industry. Tea can be a substitute for coffee. If the cost of coffee goes up high enough, coffee drinkers will slowly begin switching to tea. The price of the tea thus puts a price ceiling (limit) on the price of coffee

Substitutes are at times seemingly far removed from the industry. For example, security brokers are increasingly being confronted with issues such as real estate, insurance, money market funds, and other ways for the individual to invest capital. Manufacturers such as General Electric and retailers such as Sears and travel agencies such as American Express, not to forget brokers such as Merrill Lynch have encroached on banks' turf for over two decades (Rosenblum *et al*, 1983)

Buyers will consider substitutes in a price – performance trade off. However substitutes are less compatible with complementary products, and complementary products increase the functional value beyond the products own performance characteristics. Porter (1980) goes on to state that

> "Substitutes limit the potential returns of an industry by placing a ceiling on the prices firms in the industry can profitably charge. The more attractive the price- performance alternative offered by substitutes, the firmer the lid on industry profits"

Porter also observes that substitutes not only limit profits in normal times, they also reduce the bonanza an industry can reap in boom times. He cites the example of fiberglass producers who in 1978 enjoyed unprecedented demand as a result of high-energy costs and severe winter weather. However, the industry could not raise their prices due to excess supply of insulation substitutes such as cellulose, rock wool and Styrofoam. Porter continues to state that the substitute goods that deserve the most attention are those that

1) Are subject to trends improving their price – performance trade off with the industry's product, or
2) Are produced by industries earning high profits.

In the second instance, substitutes rapidly come into play if some development increases competition in their industry and causes price reduction or performance improvement.

2.2 Theory of strategic responses

According to Porter (1985),

"Demand for a product is affected by the cost and quality of substitute products. If the cost of a substitute falls, or if its ability improves to satisfy the buyer's need, industry growth will be adversely affected."

He gives the example of television and radio that have made inroads and have made the demand for live concerts by symphony orchestras and other performing groups fall. There is a depressing effect of rising prices on the demand for such products as chocolate candy and soft drinks relative to their substitutes.

Porter also asserts that in the prediction of long-term growth, a firm must identify the substitute products that can meet the needs its product satisfies. Then technological and other trends that will affect the cost or quality of each of these substitutes should be charted. Comparing these with the analogous trends for the industry will yield predictions about future industry growth rates and identify critical ways in which substitutes are gaining, thereby providing leads for strategic action.

Analysis of trends in the external environment can be important in deciding whether to try and head off a substitute strategically or to plan strategy with it as an inevitable key force. Porter cites an example of the security guard industry where electronic alarm systems represent a potent substitute. He argues that they can become more important since labor intensive guard services face inevitable cost escalation whereas electronic alarm systems are highly likely to improve in performance and decline in costs. The appropriate response of security guard firms is probably to offer packages of guards and electronic systems based on the redefinition of a security guard as a skilled operator, rather than try to out compete electronic systems across the board.

2.3 Previous studies

Most of the studies done in strategic responses are in industries other than banking. Only a few studies on strategic responses were concerned with the banking industry.

2.3.1 Studies on Strategic Responses

Strategic responses of organizations have been studied extensively, especially in the oil industry. Chepkwony (2001), made an inquiry into the strategic responses of petroleum firms in Kenya to challenges of increased competition in the industry. Isaboke (2001) also did an investigation of the strategic responses by major oil companies in Kenya to the threat of new entrants into the industry. Murage (2001) studied the competitive strategies of the new entrants into the oil industry, the members of the Kenya Independent Petroleum Dealers Association, and the competitive strategies they were adopting. Sheikh (2000) studied the strategic responses and adjustments in strategic variables that insurance companies in Kenya have adopted following liberalization. Thiga (2002) sought to identify the changes affecting Airline companies represented at the Jomo Kenyatta International Airport, Nairobi, and how they were responding to changes in the environment. Kandie (2001) was concerned with the strategic responses Telkom Kenya Ltd is using to cope with the competitive environment.

There are other studies on strategic responses in other industries such as that of Kombo (1996), which sought to determine whether motor vehicle franchise holders in Kenya have changed their missions, goals, objectives, policies and plans in response to competition.

2.3.2 Studies in the Banking Industry

There have also been quite a number of studies in the banking industry. Koros (2001) carried out an evaluation of the financial performance of non-banking financial institutions that converted into commercial banks in Kenya. Gathoga (2001) set out to identify the strategies that the commercial banks have applied to respond to changes in the environment. Shimba (1993) documented strategic planning practices within the financial sector in Kenya. Bett (1992) looked at accounting measures in the banking sector, using accounting measures to measure performance. Ndegwa (1996) set out to assess the quality of service in commercial banks and the financial institutions.

2.3.3. Studies on the Threat of Substitutes in the Banking Industry

There is very little evidence to suggest a study of this nature has been undertaken, whether in the banking industry or in other industries in Kenya. Gathoga (2001) identified factors affecting commercial banks in Kenya, among them global and local competition, bargaining power of the suppliers, increasingly demanding customers, changes in information technology, and the threat of substitute products. However the strategic responses identified were those allowing for effective interaction with the external environment and not specifically responses dealing with the threat of substitute products. The studies in the banking industry were not concerned with the threat of substitutes, and those in the strategic response area did not cover the area of the threat of substitutes. Some were concerned with competition in general, and others were not specifically on commercial banks, but rather in the financial institutions.

