RESPONSE STRATEGIES BY ISLAMIC BANKS TO COMPETITION IN THE COMMERCIAL BANKING SECTOR IN KENYA

By

Bintiomari N'teuzi Wendo

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DECLARATION

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

Signed …………………………….....   Date……………………………………

BINTIOMARI N’TEUZI WENDO

D61/8293/2006

This project has been submitted with my approval as the university supervisor.

Signed ………………………………….   Date   ……………………………………..

DR. MARTIN OGUTU

DEPARTMENT OF BUSINESS ADMINISTRATION

SCHOOL OF BUSINESS

UNIVERSITY OF NAIROBI

DEDICATION

To my late father Omari Hamisi Wendo (may the Almighty Allah rest his soul in eternal peace) who always looked forward to the day he would see me graduate with a Masters Degree.

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ABSTRACT

The entry of both Gulf African Bank and the First Community Bank into the Kenyan commercial banking sector ushered the first 100% Shari'ah complaint financial institutions with an array of products for their customers. There is currently a lot of expectation from both Muslims and non Muslims for this alternative form of banking that has brought in a new form of partnership and interest free banking. This is because the public has suffered for too long from high interest rates and volatile fluctuation of interest rates by conventional banks. A large section of the Muslim community remains untapped by the banking industry due to non availability of riba-free banking on low incomes. The business community in Nairobi, Mombasa and other towns with sizeable Muslim communities is currently the potential lucrative market for Islamic banking.

This study sought to find out the challenges of competition faced by Islamic banks and to identify the response strategies by Islamic banks to competition in the Kenyan commercial banking sector. The study used primary data collected from various heads of departments of the two Islamic banks by way of personal interviews. The study found out that in order for these banks to survive and even prosper in such a competitive business environment its was very crucial for these banks to adopt strategies that matched the market dynamics and enable them respond to market needs as and when they arise. It is worth noting that the two fully fledged Islamic banks do not perceive convectional banks to be a threat to their survival, they are therefore each others competitor as they both strive to gain a bigger market share of the Muslim community in Kenya.

Islamic banking being a new concept in Kenya we would all have expected the Islamic banks to face a considerable number of challenges as a result of competition but on the contrary these banks have had a very positive reception from the Muslim community in Kenya and the general public at large. These banks have so far managed to garner large numbers of very loyal customers in the short period they have been in operation. The rapid expansions of Islamic banks in less than three years of being in operation have therefore demonstrated the viability and feasibility of non-interest-based operations in the Kenya banking sector.

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CHAPTER ONE: INTRODUCTION

1.1Background of the study

The modern banking system was introduced into the Muslim countries at a time when they were politically and economically at low ebb, in the late 19th century. Banks were generally confined to the capital cities and the local population remained largely untouched by the banking system. The local trading community avoided the “foreign” banks both for nationalistic as well as religious reasons. However, as time went on it became difficult to engage in trade and other activities without making use of commercial banks. Even then many confined their involvement to transaction activities such as current accounts and money transfers. Borrowing from the banks and depositing their savings with the bank were strictly avoided in order to keep away from dealing in interest which is prohibited by religion (Rad 1991).

Islamic banking has the same purpose as conventional banking except that it operates in accordance with the Islamic rules known as Shari’ah on transactions. He reiterated that Islamic banking activities must be practiced consistently with the Shari’ah and its practical application through the development of Islamic economics. Many of these principles upon which Islamic banking is based are commonly accepted all over the world, for centuries rather than decades. These principles are not new but arguably, their original state has been altered over the centuries (Gafoor, 1995).

According to Terdman (2006) the Kenyan government allowed financial institutions to offer Islamic banking services that charge no interest in 2006 which was the first time the government made credit access possible for those who had been left out of the financial services because of their faith. The Islamic banks would conduct their activities in a purely Islamic mode, which included a stipulation that money, must be invested ethically and that the giving or receiving of interest is forbidden. However, the banks would not invest in businesses that are deemed "unethical', such as tobacco, gambling, alcohol and pornography. The banks would also provide services to non-Muslims wishing to try the Islamic banking system. A precursor to the Islamic banks was launched on December 21, 2005, when Barclays became the first bank to launch Islamic banking products to meet the discerning needs of its thousands of customers in Kenya.

The bank launched La Riba Current Account, an Interest-free bank account, designed to address the sensitivities of customers who adhere to the Muslim faith, which forbids the earning or payment of interest later KCB followed suit with their launch of the Amana Savings Account.

1.1.1 Response strategies

Strategy is the determination of long term goals and objectives, courses of action and allocation of resources Chandler (1962). Strategy is a very broad term which commonly describes any thinking that looks at the bigger picture. Successful companies are those that focus their efforts strategically. To meet and exceed customer satisfaction, the business team needs to follow an overall organizational strategy. A successful strategy adds value for the targeted customers over the long run by consistently meeting their needs better than the competition does.

Chandler (1962) further added that strategy is the way in which a company orients itself towards the market in which it operates and towards the other companies in the marketplace against which it competes. It is a plan an organization formulates to gain a sustainable competitive advantage. Strategy should by dynamic and changes constantly in order to contend with external turbulences. Experimenting with new strategies is important. Constant testing, adaptation and building on what is found to be successful with customers is the way ahead, especially when you are trying to re-invent the value provided, or the way it is produced and delivered.

The Kenyan commercial banking industry being very competitive, the Islamic banks have therefore adopted both strategic and operational responses in order to cope with competition and survive in the market. Porter (1980) suggested that in coping with the five competitive forces, there are three potentially successful generic strategic approaches to outperforming other firms in an industry these are overall cost leadership, differentiation and focus strategies.

Cost leadership requires aggressive construction of efficient-scale facilities, vigorous pursuit of cost reductions from experience, tight cost and overhead control, avoidance of marginal customer accounts, and cost minimization in areas like research and development, advertising, sale force and so on. A low cost position yields the firm above-average returns in its industry despite the presence of strong competitive forces. Another generic strategy is for an organization to differentiate its product or service offering in order to create something that is perceived industrywide as being unique. Approaches to differentiation may rest on breadth of product or service offerings, technology, special features, of customer service. Organizations with no coherent strategy are considered 'stuck in the middle," pursuing a muddling strategy. Differentiation provides insulation against competitive rivalry because of brand loyalty by customers and resulting lower sensitivity to price. It also increases margins, which avoids the need for low-cost position.

The concept of being unique or different is far more important today than it was ten years ago. The key to successful marketing and competing is differentiation. Hypercompetition is a key feature of the new economy. What used to be national markets with local companies competing for business has become a global market with everyone competing for everyone's business everywhere. With the enormous competition markets today are driven by choice - your targeted customers have too many choices, all of which can be fulfilled instantly. Choosing among multiple options is always based on differences, implicit or explicit, so you ought to differentiate in order to give the customer a reason to choose your product or service. Thus, differentiation is one of the most important strategic and tactical activities in which companies must constantly engage. It is not discretionary (Kotelnikov, 2001).

Differentiation strategy has three parts which are positioning, trust building and creation of awareness. Positioning is a new approach to communication, advertising and marketing. It is an organized system for finding a window in the mind of your prospect in order to position effectively over there a product – merchandise, a service, a company, or a person – against its main competitors. The mind accepts only that new information which matches its current state. It filters out everything else. In other words, positioning is a process by which a psychological "anchor" has been placed into the minds of prospects so that they come to choose one specific person or company over another (Kotelnikov, 2001).

Positioning is what you do to the mind of the prospect – you look for the solution of your problem inside the prospect's mind. Anyone can use positioning strategy to get ahead in the game of life. Marketing as a differentiation strategy is especially interesting in the context of banking competition because marketing knowledge is an intangible asset not as easily imitated as physical products (Kotelnikov, 2001). The key to successful marketing is differentiation. If consumers don't perceive your brand(s) as being different from those offered by the competition, you won't win the marketing war. The battle for consumer minds is a battle of perceptions not products. Your position determines whether or not your customer buys, whether he buys again and whether he refers others to you. Everything that you do with regard to your customer affects the way your customer thinks about you.

