

**COMPETITIVE STRATEGIES ADOPTED BY NATIONAL BANK
OF KENYA TO COPE WITH ENVIRONMENTAL CHANGES**

BY

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DECLARATION

This project is my original work and has not been presented for the award of a degree in this University or any other Institution of higher learning for examination.

Signature Date

BENJAMIN WAMBUA MUTUA

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

Signature Date

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DEDICATION

This project is dedicated to my wife Francisca Ndoti and son Roy Wambua for support and encouragement throughout the period.

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I acknowledge the power of God, the maker, and the provider of knowledge for enabling me to complete my MBA in the right spirit. Most importantly, I sincerely wish to acknowledge the support from my supervisor Mr. E.O. Mududa without whom I could not have gone this far with my project work. To the University of Nairobi for offering me the opportunity to do this study and all my lecturers who contributed in one way or another in quenching my thirst for knowledge, I owe you my gratitude.

To you all, God bless.

ABSTRACT

The objective of the study was to determine the competitive strategies adopted by National Bank of Kenya (NBK) to changes in the environment. The research was designed as a case study of National Bank of Kenya. Primary data was collected from managers, general managers and directors through in-depth interviews using an interview guide, while secondary data was obtained from the National Bank library as contained in the banks strategic plan. The study established that NBK has competitive strategies are in areas such as strategic transformation, corporate governance, strategic business growth and development, information communication technology, corporate social responsibility, risk management, market segmentation and product diversification, other competitive strategies by national bank of Kenya, retirement benefit obligations, fiduciary activities, and segmental reporting. NBK is confident these initiatives and changes will have positive impact and help the bank achieve the planned business growth which in turn will help realize the goal of transforming National Bank of Kenya into a leading bank in the coming years. The study recommends that banks should analyze their target market, identify their competition and learn from your competition and your customers. Banks should gain in-depth insights about their customer portfolio and consider human resource management as a mean to gaining competitive advantage. The study also recommends that banks should continuously maintain the competitive advantage they have gained by predicting future trends in the banking industry, constantly researching and monitoring competitors, and adapting to customer's wants and needs.

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ACRONYMS AND ABBREVIATIONS

NBK	National Bank of Kenya
ATMs	Automated Teller Machines
KCB	Kenya Commercial Bank
CSR	Customer Service Relations
CBK	Central Bank of Kenya
LTD	Limited Company
EVR	Environment, Values and Resources

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

As Porter (1985) explains, “many firms operate within an environment whereby they are expected to meet various stakeholder’s expectations hence the need to formulate strategies that could help them meet this need” (p.61). On the other hand, organizations operate within an environment with high competition which influences the firm’s strategic process and hence determines the firm’s achievement and purpose (Sharma, 2008).

According to Ansoff and McDonnell (1990) it is through strategic management that a firm will be able to relate itself to the environment to ensure that its success and also secure itself from surprises brought about by changing environment. They argue that this will be done firstly, positioning the firm through strategy and capability planning, secondly, real time strategic response through issue management and thirdly, systematic management of resistance during strategic implementation.

A mismatch between the environment and the organization brought about by failure to respond to changes in the environment creates a strategic problem (Aosa, 1992). A strategic problem requires a strategic response (Ansoff and McDonnell, 1990). According to Pearce and Robinson (1998) strategic response can be defined as a set of decisions and actions that results into formulation and implementation of plans designed to achieve firm’s objectives.

The survival and success of an organization can only be achieved if an organization aligns its strategies to environmental changes. This is influenced by both the internal environment as well as external environment. All organizations are environment serving and therefore totally dependent on the environment. Kumar (2006) explains that “environmental influence has necessitated the need for financial institutions to redefine their modes of service delivery and goals so as to maintain and remain relevant in the ever changing and dynamic environment (p.104-105). These changes have financial implications and hence a great challenge to most of the organizations.