Further afield, Kane (1977) has described how regulated institutions employ the political process to gain advantages and protect themselves from the competition in the US. Their aim is to extend regulations governing banks to the non-regulated competitors, and / or to seek further relaxation of regulatory constraints to promote a level playing field. A case study of Stone Ridge Bank (Newman *et al, 1989)* indicates that this bank was caught in a situation where strategic planners in non-bank organizations invaded the financial services turf previously the preserve of commercial banks. American Express, for example, expanded its international booking agency into credit cards and insurance while Merrill Lynch, a stoke brokerage business, converted into an array of financial services including investment banking, insurance and the equivalent of a checking account. The examples quoted indicate that much of the competition that commercial banks will face will come from non-banks in Kenya, as already is the case (Marketing Intelligence, 2003). Newman proposes four broad options that commercial banks can take, namely, expect to become a part of a mega bank organization, become an aggressor, defend a special piece of turf or build a cooperative processing organization. However each of these options hold uncertainties due to the unpredictability of the external environment.

Rosenblum et al, (1983), found that commercial banks have attempted to meet the non-bank challenge by offering products and services such as money market mutual funds and discount brokerage services that are the domain of non banks. They also tried to circumvent regulatory geographical barriers to compete on an even keel with these institutions. These are observed to be strategic in nature as they involve the whole organization, with a possible change in objectives and mission statements, and large capital expenditure.

Responses to substitutes that are not classified as strategic responses will include those responses that do not involve the whole organization and do not constitute a large capital investment. Some examples of this type of response are increased advertising, promotions and activities meant to draw attention to the product and differentiate it from the substitutes in the eyes of the consumers (Kotler, 2000).

2.4 Products in commercial banking

From their role, products offered by commercial banks can be divided as follows:

- Interest products
- Non-interest products.

2.4.1 Interest Products

The interest products will include interest-earning accounts such as savings accounts, fixed deposit accounts and call deposit accounts. Interest products also include financing facilities such as loans, mortgages, leasing arrangements and asset finance products.

2.4.2 Non interest products

These can be further subdivided into

- Foreign exchange dealings
- Custody and securities services
- Export financing
- Letters of credit
- Import financing
- Guarantees
- Funds transfers (local and international)
- Checking accounts

CHAPTER THREE: RESEARCH METHODOLOGY

This part sets out the research methodology that is adopted so that the objectives stated in chapter one of the study are met. This part will discuss the population of interest, the sample design, the data collection method and instrument and the data analysis techniques.

3.1 Population

The population of interest consists of all the commercial banks registered in Kenya that participate directly in the clearinghouse. There are 45 such banks according to the latest Central Bank of Kenya website update. The target population was all the commercial banks (Appendix 1). The population of interest was not considered large; therefore a census on the 45 registered banks was carried out. However, only 15 out of the 45 banks responded, constituting a sample size of 33% of the entire population.

3.2 Data collection

Primary data was collected by use of a semi – structured questionnaire (see appendix 4). The questionnaire comprised of 4 parts. Part A l collected data on classification questions, part B collected data on products that were considered substitutes and identification of which substitutes were considered a threat, and part C collected data on strategic responses of the banks to the threat of substitutes. Part D consists of the commercial banks' perception of the future in relation to substitutes.

The questionnaire was administered by "drop and pick later" method. The respondents included managers involved in the long term planning in the commercial banks. These are senior level management such as the corporate and marketing managers, and in the smaller banks, some directors who are also responsible for strategic planning were involved in the interviews.

3.3 Data analysis

The information from the respondents was coded and edited before being used to create a database using SPSS. The study is descriptive in nature; therefore descriptive statistics were used to organize the data into mean scores and ranges. The analysis therefore consists of descriptive statistics such as means, standard deviations, percentages and ranges.

CHAPTER FOUR: DATA ANALYSIS AND FINDINGS

4.1 Introduction

There were two research objectives in this study. First was to identify the major substitute products that are a threat to commercial banks in Kenya; secondly, to determine the strategic responses of the commercial banks to the threat of substitutes. The study focuses on the following research questions: (a) to establish the factors that commercial banks consider important; (b) identify organizations considered a threat to commercial banks; (c) identify substitute products considered a threat to commercial banks; (d) factors that influence the threat of substitutes; (e) establish the effect of changes in the market on firm performance. Finally, an attempt is made to identify firm response to increased competition.

The opinion or attitudes of respondents were captured on a five-point scale and in some cases on a YES or NO scale. The following scheme on the factor analysis was used to interpret the results:

LABEL	RANGE OF MEANS
To A Very Great Extent	4.50 – 5.00
To A Great Extent	3.50 – 4.49
To A Extent	2.50 – 3.49
To A Moderate Extent	1.50 – 2.49
To A Lesser Extent	1.00 – 1.49

An alternative five-point scale used on questions relating to broad strategic responses (see table 7-9) used the following scheme to interpret the results.

LABEL	RANGE OF MEANS
Critically important	4.50 – 5.00
Very important	3.50 – 4.49
Moderately important	2.50 – 3.49
Less important	1.50 – 2.49
Not important	1.00 – 1.49

Where data was collected using a five point scale, 1 = the least important or the least extent while a 5 = the most important or to the greatest extent.

Seventy-eight percent of the companies that responded are not subsidiaries of multinationals. Therefore major strategic decisions for most banks that responded are made locally. Furthermore, all respondents agreed that they face stiff competition.

4.2 General Findings

Table 1: Factors that commercial banks consider important

	FACTOR	Mean	Mean Ranking	STD DEV	Minimum	Maximum
1	Profitability	4.86	1	0.36	4	5
2	Customer satisfaction	4.71	2	0.47	4	5
3	Survival	4.29	3	1.14	1	5
4	Competitive position	4.14	4	0.77	2	5
5	Market share leadership	4.00	5	0.78	2	5
6	Increasing shareholder value	4.00	6	1.36	1	5
7	Staff training	3.93	7	1.14	1	5
8	Technological advancement	3.54	8	0.66	2	4

The primary purpose of the question was to establish the factors that the commercial banks rated as important as this has an impact on their strategic direction and therefore their strategic responses (see table 1 above) in setting goals and objectives of the firm. Profitability, with a rating of 4 to 5 by all respondents, is rated as the most important factor, followed by customer satisfaction. This suggests customer satisfaction is only relevant as long as it contributes to profitability.