Mutual trust is a shared belief that you can depend on each other to achieve a common purpose. Trust has an important link with your organizational success. Trust elevates levels of commitment and sustains effort and performance without the need for management controls and close monitoring. Trust-based working relationships are an important source of your sustainable competitive advantage because trust is valuable, rare, imperfectly imitable, and often non substitutable. Creation of awareness on the other hand entails building a program to make your customers and prospects aware of this difference. It's much easier to get into the mind of consumers first that try to convince people you have a better product or service than the one that did get there first. Improvements are always made to product/service inventions and innovations but the first in has a head start. Once you are the leader, a position mostly gained by being first, it is pretty hard for competitors to dislodge you, as long as you keep your products up to date and of comparable quality (Kotelnikov, 2001).

The final generic strategy is focusing on a particular buyer group, segment of the product line, or geographic market. This strategy rests on the premise that the firm is thus able to serve its narrow strategic target more effectively or efficiently than competitors who are competing more broadly. The proper generic strategy will position the firm to leverage its strengths and defend against the adverse effects of the five forces.

1.1.2 Concept of Competition

Everyone has competition, though it may not always seem obvious. To be successful today, your company must become competitor-oriented. You must pursue the right competitive strategy- avoid strengths of your competitors and look for weak points in their positions and then launch marketing attacks against those weak points. Today, the old business adage of never underestimate you competitor holds more meaning than ever, but many companies do not take time to objectively assess their company or products and compare them to their adversaries in the marketplace. Worse yet, some companies even feel that their products have no competition. Though it can be daunting to look at the realities of your market, understanding your competitive business environment is critical when planning for your company's future profitability. Knowing your competition leads to new products or product improvements, sales tools, positioning your product positively against your competition's weaknesses, finding new distribution strategies and many other business decisions (Henken, 2007).

Many companies are aware of their competition but are mainly concerned in their immediate business, getting customers and satisfying those customers. By providing good products and services, these companies hope to be successful and even lead the pack. Marketing and making the customers aware of their products and company is also done to improve their business performance. Many companies are aware of their competition and their position in the marketplace, so they simply try to do their best to meet their customers' needs. In this case, "the scream rises to the top (Kurtus, 2007). Any organization that is not competitor-oriented easily faces the threat of running out of business and being irrelevant in the market in which it operates (Henken, 2007).

Porter (1980) suggested that in formulating business strategy managers must consider the strategies of the firm’s competitors. While in highly fragmented commodity industries the move of any single competitor may be less important, in highly concentrated industries competitor analysis becomes a vital part of strategic planning. Competitor analysis has two primary activities, 1) obtaining information about important competitors, 2) using that information to predict competitor behavior. The goal of competitor analysis is to understand with which competitor to compete, competitors’ strategies and planned actions, how competitors might react to a firm’s actions and how to influence competitor behavior to the firms’ own advantage. Porter

(1985) presented a framework for analyzing competitors based on the following four key aspects of a competitor: competitor's objectives, assumptions, strategy and capabilities. Objectives and assumptions are what drive the competitor, and strategy and capabilities are what the competitor is doing or is capable of doing. A competitor analysis should include the more important existing competitors as well as potential competitors such as those firms that might enter the industry. The result of the competitor analysis should be an improved ability to predict the competitor's behavior and even to influence that behavior to the firm's advantage.

Competition can have both beneficial and detrimental effects and can pose so many challenges if a proper industry analysis and competitor analysis is not done. Competition in banking can however be beneficial for the clients. Indeed, the bank industry must be considered by the same way we consider any other industries. Every client is specific because he has his own needs in terms of banking demand, which are different from another one's. In this case, competition is a good means to diversify the supply among banks. Competition in banking consists of providing the clients with the most customized service in order to better meet their needs. In this case, if the service provided by a bank does not suit the client's needs, nothing can prevent him from changing his bank to find the most adapted characteristics he is looking for. This is quite an important goal of the banking competition. An increased customer attrition rate will eventually lead to a reduction in market share hence decline in profitability and sustainability of the given bank.

1.1.3 Commercial Banking Sector in Kenya

An industry is a group of firms producing products that are close substitutes for each other (Porter, 1998). Kenya's banking sector is regulated by the Central Bank of Kenya (CBK), which issues various prudential guidelines. As at 31st December 2007, there were 43 commercial banks, which include two full fledged Islamic Banks. The total branch network was 740, up 44.5% from 512 in 2003. Most banks have lately opened (or re-opened) branches in rural areas, an indication of downstream movement by banks. Coupled with the launch of new products by the sector, this development is expected to improve access to financial services by the population (CFC Financial services Research note 2008).

The Kenyan commercial banking industry is very competitive with forty three players in the market; one has to come up with the best strategies in order to achieve a sustainable competitive advantage. The banking sector in Kenya remains one of the constantly growing sectors in the economy. With this high level of competition banks are facing a number of challenges as they strive to achieve their different corporate goals. The Kenyan banking industry is clearly exhibiting signs of an abrupt industry paradigm change bolstered by rapid development in technology and high demand from customers.

Competition between banks has shifted to technology, with players grabbing the slightest development to lead the show. Apart from smart cards, automated teller machines and Internet banking, a growing number of banks have taken advantage of the mobile phone platform to provide technology-driven products to their customers. Banks are investing heavily in technology to enhance efficiency and improve service delivery. Apart from enhancing outreach to its customers, banks are also investing heavily in technology to reduce cost of delivery. Kenyan banks are leading the way in Africa's mobile finance revolution. The runaway success of M-PESA, telecom operator Safaricom's mobile banking service, has jolted traditional bankers into action. The service is now used by 39.9% of Kenyans (FinAccess Survey 2009). Mobile banking services, or tie-ups between banks and mobile phone companies, have become a major part of Kenya's financial landscape. FinAccess found the number of the financially excluded people fell 5.7% between 2006 and 2009, but the corresponding growth in take-up of formal financial services remained sluggish at 3.7%. There is a lot of room for innovative and technology-driven expansion. (FinAccess Survey 2009).

The Kenyan banking industry over the past three years have seen lending rates being slow to fall because cost of delivering banking services remains high but this could change in the future as banks invest more in technology. It costs an estimated Kes 50 million to set up one physical branch, a fact that has discouraged commercial banks from setting up in remote locations. Increased investments by commercial banks in technology and new delivery channels is happening when a large chunk of the population still do not run an account. A recent financial access survey indicates that an estimated 33 per cent of the population has no access to any form of financial services. Bankers must therefore fight to win the attention of the unbanked and banks are now placing huge bets on technology to provide affordable financial services.

1.1.4 Islamic Banking in Kenya

Islamic banking is a system of conducting trade and banking activities in line with the principles of Islamic Shari'ah while avoiding all the prohibited activities such as interest or riba, gharar (uncertainty), financing of haram (unlawful) trade and businesses. It is not banking based on pricing money and earning interest as conventional interest-based banks do, but it is a system of trade where goods and services are sold and capital is invested by taking risk to earn halal (lawful) profits. It is also not just a change of name as many mis-understand it to be but is based on the Quranic injunction of "Allah has permitted trade and forbidden riba". Islamic banking promotes creation of wealth in society through its social responsible ways of doing business. Gulf African Bank for example recognizes the duty towards its stakeholders including its clients who trust them with their money (GAB link issue No.1 2008).

Islamic banking industry has been trying for the last over two decades to extend its outreach to bring it at least to the level of conventional banking. But the absence of Shari'ah-compliant legal framework that is needed to make interest-free banking acceptable and create sound financial institutions has been the major snag behind its low penetration in the financial market. It is time to take stock of challenges faced by the Islamic banks as they need a number of supporting institutions/arrangements to perform functions which are being carried out by various financial institutions in the conventional framework. Attempts should be made to modify the existing structure to provide better products and quality service within the ambit of Islamic laws Karimi (2008).