National bank of Kenya, just like any other bank operating in the country is not an exception to the inter-dependency with the environment. In the recent past the bank has adopted strategies that are competitive enough to deal with the changing environment. Therefore, a study on the strategies and the factors influencing them was found necessary.

1.1.1 Concept of Strategy

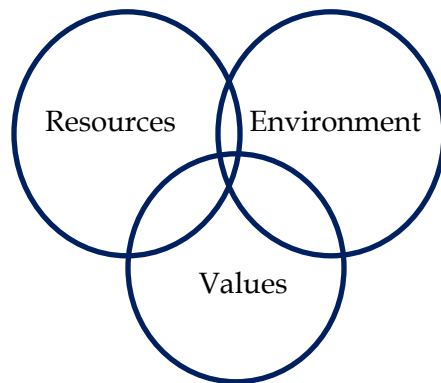
According to Pearce and Robinson (2010) By strategy, managers mean their large-scale, future-oriented plans for interacting with the competitive environment to achieve company objectives. A strategy is a company’s game plan. Although the plan does not precisely detail all future deployments, it does provide a framework for managerial decisions. A strategy reflects a company’s awareness of how, when and where it should compete; against whom it should compete and for what purpose it should compete” (p 3-4). Therefore it is difficult for any organization to operate without strategies to deal with the environment.

Strategic issues require top management decisions because strategic decisions overarch several areas of a firm's operations, they require top management involvement. Usually only the top management has the power to authorize the necessary resource allocations. Strategic issues require large amounts of the firm's resources. Strategic decisions involve substantial allocations of people, physical assets, or money that either must be redirected from internal sources or secured from outside the firm. They also commit the firm to actions over an extended period, for these reason then they require substantial resources. Strategic issues often affect the firm's long-term prosperity. Strategic decisions commit the firm for a long time, typically around five years however the impact of such decisions often lasts much longer once a firm was committed itself to a particular strategy, its image and competitive advantages usually are tied to that strategy.

Porter (1985) views strategy as what makes the corporate whole and add up to more than same of its business units. He further classifies strategy in two levels that is corporate level strategy and business level strategy. Corporate level strategy defines what kind of business the organization is in and also the managers should manage their various business units. On the other hand, business level strategy explains how to create competitive advantage in each of the business unit in which the organization compete. Thompson and Stickland (2008) argues that the concept of strategy defines the various approaches that top corporate managers use as to be able to achieve a better performance of the set of business in which the organization has diversified to. Therefore the emphasis on the role of key business units manages to influence the strategic decisions. An

alternative view of strategy is the interaction of the external environment, the resources and values of the organization as illustrated below.

Fig 1: The EVR Diagram



Source: Thompson, J.L. (2001) *Strategic management (4th ed)*, London, Thompson Learning.

Competition in the recent past has become one of the major challenges and factor that has contributed to the diverse strategic behavior among organizations in general. Organizations in Kenya are characterized by an aggressive competitive environment with a lot of competitors which calls from them to re-adjust and adjust their strategies often so as that they can become strategically fit. Porter (1985) has outlined the various challenges and forces that firms face from gaining competitive advantage, they include; buyer and seller bargaining power, threats of new substitutes, products and rivalry among products as outlines in his five forces model. He further defines the various strategies and strategic responses that can be used by firms to curb with the various changes within the environment. They include; cost efficiency strategy, product differentiation, focus strategy, avoidance strategy and low cost strategy.

Pearce and Robinson (2010) observe that Business managers evaluate and choose strategies that they think will make their business successful. Business become successful because they possess some advantage relative to their competitors” (p.259). Competitive advantage can be found in the business cost structure and its ability to differentiate the business from competitors. Businesses that create competitive advantage from one or both of these sources usually experience above average profitability within their industry. Business that lack a cost of differentiation advantage usually experience average or below average profitability within their industry.

1.1.2 Environmental Dependence

Organizations can be compared with ecological entities that have mutual relationship with other entities in the environment. Organizations environmental hold opportunities and threats. Skillful strategic managers find in the firm’s environment “market niches” that are suited to the products or services that the organization has to offer successful strategic planning has therefore to take into account the environment in which the organization is operating in. environmental assessing is very important to any organization that wants to be successful and should be continuous because the environment is continuously changing.