Respondents lacked agreement on the extent of importance of survival, increasing shareholder value and staff training. This is because the three variables have a standard deviation larger than one. Furthermore the evidence is that some respondents consider shareholder value, staff training and survival as less important. It is difficult reconciling the ranking of far profitability (high) and shareholder value (low) given that it is profits that translate into value for shareholders.

Table 2:Organizations considered a threat to commercial banks

	ORGANISATION TYPE	Mean	Mean Ranking	STD DEV	Minimum	Maximum
1	Insurance companies	2.14	11	0.86	1	4
2	Micro finance institutions	2.86	8	0.95	1	5
3	Manufacturing Companies	1.69	12	0.63	1	3
4	Forex Bureaus	3.00	6	1.11	1	5
5	Cooperative Societies	3.29	5	1.33	1	5
6	Mutual Trust Funds	3.00	7	1.04	2	5
7	Independent Credit Card Issuers	2.57	9	1.09	1	4
8	Investment companies	3.36	3	1.08	1	5
9	Stoke brokers	2.43	10	0.94	1	4
10	Long term finance organizations	3.50	1	1.02	2	5
11	Money transfer organizations	3.43	2	0.85	2	5
12	Hire purchase	3.31	4	0.75	2	5

The existing and potential competition must be identified in order to define and focus the comparative analysis. Table 2 is a summary of organizations that respondents consider to be a threat. Identifying sources of threat is not a clear or straightforward task. Competitive strategies can only be effectively established at the level where the business sells products and or services in distinct markets and identifiable competitors. Where a business finds it difficult identifying its competitors, then it is an indication that the business is not properly defined.

The assumption is that competitive strategies have to be established at a level where the business sell product in distinct markets and against identifiable competitors. Leading the list of competitors to commercial banks are organizations that provide long-term finance. However most of the sampled banks do not see serious threats from those organizations. This explains why the highest source of threat, long-term finance organizations, has a score of between to a great extent (4) to a moderate extent 3 or 3.50. Commercial banks seem not worried about these organizations. The ranking seems consistent in the sense that manufacturing companies, which are not main suppliers of finance, are ranked last.

4.3 Substitute Products

Table 3: Substitute products considered a threat to commercial banks

	Substitute Products	Mean	Mean Ranking	STD DEV	Minimum	Maximum
1	Commercial Paper	3.29	6	1.14	1	5
2	Treasury bills	3.93	1	0.73	3	5
3	Fuel cards	2.57	13	1.28	1	5
4	Hire purchase	3.29	7	1.07	1	5
5	Funds transfers	3.71	3	0.91	2	5
6	Cooperative loans	3.57	4	1.16	1	5
7	Fund raisings	2.00	16	0.78	1	3
8	Unit trust funds	2.71	12	1.27	1	5
9	Mortgages	3.29	8	1.33	1	5
10	Money back life policies	2.21	15	0.97	1	4
11	Education policies	2.29	14	0.99	1	4
12	Shares	2.79	11	0.80	1	4
13	Forex Beaureau services	3.85	2	1.21	1	5
14	Manufacturer leasing agreements	3.29	9	1.27	1	5
15	Western Union money transfers	3.38	5	0.87	2	5
16	Merry go rounds	1.64	17	0.93	1	4
17	Non bank offshore investments	2.93	10	1.14	1	5

This section explores the possible alternative competitive strategies relating to particular product and or market arena under consideration.

The results of new or different ways of satisfying the customer needs are summarized in table 3. Again the banks are less concerned with the products of the organizations (in table 2 above) that they consider being of a less threat to them.

The respondents are to a great extent concerned about treasury bills. This is because by issuing treasury bills with attractive interest rates, Governments are competing for private savings with the commercial banks. Attractive interest rate on treasury bills would mean less funds flowing into commercial banks as deposits. The banks consider "merry go-rounds" almost irrelevant while they are concerned about funds transfers.

The study also tried to determine other external factors that affected the threat of substitutes. This was done using a five point rated scale question. The results are presented in Table 4.

Table 4: Factors affecting The Threat Of Substitutes

	Factor	Mean	Mean Ranking	STD DEV	Minimum	Maximum
1	Government	4.14	1	1.17	1	5
2	Logistics	3.79	2	0.80	3	5
3	Power play	3.38	3	0.96	2	5

The respondents considered the government as positively affecting the threat of substitutes. However some banks perceived this as not a major determinant and hence the high standard deviation. Logistics were seen as another contributor in affecting the threat of substitutes. Power play recorded the lowest mean, but with a low standard deviation meaning it is perceived by most respondents to be a significantly important factor affecting the threat of substitutes.

In establishing the threat of substitute, the study attempted to identify the effect of changes in the market on selected indicators, these being loss of market share, decline in profits and loss of customers. The findings are presented in Table 5.

Table 5: The effect of Changes in The Market On Selected Indicators.

	Market Indicator	Mean	Mean Ranking	STD DEV	Minimum	Maximum
1	Loss of market share	3.00	1	1.18	1	5
2	Decline in profits	2.86	3	1.29	1	5
3	Loss of customers	3.00	1	1.36	1	5

The high standard deviation for most of variables for this indicator suggests that there is lack of agreement among respondents on the effect of change in the market on: market share; profits; and loss of customers. The mean ranking is almost three (3) for the three variables. This suggests that a close relationship might exist among the three indicators.

It is possible that the weak link between the indicators and changes in the market is attributable to lack of a clear technique that link the two group of variables.

A prerequisite for a meaningful strategic plan is the establishment of a set of goals and objectives for the organization. The results of changes in objectives are summarized in Table 6 below.