Currently there are two purely Islamic banks in Kenya i.e. Gulf African Bank (GAB) and First Community Bank (FCB) with several other commercial banks offering Islamic Banking products. The genesis of GAB can be traced back to 2005 when a group of motivated Kenyans envisioned establishing an Islamic bank as an alternative to conventional banking in the country. GAB is the first fully Shari'ah compliant bank, to open its doors to customers in this region in January 2008. In the first year of operations the bank would open branches in Nairobi and Mombasa, growing these to 14 in the next four years, targeting Muslim-dominated areas such as Malindi, Lamu, Wajir, Garissa and Mandera. Currently the bank has twelve branches located in the Muslim-dominated parts of Kenya. It offers products that address the needs of not just Muslims, but everyone in the market. It is set to revolutionize the banking experience in Kenya and it is not just a financial service provider but a real partner in business. By conducting business on the principles of Shari'ah, the bank would provide an ethical and fair mode of banking for all. The bank would also leverage the strong historical links between the Gulf and Africa to establish a channel for attracting investments into Kenya. The Bank's name – Gulf African Bank – would become a symbol of this partnership between the Gulf and Africa (GAB website)

The banks vision is to be the leading Shari'ah Compliant Financial Services Provider in its markets and its Mission statement is to provide ethical and competitive banking solutions to all its customers in Kenya and the region by conducting business on the principles of sharia'h; contribute to the development of Kenya by supporting industry and trade and ultimately enhance the well being of all the citizens; win customer appreciation for superior service quality and become the bank of first choice by presenting products and services that exceed customer requirements; develop and encourage competent and innovative management infused with high standards of integrity, knowledge and professionalism; and deliver superior value for customers, staff and shareholders.
Currently the bank has twelve branches located in the Muslim-dominated parts of Kenya.

The second Islamic bank to open its doors to customers in the Kenyan banking sector is First Community bank (FCB). FCB is the first bank to be approved by the Central Bank of Kenya (CBK) under Cap 488 of the Banking Act to operate as a full-fledged Shari'ah Compliant banking institution. The bank received its formal approval from CBK on May 29th 2007 thereby opening the door for Sharia'h compliant banking not only in Kenya but indeed in the entire East and Central African region. The bank commenced official operations on 1st June 2008. As a committed Kenyan bank, FCB's motive is to take its alternative form of banking to as many places as possible within the country. FCB's Vision is to be the preferred Shari'ah Compliant banking partner in Kenya on the basis of strict adherence to the Shari'ah in all its activities and its Mission is to succeed as an institution and enlist the trust of all people about the viability and feasibility of Islamic finance as an alternative financial system.

Islamic banks have adopted various response strategies to competition in the banking sector. These banks have first and foremost invested greatly in their human resource by employing both qualified and experienced staff many of which were previously working with some of the key players in the industry. These banks have teams of dedicated, professional and experienced bankers and Gulf African Bank for example values empowerment, growth, professionalism, respect for the individual and teamwork (Gulf African Bank website). In addition the employees are well trained to deliver the highest levels of service to its clientele (First Community Bank website.).

Other strategic moves that these banks have taken is partnering with other financial service providers like Kenswitch and pesapoint in order to increase their automated machines network to enable easy access of funds by their customers. The partnership with M-PESA, telecom operator Safaricom's mobile banking service and Western Union money transfer services has also enabled the banks to be a one stop shop to the customers. GAB's Chief Executive Officer commented that the bank was also increasing partnership with other financial sectors players to strengthen its presence, operations and service delivery. The bank is now offering M-PESA services as an Agent to Agent on behalf of Safaricom and this will enable its customers experience privacy and prompt services through this partnership. Branch network is also another way that these banks have used to counter competition. In the first four years of operations GAB was to open branches in Nairobi and Mombasa, growing these to 14 in the next four years, targeting Muslim-dominated areas such as Malindi, Lamu, Wajir, Garissa and Mandera while FCB had planned for up to 17 branches to be fully operational by the end of its second year of business. .

1.2 Statement of the Research Problem

Competition in banking consists of providing the clients with the most customized services in order to better meet their needs. In this case, if the services provided by a bank do not suit the client's needs, nothing can prevent him from changing his bank to find the most adapted characteristics he is looking for. While customer attraction is important in such an industry of greater importance is their retention. The Kenyan banking industry being very competitive banks have therefore become competitor oriented by pursuing the right competitive strategies through avoiding strengths of their competitors and looking for weak points in their positions and then launch marketing attacks against those weak points. Competition between banks has shifted to technology with players grabbing the slightest development to lead the show. Banks are investing heavily in technology to enhance efficiency and improve service delivery. One major concern that has led to this study is the unique nature of this industry. It is very easy for customers to switch from one bank to another, operate various accounts in different banks and access different facilities from more than one bank at the same. What response strategies should the Islamic banks therefore adopt to be able to survive and even prosper against stiff competition by other commercial banks?

Islamic banking is a new concept in Kenya and it is taking its roots. The banking industry in Kenya is very competitive. Currently in Kenya there are two purely Islamic banks with several other commercial banks offering Islamic Banking products. Would these purely Islamic banks be able to survive or even prosper against stiff competition by other commercial banks? Do they have the strategies to do so? What are these strategies?

For firms to be able to retain competitive advantage they need to examine their environment both internal and external and respond accordingly (Porter, 1985). Ansoff and McDonnell (1990) also point out that the success of every organization is determined by the match between its strategic responsiveness and strategic aggressiveness and how they are matched to level of environmental turbulence. This is because each level of environmental turbulence has different characteristics, requires different strategy (ies), and requires different firm capabilities. Therefore, each level of environmental turbulence requires a matching strategy, and the strategy has to be matched by appropriate organizational capability for survival, growth and development.

There are several studies that have been done so far on the Kenyan Commercial banking industry this would include works of Muriuki (2007), Mbaabu (2007), Ndeti (2007) amongst others but none have been done about strategies adopted by Islamic banking to cope with competition in the Kenyan commercial banking industry. These works looked at the Kenyan Commercial banking industry in different perspectives. Some looked at the strategies adopted by commercial banks in Kenya in their retail banking; response strategies of banks to competition in the credit card sector in Kenya and factors determining brand loyalty: The case of commercial banks in the wetlands area of Nairobi. None of them however, captures the challenges faced by Islamic banks in Kenya. This research intends to fill that gap. This would be a baseline research in Kenya.

This study addresses the strategies Islamic banks have adopted to cope with competition in the Kenyan Commercial banking industry and the challenges of competition faced by these banks by answering the following two questions.

i. What are the challenges of competition that Islamic banks are facing in the Kenyan commercial banking sector?

ii. What response strategies have Islamic banks adopted to cope with competition in the Kenyan commercial banking sector?

1.3 The Research Objectives

The main purpose of this research would be:-

i. To determine the challenges of competition faced by Islamic Banks in Kenya.
ii. To establish the response strategies Islamic banks have adopted to cope with competition in the commercial banking sector in Kenya.

1.4 Significance of the study

It would be interesting to understand if Islamic banks have tangible strategies to survive this competitive industry as it would benefit the Central Bank of Kenya and other policy makers who are have the sole responsibility of coming up with more policies and laws governing Islamic banking in order to provide a more level-playing field for Islamic institutions.

Other bodies likely to benefit hugely from this study include potential Islamic banking investors, all stakeholders doing business with Islamic banks and commercial banks competing with the Islamic banks. This study will help them understand this new concept of Islamic banking and also appreciate that Islamic banking is both viable and feasible in the Kenyan banking sector.

This study will also help future researchers and academicians who would wish to conduct further research on this area such as the general challenges not necessarily as a result of competition facing Islamic financial institutions in Kenya, what distinguishes Islamic banking and products from convectional banking and on personal note it would advise the researcher whether her employment is long-term or short-term due to lack of proper strategies.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter presents a review of the related literature on the subject under study by various scholars, researchers, analysts and authors. The research has drawn materials from several sources which are closely related to the theme and objective of the study. The review was undertaken in order to eliminate duplication of what has been done and provide a clear understanding of existing knowledge.

2.2 Concept of Strategy

The concept of strategy has been borrowed from the military and adapted for use in business. A review of what noted writers about business strategy have to say suggest that adopting the concept was easy because adaptation required has been modest. In business, as in military, strategy bridges the gap between policy and tactics. Together strategy and tactics bridge the gap between ends and means. (Fred Nickols, 2000).

Johnson and Scholes (2004) noted that strategy is the long term direction and scope of an organization that facilitates the achievement of an advantage for the organization over competition. Strategy can be seen as the search for strategic fit with the business environment and as a way of creating opportunities by building on an organization's resources and competencies. This is called resource- based view of strategy, which is concerned with exploiting the strategic capability of an organization, in terms of the resources and competencies, to provide competitive advantage and/or yield new opportunities.

Mintzerg (1994) defined strategy in four different ways: - strategy as a plan, as a pattern in actions over time, as a position and finally as a perspective. He argues that strategy emerges over time as intentions collide with and accommodate a changing reality. Thus, one might start with a perspective and conclude that it calls for a certain position, which is to be achieved by way of a carefully crafted plan, with the eventual outcome and strategy reflected in a pattern evident in decisions and actions over time. This pattern in decisions and actions defines what Mintzberg called "realized" or emergent strategy. Chandler (1992) referred to strategy as involving the “determination of the basic long term goals and objectives of an enterprise, and the adoption of course of action and the allocation of resources necessary for carrying out these goals”.