Since the landmark paper by Ansoff and McDonnell (1990) the issue of strategic response to environmental changes has general interest among management theorist. It has provided substantial boost in the development of the basis within which environmental response can be explained. It is from good understanding of the environment that organizations will secure themselves from effects of the changing environment.

Environmental changes can be categorized into two; the internal changes and the external changes. The internal environmental changes can be defined as factors within the organization that influences decision making and choices they make. External environmental changes are factors beyond the control of the firm that influences choice of direction and action, organizational structure and internal processes.

Some of the internal environmental changes that affects banking industry in Kenya include: management structure and nature, organization mission, goals and objectives, organization culture and employee behavior. Since these changes are within the organization changes can be made on structures, culture and behavior of the employees to ensure that the organizations as a whole remain competitive in the market. The external environmental changes affecting banks in Kenya include; changing customer needs stiff competition from other financial institutions, technological changes, political changes, demographic changes as well as public expectations.

1.1.3 Banking Industry in Kenya

There are 45 commercial banks in Kenya some of which are small to medium sized and are mostly locally owned and large banks most of which are foreign owned. The banking industry in Kenya is governed by the companies Act, the Banking Act, the Central Bank of Kenya Act and various prudential guidelines issued by the Central Bank of Kenya (CBK). The banking Act (2004) defines a bank as a company, which carries on or, proposes to carry on, banking business but does not include Central Bank of Kenya.

The history of commercial banks in Kenya is long, with predecessors of the three major commercial banks set up before 1920's. By independence in 1963, Kenya had 10

commercial banks with the 'big three' – National and Grind Lays Bank, Barclays Bank and Standard Bank. Three banks were established by the 1970's namely; the Cooperative Bank of Kenya, National Bank of Kenya (NBK) and Kenya Commercial Bank (KCB). The latter took over Grind Lays Bank to become the biggest bank in the country. By 1970's, KCB and NBK accounted for 22% each of all the commercial banks in Kenya.

The banking sector in Kenya has witnessed stiff competition forcing banks to repackage their services and products to satisfy the needs of customers and return their market share. Institutions are therefore increasingly offering e-banking services for both residents and non-residents. Islamic banking has emerged as a new market product. In response to this, some of the institutions have redefined their business strategies while leveraging on innovative and affordable products to capture this new market segment.

There have been also several important technological advancements in the industry in recent years in response to environmental changes and in order to enhance efficiency in form of improvement in communication and data processing ranging from computerization of all operations, introduction of Automated Teller Machines (ATMs), on-line system of communication and banking among others. Such improvements are giving the institutions opportunities to raise productive efficiency. Banks have also introduced new products or changed the product mix to suite their clientele.

1.1.4 National Bank of Kenya

National Bank of Kenya Limited was incorporated on 19th June 1968. The main objective of its establishment was to help Kenyans to get access to credit and control their economy after independence (National Bank of Kenya, 2012). It has been operating below its

capacity due to increased bad debts in loan portfolio amounting to 36billion which was politically motivated and pushed the bank into massive losses in the late 1990s and early 2000. However, the situation has changed and it has started recording profits in the recent years (NBK, 2012).

The financial changes outlined by different authors above, explains the challenges that most banks are facing and especially NBK. In this era of rapid environmental changes, NBK has put some strategic responses which has assisted it to grow upto the present but more efforts needs to be done to ensure they return to their position in 1970's and 1980's.

1.2 Research Problem

The environment is what gives the organizations their means of survival. However, it is also the source of threats. The environment in which companies operate is continually changing, sometimes quite rapidly and managers have to be on their toes and to be prepared to respond quickly to environmental shifts (Daft et al, 2010). Business managers evaluate and choose strategies that they think will make their business successful (Pearce and Robinson 2010). Businesses become successful because they possess some advantage relative to their competitors. Thompson and Stickland (1993) further explain that since managers tailor strategy to fit the specifics of their own company's environment, there are countless variations. In this sense, there are as many competitive strategies as there are companies trying to compete, and thus managers should choose those strategies that will ensure great success of their business.