Table 6: Change in Objectives

	Objective	Yes %	No %	Total
1	Corporate mission	78.57	21.43	100
2	Structure	92.86	7.143	100
3	Range of products and services	85.71	14.29	100
4	Market segments served	78.57	21.43	100
5	Staffing	92.86	7.143	100
6	Planning	92.86	7.143	100

The least change seventy nine (79) percent was in mission statement. Mission statement indicates the sectoral focus of the bank. Mission statement is about the purpose of the organization, and by its very nature not likely to change much. Eighty five per cent of the respondents changed their range of products; nearly all firms re-organized their organization structure, staff and planning process in response to change in the market.

4.4 Strategic Responses

This section was largely based on Porter Mode of generic strategies. It identifies the appropriate courses of action adopted by responding banks to achieve their goals and objectives. The result (see Table 7) are based on the assumption that to be successful a bank must either be able to supply the service from the lowest cost base in the industry or able to command a higher price in the market by differentiating its product in the minds of its customers. If it fails on the differentiating and cost leadership strategies then it should adopt the third strategy, which is focus on a particular segment of the industry "niche" where it can command a sustainable competitive advantage.

Table 7: Broad Strategic Responses

	Strategic Response	Mean	Mean Ranking	STD DEV	Minimum	Maximum
1	Cost leadership	3.57	7	0.76	3	5
2	Differentiation	4.00	4	0.68	3	5
3	Market focus	4.57	1	0.51	4	5
4	Market penetration	4.21	2	0.70	3	5
5	Market development	4.07	3	0.62	3	5
6	Product development	4.00	5	0.78	2	5
7	Diversification	3.71	6	0.83	2	5
8	Mergers	1.75	9	1.06	1	4
9	Acquisitions	1.17	10	0.58	1	3
10	Joint Venture	2.31	8	1.65	1	5

The result show that banks consider market focus as most appropriate and give same rank to other factors except for mergers and acquisitions.

The study was also interested in finding out the changes relating to cost leadership by commercial banks in response to the threat of substitute products in the market.

Table 8: Changes Relating to Cost Leadership

	Factor	Mean	Mean Ranking	STD DEV	Minimum	Maximum
1	Technology	4.29	2	0.83	2	5
2	Cost cutting	4.21	3	0.58	3	5
3	Retrenchments	3.93	5	1.21	1	5
4	Restructuring	4.07	4	0.62	3	5
5	Automation of processes	4.36	1	0.84	2	5

Closely linked to competitor strategies is the comparison of relative costs and investments and hence sustainable pricing strategies. The respondents consider all items listed under this section as very important to cost management. Automation of process is very important to banks (Table 8) that follow cost leadership strategy. Technology and the cost cutting are ranked next. This suggests the banks recognition of need to improve (invest) on their processes and support systems to enable them be the cheapest supplier of banking service. The impact of retrenchment, with a highest standard deviation of 1.21, on cost management is not clear-cut. All these point to the importance of understanding several things about competitors, such as their cost structures and levels of existing and planned investment.

Organizations will differentiate their products in various ways that they perceive as most effective. In the service industry, where the products are largely homogeneous, organizations are limited in the differentiation scope and have to use more innovative techniques to ensure customers view their products as different. The study tried to establish what commercial banks are doing in order to differentiate their products from those of the substitute products in the eyes of their customers. The findings were collected using a 5-rate scale and presented in Table 9.

Table 9: Changes Relating to Differentiation

	Change	Mean	Mean Ranking	STD DEV	Minimum	Maximum
1	New product development	4.14	3	0.77	2	5
2	Increased advertising	3.43	7	1.02	1	5
3	Customer service	4.57	1	0.51	4	5
4	Provision of product information	4.00	4	1.04	1	5
5	Positioning	4.21	2	0.80	2	5
6	Branding	3.86	6	1.29	1	5
7	More strategic locations	4.00	4	0.68	3	5
8	Training	3.29	8	1.20	1	5

Under a strategy of differentiation, the primary focus is on differentiating the product of the business unit by creating that which is perceived by customers as unique. Approaches to product differentiation include brand loyalty, dealer network, product design and technology. Most of the items under this section are listed as very important and above. Superior customer service is the most critical factor to take into account while considering product and or service differentiation as a strategy. The conclusion is that competitive advantage in the market is derived from providing better customer value for equivalent cost.

Table 10: Changes Relating to Focus

	Change Relating to Focus	Mean	Mean Ranking	STD DEV	Minimum	Maximum
1	Segmentation	4.07	2	0.92	2	5
2	Market Focusing	4.21	1	0.58	3	5

In terms of ranking, market focusing was perceived as more critical than segmentation for banks to achieve their objectives.

Table 11: Changes Relating to Marketing and Other Initiatives

	Change relating to Marketing and Other Indicators	Mean	Mean Ranking	STD DEV	Minimum	Maximum
1	Price discounts	2.79	7	1.25	1	5
2	Identification of customer needs	4.36	1	0.50	4	5
3	Reduction of complaints	4.36	2	0.50	4	5
4	Matching substitute prices	3.64	5	0.50	3	4
5	Developing new markets	4.14	3	0.77	2	5
6	Relationship marketing	4.07	4	0.73	2	5
7	More outlets	2.71	8	1.07	1	4
8	Strategic alliances	3.29	6	1.20	1	5

All the banks agreed that identification of customer needs and reductions of complaints were the major initiatives that would steer their businesses in the desired direction. Matching pricing was also important owing to the homogeneous nature of products in this sector. Whilst the international and newer banks regarded strategic alliances important as marketing initiatives, smaller family owned banks did not attach any importance to this strategy. Price discounts had a mixed reaction, and this is reflected on the high standard deviation.

Table 12: Additional Responses to increased Competition.

	Response	Yes %	No %	Total
1	Divestiture	33	67	100
2	Lobbying	33	67	100
3	Public relations	100	0	100
4	Influencing public leaders	67	33	100

The most effective means of warding off threats from substitute products was maintaining good public relations, which all banks admitted employing, and influencing public leaders.