Corporate strategy can be defined as the pattern in a company that determines and reveals its objectives, purpose, or goals, produces the principal policies and plans for achieving those goals, and defines the range of business the company is to pursue, the kind of economic and human organization it is or intends to be, and the nature of the economic and non-economic contribution it intends to make to its shareholders, employees, customers, and communities (Andrews 1980).

Strategy can be seen as a way of building defenses against competition and finding positions in the industry where competition is weak. (Pearce and Robinson, 1997). Competitive strategy is “about being different”. “It means deliberately choosing a different set of activities to deliver a unique mix of value”. In short, Porter argues that strategy is about competitive position, about differentiating yourself in the eyes of customer, about adding value through a mix of activities different from those used by competitors. In his earlier book, Porter defines competitive strategy as “a combination of the ends (goals) for which the firm is striving and the means (policies) by which it is seeking to get there”. Thus, Porter seems to embrace strategy as both plan and position (Porter, 1996).

Strategies exist in three different levels in an organization that is corporate strategies, business strategies and operational strategies. Corporate strategies are concerned with the overall scope of the organization and how value will be added to the different parts (business units) of the organization. At this level the organization seeks to answer the question “in what business are we in?” (Johnson and Scholes, 2004). Porter (1980) also noted that corporate strategies state the overall business domain and define the extent of diversification. They are formulated at the head office level and the principal focus is effectiveness.

Business strategies are about how to compete successfully in a particular market- or how to provide best value services in the public services. This concerns which products or services should be developed in which markets and how advantage over competitors can be achieved in order to achieve the objectives of the organization- perhaps long term profitability or market share growth. Business level strategies seek to answer the questions “how should we compete in each of our businesses?”

Functional strategies are concerned with how the component parts of an organization deliver effectively the corporate and business level strategies in terms of resources, processes and people. Indeed, in most businesses, successful strategies depend to a large extent on decisions that are taken, or activities that occur, at the operational level. Functional strategies are short term and/or rather cover day-to-day activities of an organization.

2.3 Response Strategies

The survival and success of an organization depends on an organization’s ability maintain a match between its strategy and environment; and also between its internal capability and the strategy. The environment is not static but turbulent, discontinuous and uncertain. (Grant 1998). The management job is management of business, managing managers, managing of work and workers, all in short and long-terms (Drucker, 1995). The management involves two complementary activities: strategic activities requiring entrepreneurial behavior, for future potential; and operating activities through incremental behavior, converting existing potential to profit and growth (Ansoff and McDonnell, 1990).

Strategic management is ambiguous, uncertain, complex organization-wide, fundamental and of long-term; and operational management is routine, specific and of short-term (Johnson and Scholes, 2003). Robinson and Judge (2007) indicate that in today’s dynamic world, leaders need to challenge the status quo, create visions of the future, and inspire organizational members to want to achieve the visions, and managers formulate detailed plans, create efficient organizational structures, and oversee day-to-day operations.

2.3.1 Strategic Responses

Strategic responses are mainly concerned with decisions and actions meant to achieve business objectives and purpose. Strategy answers the fundamental question of "where do we want to go? Where are we now? ; and how do we get there?" (Lowes, 2004). Porter (1980) suggested that in coping with the five competitive forces which are bargaining power of suppliers, bargaining power of buyers, the threat of substitute products, the threat of new entrants and the rivalry among the competing firms in the industry, there are three potentially successfully generic strategic approaches to outperforming other firms in the industry. The three approaches are overall cost leadership, differentiation and focus.

Cost leadership is the first generic strategy and can enable a company earn above average profits despite the presence of strong competitive pressures but it can also be difficult to implement. In a company pursuing low cost strategy, every activity of the organization must be examined with respect to cost. A low cost strategy requires a company to implement tight controls across its operations, avoid marginal customer accounts, and minimize spending on advertising and customer service. Implemented successfully in a price-sensitive market, however, a low cost strategy can lead to strong market share and profit margins.

Differentiation is the second generic strategy that an organization can adopt to cope with competition. Porter (1980) described it as "creating something that is perceived industrywide as being unique." Companies that differentiate themselves may attempt to do it on the basis of product design or features, brand image, technology, customer service, distribution, or several of these elements. The idea behind a differentiation strategy is to attract customers with the unique offering that meets their needs better than the competition, and for which they will be willing to pay a premium price. This strategy is intended to create brand loyalty among customers and thus provide solid profit margins for the company. Although the company may not be able to achieve a high market share using differentiation strategy- because successful differentiation requires a perception of exclusivity and because not all customers will be willing or able to pay the higher prices- the increased profit margins should compensate.

Focus strategy requires companies to direct their full attention toward serving a particular market, whether it's a specific customer group, product segment, or geographic region. The idea behind the focus strategy is to serve that particular market more effectively than competitors on the basis of product differentiation, low cost, or both. Since focusing on a small segment of the overall market limits the market share a company can command, it must be able to make up for the lost sales volume with increased profitability.

Johnson and Scholes (2004) argue that strategic management includes understanding the strategic position of an organization, strategic choices of the organization and turning strategy into action. Strategic management is a set of decisions and actions that result in formulation and implementation of plans designed to achieve the objectives (Pearce and Robinson, 2004). Strategic planning phase of corporate strategy formulation consists of looking towards the future, providing direction in terms of business the firm chooses to be engaged, and setting appropriate goals and objectives (Colley et al, 2002). The central questions in thinking strategically about a company's present circumstances and prospects are: - where are we now? Where do we want to go? How do we get there? (Thompson et al, (2006)

Strategic responses require organization to change their strategy to match the environment and also transform or re-design their internal capability to match this strategy. This in turn means that organizations need to harness both its tangible and intangible assets to maintain a strategic fit into its environment and strategy. If an organizations' strategy is not matched to its environment, then a strategy gap arises, it is thus important that organizations are able to shift their strategy with changes in the environment and their capability to be selected strategy in order to survive, succeed and remain relevant (Porter, 1985).

Porter (1985), in the value chain concept articulates that every firm is viewed as a collection of activities performed to design, produce, market and deliver, and to support its products and services, in two categories. Primary activities: - inbound logistics, operations, outbound logistics, marketing and sales, and services. Support activities include firm infrastructure, human resource management, technology development, and procurement. Firms' infrastructure is at times viewed as 'overhead', but is powerful source of competitive advantage. Other major strategic decisions that organizations can make are vertical integration, capacity expansion, entry and diversification (Porter, 1980). Vertical integration is the use of outsiders as well as own business units by a firm to forge a vertical system for supplying goods, services and capabilities, and alternative mix of approaches that change over time with industry condition changes (Harrigan, 1984).

Porter (1991), on the concept of dynamic strategic fit stated that firms create and sustain competitive advantage of the capacity to continuously improve, innovate and upgrade their competitive advantage over time. A successful strategy is consistent with organizations' goals and values, external environment, resources, capabilities and organizational systems. This conforms to the fact that the organization depends on the environment for its survival and its responses to the environmental situation determine its performance. Thus when there are changes in the environment, the organizations capabilities would have to change in order to ensure a continued strategic fit (Grant, 1998). Thompson (1997) defines strategic adaptations as changes that take place over time t6o the strategies and objectives of an organization. The changes in strategic responses can be gradual, evolutionary or even more dramatic. Ansoff (1990) noted that strategic responses involve changes to the organizations' strategic behavior. Such responses may take many forms depending on the organizations' capability and environment in which it operates. Well thought out strategic responses can help a firm to sustain its competitive advantage.

There is always need to adopt new strategies that match the challenges from the environment. Reengineering, downsizing, self-management and outsourcing are some of the dominant strategies that have been used for restructuring in the 1990's (Pearce and Robinson, 2000). Ansoff and McDonnell (1990) asserts that the management system used by a firm is a determining component of the firm's responsiveness to environment changes because it determines the way that management perceives the environment, diagnosis's their impact on the firm, decides what to do and implement the decisions.