National Bank of Kenya Ltd is a major player in the banking industry, has been affected by changes in the environment they operate in and is grappling with a financial crisis that

has affected performance with regards to deposits mobilization, reduction in trade volumes and volatile Kenya shilling. Customer needs keeps on changing day by day as well as technological changes and NBK must adjust their strategies to match the changing environment. CBK raised its base lending rate to banks, forcing the bank to lend at a high rate, making it impossible to lend. High inflation rates have eroded disposable income for Kenyans who are unable to save forcing the bank to turn to CBK and other banks for deposits of exorbitant rates. It is therefore very crucial for NBK's executives to be aware of the environment they operate in and come up with strategies to counter threats as they emerge.

Several studies have been done on the strategic response concept. Munuve (2010) study investigating response strategies of British American Tobacco to macro environmental changes found out that the firm main strategy was to concentrate on marketing and branding. Maina (2010) investigating Communications Commission of Kenya's strategies in response to environmental changes learnt that the firm concentrated on strengthening its internal capabilities largely technical knowledge to cope with environmental turbulence. Gitau (2009) examined strategic responses to Citibank to external environment changes.

Other studies also include Gacheri (2010) he did strategic responses by Tuskys Supermarket to its changing competitive environment and found out that the most significant factor was competition. Machau (2009) study on strategic responses to changes in the external environment by commercial banks in Kenya found out that banks targeted new customers segments and additional distribution channels. Muchelule (2010)

did strategic responses adopted by the Kenya Ports Authority to changing external environment and found out that the organization reacted by introducing low-cost but high quality services

All these studies mentioned were conducted in various industries and some on the various players in the industry but none of them touched on NBK. Thus there is an existing knowledge gap as there has been no study conducted in reference to NBK and the competitive strategies. It has adopted to cope with environmental changes in order to become one of the top players in the industry and be able to generate high revenue streams. There will be additional knowledge value added to the banking industry as one of the players is analyzed and their business techniques added to the vast field. What kind of competitive strategies has National Bank of Kenya adopted in order to cope with environment changes?

1.3 Research Objective

The objective of this study is to determine the competitive strategies adopted by National Bank of Kenya to changes in the environment.

1.4 Value of the Study

The results of this study have value in the academic field in that it will help in filling existing gaps in literature as relating environmental changes experienced by National Bank of Kenya. This is fundamental in the academic field as it becomes a valuable repository of knowledge to academic scholars who include students and researchers.

The study will be important in policy making financial regulatory organs in government financial regulatory organs in developing and enacting policies which ensure sustainable operations of financial institutions in the county. External and internal environment has a great influence on operations by financial institutions hence the results of the study will act a guide to all stakeholders in the financial sector.

The study will also be of great value to the banks management as it will identify the environmental changes facing banking industry in the current times and through its findings, the study will be able to recommend strategic responses that can be adopted by these institutions. Hence the management will be able to set their priorities and goals in line with the challenges they expect.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

Strategic response to environmental changes is one of the mostly contested issues in management and has received due attention from most researchers and management firms. This chapter briefly reviews the literature, which provides basic foundation to this study as follows, section 2.2 entails organization and the environment while 2.3 entails competitive strategies.