CHAPTER 5: SUMMARY, DISCUSSIONS AND CONCLUSIONS

5.1 Summary, Discussions and Conclusions

The first objective sought to identify the major substitute products that are a threat to commercial banks in Kenya. The results indicate that treasury bills, forex bureau services, funds transfers, co-operative loans and money transfers presented the greatest threat to bank commercial bank products whilst 'merry go rounds", fund raisings and insurance products presented the least threat. Treasury bills were considered a threat as they were providing a higher rate of return than the banks could match, they are considered by investors more secure given the recent spate of bank closures and placements under receivership. Further more, investors are not required to process their investments through the commercial banks; they can do so directly with the Central Bank by simply opening an account with them.

Organizations that offer long-term finance provide the greatest threat to commercial banks in Kenya. This could explain why some banks are in the process of designing longer-term financial products such as mortgages and leasing arrangements to be able to compete with the long-term finance providers. However organizations that converted from building societies and longer-term finance business do not perceive this as a threat at all as their portfolio of products still carries long-term finances. The respondents were also concerned about the entry of money transfer organizations into the market. This is because banks are known to charge for this service, making it is a source of income for the bank.

The apparent lack of concern for insurance products could be due to the evidence of regulations that allow commercial banks set of banking activities that other financial institutions are not allowed to transact in. It appears as if these organizations are in different segments.

It is not surprising that banks do not highly consider forex bureaus a threat to a very great extent. This is because foreign currency transactions support foreign trade. Commercial banks are better placed to support foreign trade than forex bureaus. It is possible that commercial banks have not lost their large customers to forex bureaus. In which case, forex bureaus are not considered a major threat. Furthermore, it is possible that the actual product, good or service, may not define competition because the customer may be purchasing a group of benefits or attributes rather than a specific product, for example, foreign currency. In this case the real competitors will be other businesses providing what the customer perceives as a comparable group of benefits even though the product may appear to be physical present substitute products considered a threat.

The market for manufacturer finance in this country is still in its conception stages and is currently supported by finance from the commercial banks. This would explain why these are not considered a major threat yet. However, in the study of Rosenblum (1983), these constitute a major threat to commercial banks in America. Statistics taken from that study indicate that in 1982, for example, banks financed only 47% of car loans, whilst the rest was financed by auto finance companies (33%) and credit unions and other finance companies (20%).

In the same vein, unit trust funds are relatively new in the market, interest rates are relatively low and so these do not constitute a threat yet. However, in the study carried out by Rosenblum (1983), as the interest rates took an upturn, the market mutual funds grew to over $ 230 billion by December 1982. Mutual funds reduce the deposits into the commercial banks and therefore their ability to lend, taking into consideration that commercial banks in Kenya are required under the banking act to deposit a percentage of their capital with the Central Bank. The threat that is becoming apparent to commercial banks is that of commercial paper, which is ranked 6th out of the 17 products listed as constituting of a threat. This may be because in the recent past a few corporates have opted to float commercial paper as this provides cheaper capital to borrowing from commercial banks, and these have proved successful.

The second objective of the study was to determine the strategic responses of the commercial banks to the threat of substitutes. Undeniably all banks rank customer retention highly, as well as market penetration to ensure a broader customer base. This relates directly to the importance placed on profits and by extension the customers who make the profits possible. Banks have put in place feedback systems to ensure they are meeting customer needs and attending to customer complaints.

The sharper focus on profitability has led to changes in corporate mission in most banks, the structures are leaner, and there is a wider range of products and services to close off vacant gaps. To achieve this commercial banks have redefined their automation processed and improved their technology. Larger banks have segmented their markets, offering high quality products to high value customers in convenient locations such as malls and shopping centers for a premium. Market focus, as a sustainable competitive advantage can only be achieved by either being the low cost- supplier or differentiating a product to achieve a higher selling price. The larger banks have opted for the second option. Segmentation has allowed banks to differentiate their products in an otherwise homogeneous market.

Market penetration has been another strategy of the larger commercial banks, aggressively marketing their products away from their locations. This is reflected in their rankings given on advertising, positioning and branding, which are all high. Family owned banks are different in this regard as they serve a very specific segment and therefore do not attach great importance to advertising, positioning and branding.

Most banks considered the emergence of Micro Financial institutions as an emerging threat owing to the fact that they are not subject to the same stringent rules as commercial banks. In the future there is a likelihood of increased strategic alliances, introduction of long term financing, leasing and trustee services (diversification) as a retention and growth strategy. Increased use of automated teller machines, as the recent introduction of SWITCH, a project enabling customers from smaller banks to access their accounts through commonly owned teller machines, will enable banks counter threats to accessibility and have a wider market reach.

From the forgoing discussion, the following conclusions may be drawn regarding substitute products perceived as a threat by commercial banks, and the strategic responses they are using to counter this threat.

The study revealed that commercial banks in Kenya are aware that there are products, which exist in the market, that are substitutes to their products, and that they consider them a threat enough to respond to them. Specifically they consider long-term finance products, treasury bills, money transfer facilities, forex bureaus and cooperative loans. Banks are countering the threats posed by these by customer retention strategies,, market penetration and product development to close off gaps and thereby stop customers from looking elsewhere, market penetration and branding. They are also ensuring that their organizations are leaner and that they are using appropriate technology to ward off the competition.

5.2 Limitations of the study

The major limitation of this study was the high non-response rate as out of 45 commercial banks in the country, only 15 responded. The study may not therefore be generalized to the population. There was also reluctance of some respondents in giving out information, especially relating to the strategic responses due to suspicion on how the information would be used.

The timing of the study may also have been a limitation, given that the external environment in the banking sector is currently turbulent. The study was done at a time when a few banks have gone into liquidation; others have merged in order to survive. Added to this is the political change, which is calling for transparency and greater corporate governance. Interest rates are at an all time low, and therefore commercial banks are grappling with many issues in a volatile environment at the same time.