2.3.2 Operational Strategies

Johnson and Scholes (2004) defined operational strategies as those strategies concerned with how the component parts of an organization deliver effectively the corporate and business level strategies in terms of resources, processes and people. The operations management is concerned with exploiting the present strategic position to achieve objectives, converting the potential into actual profit, and matching capability to the turbulence of the firm's environment (Ansoff and McDonnell, 1990). Porter and Kramer (2006) articulates that incorporating social responsibility into core business, is essential to good citizenship and adds value to the business and the society, and proposes two approaches:- the value chain framework of inside-out linkages; and the diamond framework or outside-in linkages.

Managerial culture emphasizes rationality and control, and a manager is a problem solver, adopts impersonal, passive attitude towards goals imbedded in organization's history and culture (Zaleznik, 1992). Leadership and management are complementary, and both are necessary for success in an increasing complex and volatile business environment. Management is coping with complexity and good management brings degree of order and consistency: leadership by contrast is coping with change (Kotter, 2001). Managers not only plan, organize, coordinate and control but also are reflective thinkers; and their activities are strongly oriented to action (Mintzberg, 1990). A manager' two specific tasks are: creating a true whole of a firm that is larger than the sum of its parts; and to harmonize the requirements of immediate and long range future in all decisions and actions. A manager sets objectives, organizes, motivates and communicates, measures, and develops people (Drucker, 1955).

In order for the twenty-first century corporations to survive in a competitive environment, they require effective learning, empowerment, and commitment from everyone; communication tools as focus-groups, organizational surveys, and management by walking around (Argyris, 1994). Real transformation takes time and requires to be tied to a well communicated vision; and without short-term wins people will resist change (Kotter, 2007). The fundamental difference of a learning organization from traditional authoritarian ones is the mastery of basic five disciplines: system thinking, personal mastery, mental model, shared vision, and team learning: with system thinking, the 'fifth principle', as the concept that underlines the five disciplines- is seeing wholes, interrelationships not things, and seeing patterns of change not snapshots (Senge, 2006).

According to Flippo (1984), the forecasting of human resources requirements in an organization is often subdivided into long-range and short-range forecasts and the latter being unavoidable by most firms. The most important role in human resources management is increased involvement in developing and implementing strategy, as firm's competitiveness depends on employees (Dessler, 2003). Human resources must be concentrated on a few major opportunities for producing significant business results (Drucker, 1964). Complementary-leadership is common and is institutionalized and the inherent risk can't be avoided in large organizations but can be managed by four pillars of alignment: a common vision, common incentives, communications and trust (Bennett and Miles, 2006).

In terms of human resource, training programs that make employees think like customers are important in achieving customer responsiveness (Hill, 2001). New technology on the other hand can shape future strategy. Discontinuity that brings major changes in technology and markets can have a substantial impact on strategy (Lynch, 2000). Marketing on the other hand is an important operational response and in order to achieve superior customer responsiveness, the marketing department must know the customer as well as communicate customer feedback to appropriate function (Hill, 2001).

In generative learning organization emphasis is on continuous experimentation and feedback, examining effect of decisions, and change of behavior to match rapid environmental changes and challenges (Luthans, 2005). No strategy can be effective unless the people are motivated to learn and trained (Kaplan and Norton, 2005). Bennis and O'Toole (2005) argue that the strongest force for change is the business community, but the major challenge is to balance practice and theory to develop interpersonal skills and practical wisdom.

The objective of brand strategy is to create a business that resonates with customers, avoid competitor strengths and exploit their weaknesses, exploit own strengths and neutralize own weaknesses; a brand with strong, memorable symbol, and a range brand with dynamic vision that creates identity across product classes (Aaker, 1996).

2.4 Concept of Competition

Competition is on the rise in all industries as more and more companies come up in the market (Porter, 1980). Globalization has caused the competition to be more intense as more experienced firms cross borders to compete in foreign land with other foreign companies and with the local firms. According to Peterson and Lewis (1999), there are different types of market structures and can be characterized on the basis of four characteristics: number and size distribution of sellers; number and size distribution of buyers; product differentiation; ease of entry and exit. The model of perfect competition assumes a large number of small buyers and sellers, undifferentiated products and ease of entry and exit. Porter (1980) observes that the state of competition in an industry depends on five basic competitive forces which are bargaining power of buyers, the bargaining of suppliers, threat of substitute products, threat of new entrants and the rivalry among existing firms. All the competitive forces jointly determine the intensity of industry competition and profitability.

Chepkwony (2001) found that for competitive strategy to be applicable to the Kenyan context, other strategic forces must be included as opposed to similar models put forward in the developed world context. These new models had the following forces; customers, suppliers, competitors, logistics, power to play and the Government. The essence of strategy formulation is coping with competition. Moreover, in the fight for market share, competition is not manifested only in the other players. Rather, competition in an industry is rooted in its underlying economics, and competitive forces exists that go well beyond the established combatants in a particular industry. Customers, suppliers, potential entrants and substitute products are all competitors that may be more or less prominent or active depending on the industry.

Competitive strategy involves positioning a business to maximize the value of the capabilities that distinguish it from its competitors. It follows that a central aspect of strategy formulation is perceptive competitor analysis. The objective of competitor analysis is to develop a profile of the nature and success of the likely strategy changes each competitor might make, each competitor's probable response to the range of feasible strategic moves other firms could initiate, and each competitor's probable reaction to the array of industry changes and broader environmental shifts that might occur (Porter, 1980). He further added that a sophisticated competitor analysis is needed to answer questions as "Who should we pick a fight with in the industry, and with what sequence of moves?" "What is the meaning of that competitor's strategic moves and how seriously should we take it?" and "What areas should we avoid because the competitor's response will be emotional or desperate?"

Firms can sometimes view competition as a threat and attention centered on gaining share and to prevent entry. But a good competitor can strengthen a firm's competitive position, to yield four strategic strengths: increase competitive advantage; improve individual structure; aid market development; and deter entry. Thus competitors are both a curse and a blessing; seeing them as a curse runs the risk of eroding a firm's competitive advantage and the industry structure, therefore a firm should compete aggressively but not discriminately (Porter, 1995).

2.5 Challenges of Competition

Organizations are environment dependent and environment serving. Organizations are in a constant two-way interaction with the environment. They receive inputs from the environment, transform or add value to them and return outputs in form of goods and services to the environment. They therefore affect and are affected by what happens in the external environment, which is beyond the organization's control. Environmental change creates pressure for change in the organization and this means that they have to respond to relevant external change to ensure they survive (Ansoff and McDonnell, 1990).

The environment is a critical factor for any organization's survival and success. It should be seen as a biosphere in which individuals and organizations live over the long-term and a community project in which to be actively involved. It is a resource to be managed and to be shared, hence the need to effectively manage the value chain system and establish collaborations, partnerships and get involved in social responsibility to enrich this resource and enhance the corporate image of the organization. It is noted that, many organizations are now more than ever being involved in social responsibility activities since good corporate image can be a source of competitive advantage. It’s imperative that managers apply critical investigation into the realities of the changing environment of the millennium through enlightened diagnosis of the problem it pose (Wooldridge and Floyd, 1990).

Organizations exist in a complex commercial, political, technological, cultural and social environment. Theses environmental changes are more complex to some organizations than to others (Miller, 1998). For survival, an organization must maintain a strategic fit the environment. The environment is important and an organization has to respond to this dynamism, heterogeneity, instability and uncertainty (Thompson, 2002). In addition, the competitive environment has been and continues to be driven by technological, innovations, globalization, and competition, extreme emphasis on price, quality and customer satisfaction. As a result, organization must continuously create and innovate in order to stay relevant and be successful.

He further states that a sustainable competitive advantage is achieved when there is a strategic fit between the external and internal environment. An organization’s external environment includes the economic forces, the social-cultural, demographic, political and technological factors. The competitive environment on the other hand includes competitors, customers and suppliers. The external component should have a strategic fit with the internal environment, which includes the organization’s system, policies, resource capability and its corporate culture (Pearce and Robinson, 1997). Kaplan and Norton (2006) argue that continual search for organizational form is driven by changes in nature of competition and economy. The world is constantly changing as business evolve new products and distribution channels emerge, requiring changing people and incentives, tangible resources and operating style (Kaplan, 2007).

Competition can pose so many challenges to the firms competing in a given industry. The high levels of competition have forced firms to improve on their cost of production to be able to have lower price performance which eventually reduces profitability. It’s also a big challenge to know the competitor’s activities hence the need for an effective competitor intelligence system. Competition has enabled the consumer to have more information and variety of choice and thereby making it difficult to create customer loyalty. Due to the enormous competition firm are also compelled to change their strategies and review their external resources and capabilities regularly to match with the changing competitive environment for them to survive. In general, competition has raised the standards of effectiveness and efficiency in firm's operations but at a higher cost and faster pace than the firm's plans (Amir, 2007).