5.3 Recommendations for further research

The external environment is rapidly changing, with most factors both in the organizations immediate and remote environment becoming increasingly versatile and fluid. The commercial banks therefore find themselves, like most other organizations, having to grapple with uncertainty, new entrants in the industry as well as increasing competition. Indeed Gathoga (2001) pointed out that the key factors that impacted on commercial banks in Kenya were increased competition and the threat of substitute products. These seem set to continue to dominate the banking industry due to the global nature of their business and the speed and magnitude of technological changes, among other factors. Further research in the following areas would therefore prove useful in not only adding to the body of knowledge but also for formulation of policy and strategy in these organizations.

i. Investigation into the relationship between ownership, leadership and the degree of responsiveness to changes in the environment.

ii. The impact of substitute products of commercial banks to economic growth in Kenya

iii. An identification and investigation of intra, inter and extra- industry effects and the extent to which they influence strategy formulation in financial institutions in Kenya

iv. An investigation into the synergy of mergers and acquisitions in the financial sector in Kenya

v. An investigation into benchmarking as a means of market leadership in commercial banks in Kenya

5.4 Recommendation for policy and practice

In light of the findings of this research, it is necessary for banks to monitor trends in the substitute products, both interest and non-interest, as these are likely to impact their profits and market share in the future. Banks also need to monitor trends in the emerging non financial competitors, notably the supermarkets and car manufacturers, as these are likely to start providing finance and counter services in the future, following world trends.

Some commercial banks are considering the possibilities of introducing longer term finance, introducing unit trust funds, and engaging in strategic alliances with retailers, insurance companies and manufacturers. This will enable them retain their customer base, as well as deliver more value to their customers as they strive to be a one - stop - shop, catering for a wider range of financial services.

Treasury bill rates are on a downward roll in the economy, and banks will have to think of innovative ways of retaining and trading on deposits. Relaxation of lending requirements, such as non-secured lending, may enable banks to pass on to depositors a higher return as well as increase shareholder value.

Most banks are controlling costs by retrenchments, employing superior technology and outsourcing of non-banking services such as transport, cleaning and courier services. It is recommended that this be balanced against risks such as breach of customer confidentiality, experience and expertise. Customer service is also key for survival and this should not be compromised by large-scale employment of cheaper, unskilled labor.

Commercial banks may also consider diversification into finance related products to enable them effectively compete with micro finance institutions as well as other substitute product providers. This will involve a redefinition of their chosen market segments as the employable population turns to small businesses due to the high rate of retrenchments across all sectors.

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Appendix 1: List of Commercial Banks in Kenya

	NAME OF COMMERCIAL BANK		NAME OF COMMERCIAL BANK		NAME OF COMMERCIAL BANK
1	African Banking Corp	16	Credit Agricole Indosuez	31	Imperial Bank Ltd
2	Akiba Bank	17	Credit Bank Ltd	32	Kenya Commercial Bank Ltd
3	Bank of Baroda	18	Development Bank of Kenya	33	K-Rep Bank Ltd
4	Bank of India	19	Diamond Trust Bank K Ltd	34	Middle East Bank K Ltd
5	Barclays Bank of Kenya	20	Dubai Bank K Ltd	35	National Bank of Kenya Ltd
6	Biashara Bank of Kenya Ltd	21	Equatorial Commercial Bank Ltd	36	National Industrial Credit Bank Ltd
7	CFC Bank Ltd	22	HFCK	37	Paramount Universal Bank Ltd
8	Chase Bank K Ltd	23	Fina Bank Ltd	38	Prime Bank Ltd
9	Charterhouse Bank Ltd	24	First American Bank of Kenya Ltd	39	Southern Credit Banking Corp Ltd
10	Citibank N A	25	Guardian Bank Ltd	40	Stanbic Bank Kenya Ltd
11	Commercial Bank of Africa Ltd	26	Giro Commercial Bank Ltd	41	Standard Chartered Bank K Ltd
12	Consolidated Bank of Kenya Ltd	27	Habib Bank A G Zurich	42	The Delphis Bank Ltd
13	Co operative Bank of Kenya ltd	28	Habib Bank Ltd	43	Trans – National Bank Ltd
14	Fidelity Commercial Bank	29	Industrial Development Bank Ltd	44	Victoria Commercial Bank
15	Credit Agricole Indosuez	30	Investments and Mortgages Bank Ltd	45	Delphis Bank

Source: Central Bank of Kenya Website.

Appendix 2: Letter of Introduction

Date………………..

To……………………………….

P O Box…………………………

Nairobi

Dear Sir or Madam:,

RE: REQUEST FOR YOUR PARTICIATION FOR AN MBA RESEARCH PROJECT

The bearer of this letter, Ruth Goro, is a student at the University of Nairobi pursuing a Masters Degree in Business Administration (MBA), specializing in Strategic Management.

As part of her coursework assessment, she is required to submit a research project report on a real management problem, **Strategic Responses of Commercial Banks in Kenya to the Threat of Substitute Products in the Banking Industry.**

Kindly assist her by completing the attached questionnaire. I assure you that the information provided is purely for academic purposes only and will be treated with the utmost confidentiality. Further, the name of your organization will not be mentioned in the report except in the list of commercial banks in Kenya, which incorporates all the commercial banks as per the Central Bank of Kenya list.

Should you be interested in the findings of the research, this will be availed to you on request by the student. A copy will also be available at the University of Nairobi library.