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter highlights the methodology that was adopted in order to meet the objectives of this study, included in this chapter is the research design, data collection instruments and data analysis procedures.

3.2 Research Design

This study used a case study. The study aimed at determining the challenges of competition faced by Islamic banks and also to establish the response strategies adopted by Islamic banks to cope with competition in the Kenyan Commercial banking sector. The use of case study enabled the researcher to collect in-depth primary data that enabled the researcher meet the objectives of the study. Because of its emphasis on detail a case study can provide valuable insights for problem solving, evaluation and strategy (Cooper, 1995). Several other researches pertaining strategies adopted by different organizations to cope with competition have successfully used it in the past (Koske 2003, Muthuya 2004 and Dsouza 2007) among others.

3.3 Data Collection

Primary data was used in this study. Data was collected through personal interviews that were conducted by the researcher. An interview guide (see Appendix II) was designed to capture detailed information and it was filled by the various head of departments that is Head of Sales and Marketing, Head of Retail Banking, Head of Human Resource and also the Chief Executive Officers of the two banks as they were best placed to know the strategies the banks have adopted to cope with competition.

3.4 Data analysis

Once data was collected, it was analyzed using content analysis. Content analysis was chosen because it doesn’t restrict the respondent on answers and has the potential of generating information with much detail. A comparison of the data collected from the two banks was done in order to establish the most common strategies used by the two banks.

CHAPTER FOUR: DATA ANALYSIS AND INTERPRETATION OF RESULTS

4.1 Introduction

This study sought to obtain information on the two main objectives identified as determining the challenges of competition faced by Islamic Banks in Kenya and also to establish the response strategies to competition by Islamic banks in the Kenyan commercial banking sector. Primary data was collected from eight (8) respondents from the two Islamic Banks in Kenya. Data from the respondents was collected by direct personal interviews. Both the challenges of competition faced by the Islamic banks and the response strategies to competition are qualitatively analyzed for in-depth understanding.

4.2 Challenges of Competition

The reception has been good and the Islamic banks have received a lot of support from both the Kenyan government and the Muslim community and the public at large. Surprisingly, from the interviews done it was observed that these banks have experienced only a few challenges as follows.

4.2.1 Increased cost of service delivery

Islamic banks have experienced an increase in cost of service delivery over time this is largely as a result of increase in volumes or customer base. As more and more customers come on board the banks need to hire more resources in order to meet the varying needs of the customers. These banks have had to employ more people to ensure that their branches are adequately staffed at all the time. Another area that has largely contributed to the increase in cost is the huge investment in Technology. The Islamic banks have had to keep on upgrading their systems over time so as to cope with the ever increasing customers demand for efficiency and excellent customer service. As the workload increases due to increased customer base the systems too have to constantly be upgraded to increase their capacity in order to attain the expected Turn around Time (TAT) in service delivery and respond promptly to the market needs so that the banks can survive and prosper against the stiff competition in the industry.

The Islamic banks have therefore come up with various methods on how to effectively manage cost in order to remain profitable in the long run. These banks have embarked on serious cost management systems through automation of almost all the banking activities, they have also tendered some systems and even outsourced various activities as its cheaper compared to hiring new resources. A great emphasis is being placed on operational efficiency and resource optimization like job rotation for all the staff so that they become all round people at all levels; all these activities are geared to cost minimization to enhance profitability.

4.2.2 Change of organizational Strategy

It is said that if you do not change, change will change you. As a way of responding to the fierce competition in the Kenyan banking sector, GAB has therefore been forced to change some of its strategies so that it does not become a slave of its own strategies. From inception GAB had aimed at having a large branch network throughout the country mostly the Muslim dominated areas but these expansion plans were halted in the second year of operation and it was decided that more branches will only be opened in the areas where there is a lot of business that is adding greater value to the bank. This was as a result of the not so good reception in some of the areas like Kisumu for FCB. Kisumu which is moderately populated with Muslim it was originally believed to be one of the areas where business would be booming but on the contrary business did not pick up as expected. GAB therefore decided that it will add more branches in Nairobi and Mombasa which are the cash cows of the bank.

Another strategic plan that had to be halted for some time was a freeze on employment whereby the bank instead of employing new staff it did some internal transfers and promotion of its staff from one area to another for some retaining the same salaries this was aimed at cutting cost. Slashing of the marketing budget was another strategic change that had to be done in order for the bank to remain competitive. Advertising and publicity cost had to be reduced so that the banks cost did not surpass its profits. For the bank to break even and even start earning some profits after recovering the initial set up costs the bank’s spending had to be maintained at a minimum.

4.2.3 Pricing

The difference between Islamic banking and convectional banking is very huge however while pricing their various products the two Islamic banks have had to benchmark with the market rates for them to remain relevant and competitive in the banking industry. Many customers see Islamic banking as being the same as convectional banking thus posing a huge challenge for the staff in trying to explain and counter explain the differences between the two. These banks have also been forced to constantly review their bank tariffs in relation to the current market rates because customers have their own expectations when deciding to join a particular bank.

4.3 Response Strategies

The two Islamic banks have adopted both strategic and operational strategies in order to remain competitive and sustainable in the Kenyan banking sector. Surprisingly, from the respondents interviewed it was observed that the two Islamic banks do not see competition from the convectional banks to be a threat to their survival. This was attributed to the fact that the two banks offer a unique form of banking with a totally new experience to their clients and also they have niche markets in the Muslim community in Kenya. Competition is basically from each other as they both compete to gain a big market share from the same Muslim community in Kenya. It was however observed that Islamic banking is for everyone because the ethics behind it applies across all religions.

4.3.1 Strategic Responses

Strategic responses are mainly concerned with decisions and actions meant to achieve business objectives and purpose. The strategies used by the two banks are as follows.

4.3.1.1 Branch Network

From the respondents of the two banks it was observed that branch network is one of the major strategic responses to competition in the industry. This is complimented by the strategic locations of the banks premises whereby currently the branches are situated in the Muslim dominated areas such as Mombasa, Nairobi, Garrisa, Malindi, Lamu and Kisumu. From inception FCB and GAB aimed at opening 17 and 14 branches in the first two to four years of operations respectively. This has come to pass because currently FCB has seventeen branches while GAB has twelve branches all located in the Muslim dominated areas in Kenya. These banks even aim at going regional by opening branches in the neighbouring countries like Uganda and Tanzania and even going further afield. A huge branch network assists in accessibility of the bank premises to both the existing and potential customers this consequently helps in creating awareness of the bank and also helps them become branchless banks.

4.3.1.2 Excellent Customer Service

Another strategic move that these banks have put in place for them to excel in the Kenyan banking sector is emphasis on excellent customer service. Staff training on customer service has been on going as this helps to sensitize all the staff about the importance of impeccable customer service. The focus of people is therefore providing solutions to customers' problems and using any opportunity that comes along to cross sell the various products being offered. FCB has Islamic Finance Training Center (IFTC) which is a fully owned project of the bank and it was created as a dedicated training center to nurture and build skills and competencies of the banks staff at various levels to meet current business needs and to create a wealth of knowledge that is required for the future requirements of the bank.

Excellent customer service is paramount to the banks competitiveness and sustainability. GAB for instance received an award after being rated as the 2nd bank in Kenya with the most satisfied customers from the banking survey 2009. Excellent Customer service should yield more than the customer's expectations and this will leave the clients delighted because they will be able to identify themselves with the banks. Excellent customer service means that the focus of the business is on customer satisfaction and delight. It entails putting the customer's point of view first. A satisfied customer is the best guarantee for stability of the organization in the long-run. Banks can satisfy their customers only by providing customized, cost effective and timely services .With the help of technology these banks are able to provide plethora of products and services to their customers which suit them. A lot of emphasis is also being placed on customer growth and retention as this will automatically lead to increased profitability of the banks. Given the relatively low switching costs; customer retention calls for customized service and hassle free, flawless service delivery.