Thanking you in advance for your cooperation,

Dr Ogutu
Supervisor and Lecturer
Tel: 020 – 732160

Ruth Goro
MBA Student
Tel: 0722-530938

Appendix 3: Mergers of Institutions Since 1994

No	Institution	Merged With	Current Name	Date Approved
1	Indosuez Merchant Finance	Banque Indosuez	Credit Agricole Indosuez	10.11.1994
2	Transnational Finance Ltd	Transnational Bank Ltd	Transnational Bank Ltd	28.11.1994
3	Ken Baroda Finance Ltd	Bank of Baroda (K) Ltd	Bank of Baroda (K) Ltd	02.12.1994
4	First American Finance Ltd	First American Bank Ltd	First American Bank (K) Ltd	05.09.1995
5	Stanbic Bank (K) Ltd	Stanbic Finance (K) Ltd	Stanbic Bank (K) Ltd	05.01.1996
6	Mercantile Finance Ltd	Ambank Ltd	African Mercantile Banking Corp. Ltd	15.01.1996
7	Delphis Finance Services Ltd	Delphis Bank Ltd	Delphis Bank Ltd	17.01.1996
8	CBA Financial Services Ltd	Commercial Bank of Africa Ltd	Commercial Bank of Africa Ltd	26.01.1996
9	National Industrial Credit Bank Ltd	African Mercantile Banking Corp.	NIC Bank Ltd	14.06.1997
10	Giro Bank Ltd	Commerce Bank Ltd	Giro Commercial Bank Ltd	24.11.1998
11	Guardian Bank Ltd	First National Finance Bank Ltd	Guardian Bank Ltd	24.11.1998
12	Diamond Trust Bank (K) Ltd	Premier Savings and Finance Ltd	Diamond Trust Bank (K) Ltd	12.02.1999
13	National Bank of Kenya Ltd	Kenya National Capital Corp	National Bank of Kenya Ltd	24.05.1999
14	Standard Chartered Bank (K) Ltd	Standard Chartered Financial Services Ltd	Standard Chartered Bank (K) Ltd	17.11.1999
15	Barclays Bank of Kenya Ltd	Barclays Merchant Finance Ltd	Barclays Bank of Kenya Ltd	22.11.1999
16	Habib A G Zurich	Habib Africa Bank Ltd	Habib Bank A G Zurich	30.11.1999
17	Guilders Inter. Bank Ltd	Guardian Bank Ltd	Guardian Bank Ltd	03.12.1999
18	Universal Bank Ltd	Paramount Bank Ltd	Paramount Universal Bank	11.01.2000
19	Kenya Commercial Bank	Kenya commercial finance Co.	Kenya Commercial Bank Ltd	21.03.2001
20	Bullion Bank Ltd	Southern Credit Banking Corporation Ltd	Southern Credit Banking Corporation Ltd	07.12.2001

Source: Central Bank of Kenya Website

Appendix 4: Questionnaire

A SURVEY OF THE STRATEGIC RESPONSES BY COMMERCIAL BANKS TO THE THREAT OF SUBSTITUTE PRODUCTS

Part A

1. Name of company:____

2. Year of establishment in Kenya:_______________________________

3. Is the organization a subsidiary of a multinational? Y [ ] N [ ]

4. Please indicate the level of competition your company is facing now

i. Very High [ ]

ii. Fairly high [ ]

iii. Low [ ]

Part B

5. Please indicate the extent to which the following factors are important to your organization (kindly tick the relevant box for each)

	5 To a very great extent	4 To a great extent	3 To a moderate extent	2 To a lesser extent	1 To no extent
Profitability	[ ]	[ ]	[ ]	[ ]	[ ]
Market share leadership	[ ].	[ ]	[ ]	[ ]	[ ]
Technological advancement	[ ]	[ ]	[ ]	[ ]	[ ]
Customer satisfaction	[ ]	[ ]	[ ]	[ ]	[ ]
Staff training	[ ]	[ ]	[ ]	[ ]	[ ]
Competitive position	[ ]	[ ]	[ ]	[ ]	[ ]
Survival	[ ]	[ ]	[ ]	[ ]	[ ]
Increasing shareholder vaue	[ ]	[ ]	[ ]	[ ]	[ ]

6. To what extent do you consider the following organizations a threat to your organization?

	5 To a very great extent	4 To a great extent	3 To a moderate extent	2 To a lesser extent	1 To no extent
I. Insurance companies	[ ]	[ ]	[ ]	[ ]	[ ]
II. Micro finance institutions	[ ]	[ ]	[ ]	[ ]	[ ]
III. Manufacturing Companies	[ ]	[ ]	[ ]	[ ]	[ ]
IV. Forex Bureaus	[ ]	[ ]	[ ]	[ ]	[ ]
V. Cooperative Societies	[ ]	[ ]	[ ]	[ ]	[ ]
VI. Mutual Trust Funds	[ ]	[ ]	[ ]	[ ]	[ ]
VII. Independent Credit Card Issuers eg oil cos and Senator	[ ]	[ ]	[ ]	[ ]	[ ]
VIII. Investment companies	[ ]	[ ]	[ ]	[ ]	[ ]
IX. Stoke brokers	[ ]	[ ]	[ ]	[ ]	[ ]
X. Long term finance organisations	[ ]	[ ]	[ ]	[ ]	[ ]
XI. Money transfer organisations	[ ]	[ ]	[ ]	[ ]	[ ]
XII. Hire purchase	[ ]	[ ]	[ ]	[ ]	[ ]

Any other Organisation (specify)____________________________________

____

7. To what extent do you consider the following substitute products a threat to your organization?

	5 To a very great extent	4 To a great extent	3 To a moderate extent	2 To a lesser extent	1 To no extent
I. Commercial Paper	[ ]	[ ]	[ ]	[ ]	[ ]
II. Treasury bills	[ ]	[ ]	[ ]	[ ]	[ ]
III. Fuel cards	[ ]	[ ]	[ ]	[ ]	[ ]
IV. Hire purchase	[ ]	[ ]	[ ]	[ ]	[ ]
V. Funds transfers	[ ]	[ ]	[ ]	[ ]	[ ]
VI. Cooperative loans	[ ]	[ ]	[ ]	[ ]	[ ]
VII. Fund raisings	[ ]	[ ]	[ ]	[ ]	[ ]