4.3.1.3 Technology

From the respondents it was also observed that technology is a very important aspect in the success of the two banks. With the help of innovative information technology, these banks are able to reduce the transaction cost and handle a large number of transactions in no time. These banks are able to provide customized products easily and customers can easily access many services through internet by sitting at home. To provide better services to their customers, these banks are embracing Customer Relationship Management [CRM] facilitated by the availability of conductive technology. Innovation in technology is also helping these banks to cross sell other products offered by these banks thus enhancing efficiency and improving on service delivery. The two banks are currently using Path Solution's Islamic MAL banking system (iMAL). Path Solution's is the leader in the provision of high quality integrated Shari'ah compliant software solutions to the world's Islamic banking industry. This system enables the two banks to provide premium Shari'ah compliant retail, commercial services and investment banking solutions to meet the diverse needs of their customers. Good technology acts as the back bone to ensure there is reliable service delivery.

4.3.1.4 Partnership with other Financial Service Providers

Another observation that was made from the interviews done was that the banks are also in partnership with other service providers in the financial sector to strengthen their presence, operations and service delivery. These banks are in partnership with Reappoints and Kenswitch ATM providers and this has boosted their accessibility by its clients through the huge ATM network throughout the country. Reappoints has a huge network of over 110 ATMs in 46 towns around the country located conveniently in shopping outlets, fuel stations, many towns and airports while Ken switch has over 250 outlets countrywide. Clients can now access their funds 24 hours without necessarily visiting the banks' premises. It is also worth noting the partnership between GAB and Safaricom Mobile phone service provider whereby GAB is now offering M-Pesa services as an Agent to Agent on behalf of Safaricom. GAB also offers Western Union money transfer services to the general market not necessarily its customers. It is through such partnerships that the bank is now becoming a one-stop-shop to its clients.GAB is offering both retail and super Agent services and this has automatically helped to increase on efficiency by reducing time lapse between deposits or withdrawals and actual update of Agent electronic float.

4.3.1.5 Product Differentiation and Innovation

Another strategic move that these banks have put in place as a way of countering the fierce competition in the banking sector is product differentiation and innovation. Product differentiation and innovation entails offering products and services that are viewed as being unique in the minds of the customers. The Islamic banks realize that they have different type of customers with varying needs thus the need to come up with various tailor-made products for the different type of clients. These banks have bank accounts varying from children to women to business people to the small and medium enterprises all aimed at adding value to the lives of the individual clients. These products also come with various incentives not just to attract customers but also retain them in the long run.

GAB has Annisaa savings account a very unique account designed for the ladies, Business Current and Personal Current accounts, Hajj savings account which is designed for those who would like to achieve their lifetime dream of going for Pilgrimage in the Holy city of Mecca. Children are also not left out as there is an account specifically designed for them called SASA account aimed at creating a platform for parents and guardians to save for their children’s future from as early as birth to seventeen years and immediately after open Students account from the age of eighteen. FCB on the other hand is offering both personal and business banking services with accounts like Lulu savings account for the ladies, Bursars Family savings account, student account, Lobbyer savings account for those intending to save in order to go for Hajj in Mecca. Other products offered by these banks include Real Estate finance, Youth Finance, Micro finance and Shari’ah Compliant Mortgage Finance and many more.

4.3.2 Operational Strategies

Operational strategies are those strategies concerned with how the component parts of an organization deliver effectively the corporate and business level strategies in terms of resources, processes and people. These strategies are as follows.

4.3.2.1 Conferences, Seminars, Forums and Dinners

Islamic banking is knowledge based and for many years it has been discredited because of its operations because people think it's just like convectional way of banking. Islamic banking being a new concept in Kenya with so many people having various misguided perception about it, the two Islamic banks have therefore being holding conferences, seminars, forums and even dinners to both the existing and potential clients in order to impart comprehensive and practical knowledge on Islamic finance products. The first ever East and Central Islamic Banking Conference was held in April 2009 hosted by GAB in partnership with Quantum Training. This conference bought together recognized scholars from different parts of the world and the main aim was to equip the participants with comprehensive, practical and up-to-date knowledge in Islamic finance systems. The second annual Conference on Islamic Finance was also held in April 2010 and the main aim was to give the African perspective of Islamic Finance and Islamic financial products. The conference focused on challenges and solutions and aimed at enlightening the attendees on the importance of Shari'ah, theory of Islamic contracts and the use of and application of a variety of Islamic financial products especially in Africa.

Various forums and seminars have been held for different type of clients like seminars for the ladies majorly covering the ladies products offered by the two banks, GAB's Annisaa account holders in Mombasa were treated to a one day workshop that saw attendees learn money saving skills and also received financial advice from the bank's staff. FCB on the other hand in conjunction with Jamia Mosque committee and 3Z foundation sponsored an efficiency training seminar for Kadhi's courts in Mombasa. Several forums for the Imams in Kenya have also been held in different parts of the country which are basically aimed at sensitizing the concept of Islamic Banking in Kenya and also make them become ambassadors for Islamic banking to the rest of the Muslim community.

As a way of appreciating its customers and also create some level of customer loyalty GAB for instance has been holding dinners for its high net worth clients on several occasions and also whenever a new branch is opened dinner is normally served to both the existing and potential clients. All these events are aimed at imparting knowledge to the people especially the Muslim Community which is the Niche market for the banks about the whole concept of Islamic banking and finance who will then spread the word to the other citizens who majorly discredit Islamic banking thinking it's just another way of banking more like the usual conventional banking.

4.3.2.2 Sales Campaigns and Marketing

From the respondents of GAB it was identified that the bank has been carrying out various sales and marketing campaigns in order to create awareness and also attract more customers. GAB has had two sales campaigns so far involving both its staff and clientele dubbed Changamka and Bambika both aimed at bringing new liabilities to the business in terms of customer deposits. During such campaigns there are normally fabulous prizes to be won especially by staff members who bring in the highest deposits on board. These campaigns provide a wonderful opportunity to promote the bank and ensure that it remains the most preferred bank in a competitive market. Customers are never left out because there is a programme for them called "Recommend a friend" where customers get an instant gift and get to introduce their friends , family and colleagues to the bank. The bank usually set targets for each campaign and the incentives offered are what motivate both the staff and the customers so that they can grow together.

Employment of Direct Sales Representatives (DSR) is another sales and Marketing tool that both the Islamic banks have embraced in order to mobilize more people to come on board. The sales team is a good channel for creating awareness about the banks and a lot of business is usually brought on board because the DSR are usually given certain targets to meet in a given period failure to do so leads to termination of their contracts. Their main source of motivation is the bonuses that are normally paid once they surpass their targets. DSR's are normally employed on temporary contractual basis and they are paid a retainer salary which is very minimal and commissions once they perform excellently on their jobs. DSR's normally visit the customers in their business premises or work place instead of waiting for customers to come over to the banks' premises. This eventually helps in personalizing the banks' services.

4.3.2.3 Contact centers

In order to attain excellent customer service both the Islamic banks introduced contact centers to serve as a platform where they could interact with their clients easily and timely. The establishment of a contact center by GAB basically is in line with the banks' policy of providing world-class service to its customers. A contact center is essentially a communication hub both from and to the customers aimed at attending to customers' needs either from enquiries on general information as well as handling customer's queries. This therefore ensures that the customers will only go to the bank's branches only when it's very necessary. Apart from offering customers convenience, the contact centers also play the marketing role on informing customers about the banks' products both existing and new products. Another important role that the contact centers play is to gather information from customer's feedback which is essential for converting the banks into a customer-oriented institution, this feedback is then acted on promptly and any issues raised are sorted out immediately. In the same line customer satisfaction surveys are also conducted periodically so as to keep adapting to the ever changing and increasing customer requirements.

4.3.2.4 Media Advertising and Publicity.

The two Islamic banks have also been using the media as a way of creating more awareness to the Muslim community and the general public at large. A lot of write-ups have been done in the Friday Bulletin a publication of the Jamaal Mosque Committee majorly advertising the banks products and the different sales campaigns and promotions being done by these banks. Radio Raman and Iqra FM the two largely known Muslim FM stations in Kenya have also been used as a platform to reach the Muslim community which is the core market of the two banks. Media has been used to impart knowledge about Islamic Banking and Finance to Muslims in Kenya so that they can understand the whole idea Shari'ah Compliance banking. At GAB plans are also underway to start large scale advertising through the big media houses like Citizen Television and Radio, NTV and KTN aiming to reach out to a large audience countrywide.