Any other product(s) (specify)____

____

8. To what extent have the following positively influenced the threat of substitutes that you are facing?

	5 To a very great extent	4 To a great extent	3 To a moderate extent	2 To a lesser extent	1 To a least extent
I. Government	[ ]	[ ]	[ ]	[ ]	[ ]
II. Logistics	[ ]	[ ]	[ ]	[ ]	[ ]
III. Power play	[ ]	[ ]	[ ]	[ ]	[ ]

Any other factor(s) (specify)____

____

____

____

9. Following the changes in the market, to what extent has your organization been affected in the following parameters?

		5 To a very great extent	4 To a great extent	3 To a moderate extent	2 To a lesser extent	1 To a least extent
IV.	Loss of market share	[ ]	[ ]	[ ]	[ ]	[ ]
V.	Decline in profits	[ ]	[ ]	[ ]	[ ]	[ ]
VI.	Loss of customers	[ ]	[ ]	[ ]	[ ]	[ ]

Any other effect(s) (specify)______________________________________

____

Part C

10. Has there been a change in the following company objectives? (Tick one as appropriate)

	Y	N
Corporate mission	[ ]	[ ]
Structure	[ ]	[ ]
Range of products and services	[ ]	[ ]
Market segments served	[ ]	[ ]
Staffing	[ ]	[ ]
Planning	[ ]	[ ]

Any other changes (please specify)______________________________________

____

11. How important has each of the following strategic responses been to your firm in response to the changes in the market? (Rank them in order of importance: 5 being most important and 1 being the least important).

		5 Critically important	4 Very important	3 Moderately important	2 Less important	1 Not important
I.	Cost leadership	[ ]	[ ]	[ ]	[ ]	[ ]
II.	Differentiation	[ ]	[ ]	[ ]	[ ]	[ ]
III.	Market focus	[ ]	[ ]	[ ]	[ ]	[ ]
IV.	Market penetration	[ ]	[ ]	[ ]	[ ]	[ ]
V.	Market development	[ ]	[ ]	[ ]	[ ]	[ ]
VI.	Product development	[ ]	[ ]	[ ]	[ ]	[ ]
VII.	Diversification	[ ]	[ ]	[ ]	[ ]	[ ]

Please explain diversification type ______________________________

IX.	Merger	[ ]	[ ]	[ ]	[ ]	[ ]

Please explain merger type ______________________________

X.	Acquisitions	[ ]	[ ]	[ ]	[ ]	[ ]

Please explain acquisition type ______________________________

XI.	Joint venture	[ ]	[ ]	[ ]	[ ]	[ ]

Please explain joint venture type ______________________________

12. How important are changes in each of the following areas, which your organization has initiated, in response to increase in substitute products? (Please tick one each as appropriate)

Cost leadership	5 Critically important	4 Very important	3 Moderately important	2 Less important	1 Not important
I. Technology	[ ]	[ ]	[ ]	[ ]	[ ]
II. Cost cutting	[ ]	[ ]	[ ]	[ ]	[ ]
III. Retrenchments	[ ]	[ ]	[ ]	[ ]	[ ]
IV. Restructuring	[ ]	[ ]	[ ]	[ ]	[ ]
V. Automation of processes	[ ]	[ ]	[ ]	[ ]	[ ]

Differentiation	5 Critically important	4 Very important	3 Moderately important	2 Less important	1 Not important
VI. New product development	[ ]	[ ]	[ ]	[ ]	[ ]
VII. Increased advertising	[ ]	[ ]	[ ]	[ ]	[ ]
VIII. Customer service	[ ]	[ ]	[ ]	[ ]	[ ]
IX. Provision of product information	[ ]	[ ]	[ ]	[ ]	[ ]
X. Positioning	[ ]	[ ]	[ ]	[ ]	[ ]
XI. Branding	[ ]	[ ]	[ ]	[ ]	[ ]
XII. More strategic locations	[ ]	[ ]	[ ]	[ ]	[ ]
XIII. Training	[ ]	[ ]	[ ]	[ ]	[ ]

Focus		5 Critically important	4 Very important	3 Moderately important	2 Less important	1 Not important
XIV.	Segmentation	[ ]	[ ]	[ ]	[ ]	[ ]
XV.	Market Focussing	[ ]	[ ]	[ ]	[ ]	[ ]

Marketing and other initiatives		5 Critically important	4 Very important	3 Moderately important	2 Less important	1 Not important
XVI.	Price discounts	[ ]	[ ]	[ ]	[ ]	[ ]
XVII.	Identification of customer needs	[ ]	[ ]	[ ]	[ ]	[ ]
XVIII.	Reduction of complaints	[ ]	[ ]	[ ]	[ ]	[ ]
XIX.	Matching substitute prices	[ ]	[ ]	[ ]	[ ]	[ ]
XX.	Developing new markets	[ ]	[ ]	[ ]	[ ]	[ ]
XXI.	Relationship marketing	[ ]	[ ]	[ ]	[ ]	[ ]
XXII.	More outets	[ ]	[ ]	[ ]	[ ]	[ ]
XXIII.	Strategic alliances	[ ]	[ ]	[ ]	[ ]	[ ]

12. Kindly indicate any other responses you have employed in response to the increased threat of substitute products

	Y	N
Divestiture	[ ]	[ ]
Lobbying	[ ]	[ ]
Public relations	[ ]	[ ]
Influencing public leaders	[ ]	[ ]

Part 4

13. What are the perceived threats or potential threats that substitutes are likely to pose into the future?____

____

____

14. What are the other strategies that your organization or industry is likely to use in the future? ____

____

____

____

15. What are the likely challenges regarding the threat of substitutes that are likely to face the commercial banks in the future?____________________________________

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THANK YOU FOR TAKING THE TIME TO COMPLETE THIS QUESTIONNAIRE.