4.3.2.5 Corporate Social Responsibility (CSR)

Islamic banking first and foremost promotes creation of wealth in society through its social responsible ways of doing business. The two Islamic banks have a commitment for CSR and will continue to undertake such activities for the betterment of the community. FCB since inception has been undertaking several community development initiatives in diverse sectors including support for educational activities, as well as youth sporting activities. Support for education comes at the top and it is because of this that the bank has been involved since its first few months of operation into supporting educational functions and forums. The bank has sponsored a number of such functions in Nairobi, Mombasa and Garissa in addition to running various civic education forums for teachers particularly on matters of Islamic banking and finance. GAB on the other hand has involved in various community activities like helping the needy with both material and financial assistance during the Holy month of Ramadan.

4.3.2.6 Customer surveys and suggestion boxes

Several customer surveys have been conducted both internally and externally basically aimed at getting customer's feedback about the service offering of these banks and also gathering their suggestions about what they think should be done to improve the services. GAB for example received an award after being rated as the 2nd bank in Kenya with the most satisfied customers from the banking survey 2009. The suggestion boxes placed in the banking halls of these banks also provide a confidential way for customer to air their complaints and complements about the services and products being offered. 'Mystery shoppers' have also been used by the management either by visiting the banks premises or just making telephone calls to the various branches just to get a feel of the services being offered and see if the members of staff are all working towards achieving the banks' aim of offering excellent customer service.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter gives a summary of the research conclusions. It also offers a number of recommendations useful to the banks managers, scholars, planners, policy makers and other banks about Islamic banking and Finance.

5.2 Summary

This study sought find out the challenges of competition faced by Islamic banks in Kenya and establish the response strategies by Islamic banks to competition in the Kenyan commercial banking sector. It targeted the various head of departments of the two fully fledged Islamic banks in Kenya who were in a better position to tell these strategies. It used primary data which was collected using personal interviews. The main strategies which were broadly categorized as strategic and operational responses included the following as strategic responses branch network, excellent customer service, technology, partnership with other financial service providers, product differentiation and innovation while operational responses included conferences, seminars, forums and dinners, sales campaigns and marketing, contact centers, media advertising and publicity, corporate social responsibility and customer surveys and suggestion boxes. The very few challenges of competition faced by these banks included increased cost of service delivery, change of organizational strategies and pricing.

The introduction of fully fledged Islamic Banking in Kenya has been eagerly awaited by the Muslim community as the last four years has seen launching of Islamic banking windows by a number of conventional banks. A precursor to the Islamic banks was launched on December 21, 2005, when Barclays became the first bank to launch Islamic banking products to meet the discerning needs of its thousands of customers in Kenya. The bank launched La Riba Current Account, an Interest-free bank account, designed to address the sensitivities of customers who adhere to the Muslim faith, which forbids the earning or payment of interest later KCB followed suit with their launch of the Amana Savings Account.

The entry into the market of both Gulf African Bank and the First Community Bank ushered the first 100% Shari'ah complaint financial institutions with an array of products for their customers. There is currently a lot of expectation from both Muslims and non Muslims for this alternative form of banking that has brought in a new form of partnership and interest free banking. The public has suffered for too long from high interest rates and volatile fluctuation of interest rates by conventional banks.

A large section of the Muslim community remains untapped by the banking industry due to non availability of riba-free banking on low incomes. The business community in Nairobi, Mombasa and other towns with sizeable Muslim communities is currently the potential lucrative market for Islamic banking. The challenge is, however, to convince the Muslim community that these are truly fully fledged Islamic banks with reputable Shari’ah advisory boards of international standards. Both Muslim and non-Muslims are looking forward to interest-free banking service that is efficient, modern, solid, and transparent and customer friendly. These banks have therefore invested heavily in the latest state of the art technology to reduce costs and remain competitive with conventional banks. So far the reception has been very good with so much goodwill from the Muslim community which is the niche market for the two banks and each bank has gained a considerable market share of loyal customers which has contributed greatly to the rapid growth and expansion of these banks. The regional market is huge as both Muslims and non-Muslims welcome this form of banking that is transparent, and offer caring partnership and free from the uncertainty of interest rate fluctuations.

5.3 Conclusion

This section will give a summary of the key conclusions made from the findings of the study as discussed in chapter four. From the study, GAB and FCB the two fully fledged Islamic banks are using both strategic and operational strategies to cope with the fierce competition in the banking sector. Interestingly, the Islamic banks do not perceive competition from the convectional banks to be a threat to their survival because Islamic banking is different from the convectional way of banking as it is based on the Quranic injunction of God has permitted trade and forbidden riba. Competition therefore is between the two banks as each of them tries to gain a huge market share from the Muslim community in Kenya which is the niche market of these banks.

The rapid expansions of Islamic banks in less than three years of being in operation have demonstrated the viability and feasibility of non-interest-based operations. This must be surprising to those who believed that banks and financial systems could not operate in a modern economy without reliance on an interest rate mechanism. Indeed, experience has shown that Islamic banks are powerful means of mobilizing resources. The support has been great however these banks have also faced a few challenges as they carry out their daily activities. One of the challenges faced by these banks is increasing cost of service delivery largely attributed to the increase in customer base and demand. Another challenge faced is the issue of pricing the various products offered by these banks and also these banks have sometimes been forced to halt or and even change their strategies as a way of responding to the market needs and also cope with competition.

5.4 Limitations of the Study

The only limiting factor that was identified for this study was the issue of time allocation during data collection as it was felt by the researcher that the respondents did not allow for in depth interviews to be conducted because of their busy work schedules. Nevertheless, much data was collected in the little time that was allocated by each respondent to the researcher and the data collected was adequate enough to meet the objectives of the study.

5.5 Recommendations for further Research

There is a chance of finding more in this field like what are the challenges facing Islamic financial institutions; studies can also be done about Islamic insurance systems known as Takaful Insurance and security markets and also risk management and liquidity in Islamic banking.

5.6 Implication on Policy and Practice

In the recent past we have seen convectional banks in Kenya coming up with Islamic banking products, it would be of interest to find out the challenges these convectional banks are facing as a result of competition and the strategies they have put in place to cope with competition. The Kenyan government should also come up with more Islamic banking laws in order to provide a more level-playing field for the Islamic banks. The central bank should speed up the formulation of laws and regulations that would see the issue of Shari'ah-compliant bonds, known as sukuk and also Shariah complaint bills.

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APPENDICES

APPENDIX 1: LETTER OF INTRODUCTION

November 2010.

Dear Respondent,

I am a student at the School of Business, University of Nairobi and currently am conducting a research on **Response Strategies by Islamic Banks to Competition in the Commercial Banking Sector in Kenya.** This study is being carried out as part of management research project in partial fulfillment of the requirements for the award of the degree of Master of business Administration.

This Interview guide has been designed to collect views on the research topic and the information collected will be used strictly for academic purposes and will be treated with utmost confidence. A copy of the final research will be availed to you upon request.

Thank you for your kind assistance.

Yours Faithfully,

BINTIOMARI WENDO

MBA student

APPENDIX II: INTERVIEW GUIDE

Position held………………………………………………………………………………..

1. For how long has the bank been in operation?..
2. Is competition the most significant factor that poses a threat to the survival of the bank? Please explain……………………………………………………………..
3. What is the bank doing in response to the increasing customer's demand for high quality services?..
4. a). Has the bank experienced any cases of customer turnover since the time it started operating in the industry..

   b). What is the bank doing in order to create customer loyalty……………………
5. a). Has the bank experienced any problem to do with increased cost of service delivery?..

   b). What is the bank doing to counter this challenge?..

   c). How does the bank ensure that it remains profitable despite the increased costs of service delivery?...
6. A competitive environment requires high level of efficiency for one to survive. What measures has the bank put in place in order to serve its customers very efficiently and profitably?...
7. What is the bank doing in order to remain competitive while dealing with the issue of pricing its products?..
8. What are the various strategies that the bank has been using to cope with competition in the industry?...

9. Has the bank been forced to change any of its strategies in order to match competition since the time it started its operations?..

10. In your own assessment, does the bank currently posses the necessary resources and competencies to match the high level of competition in the industry?...............

11. What is the bank doing in order to be perceived different or unique in the minds of the customers as a way of being competitive in the industry?..............................

12. What is the bank doing in order to create more awareness to both its existing and potential customers?...

13. From your own perspective, do you think the response strategies that the bank has adopted to cope with competition been successful? Please elaborate……………...