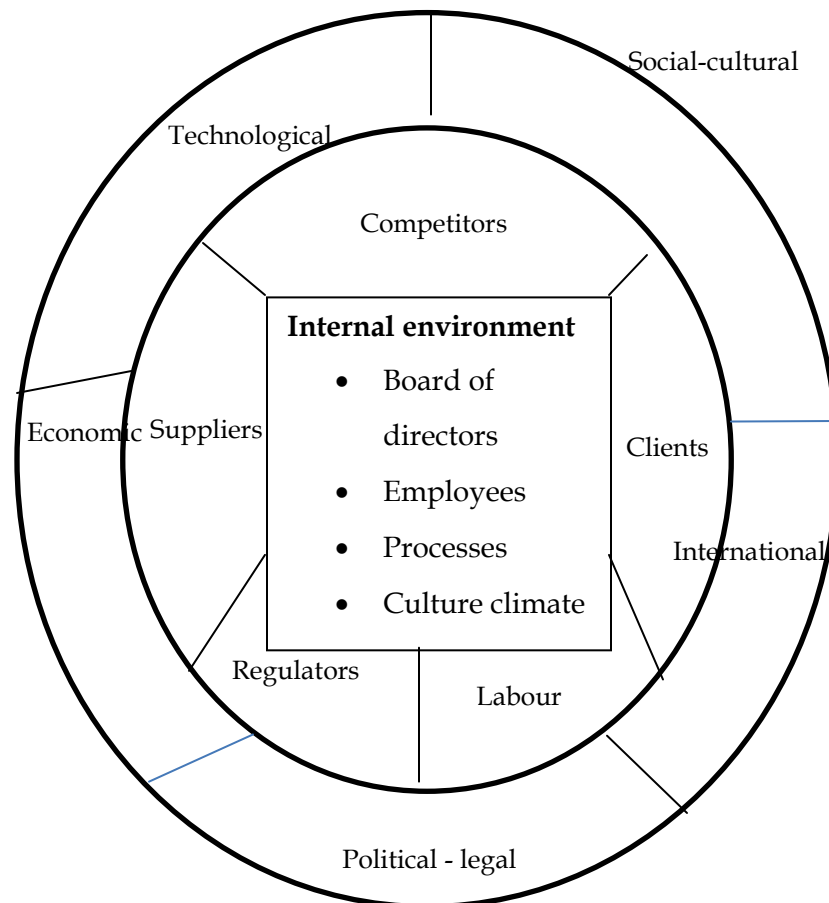
2.2. Organization and the Environment

The environment refers to the pattern of all the external and internal conditions of an entity or business organization. According to Pearce and Robinson (1991) describe external environment also all conditions that affect strategic options but which are beyond the firms control. The banking sector has witnessed tremendous changes in the past involving re-branding and changes of image, in doing so it will depend on the external environment as well as the internal environment and hence the need of good understanding of the environment.

Porter (1985) defines the organization environment into two categories; the external environment which is constituted by the forces that are outside the control of the organization and on the other hand, the internal environments consisting of all the forces within the organization, and are within the organization control. The general environment consists of economic, technical, social-cultural, political – legal and international dimensions. Inside this overall sphere of influence the firm operates within a narrow risk environment that consisted of influencing groups and organizations including clients,

competitors, suppliers and regulators. The relationship of general environment, the task environment and the international environment is depicted in Figure 2.1

Figure 2.1: Organization and its environment



Source: Burton and Thakur, (1998)

Daft et al, (2007) in discussing the topic on organization environment, points out that environment comprises several sectors or subdivisions that contain similar elements. They analyzed ten factors that are found within an organization setup. These include

industry, raw materials, human resources, financial resources, market, technology, economic conditions and government.

Burton and Thakur (1998) argues that every organization needs to be perceived as operating in an environment that reaches beyond its optical boundaries. It's functions within an external environment that is defined as all the forces and conditions outside the organization that influence the organization and its behaviour. On the other hand internal environment is defined as all the forces and conditions within the organization that influence its behaviour. They explain that environmental context become clearer if the external environment is divided into two district segments. First the general environment is composed of those major forces that affect the organization and its environment. The general environment consist of economic, social-cultural, political-legal and international dimension. Inside this overall sphere of influence the firm operates within a narrow task environment that consist of influencing groups and organizations including clients, competitors, suppliers, regulators and labour.

All organizations regardless of their nature are in constant interaction with the environment, and thus they cannot assume what is happening in the environment. On the other hand, since organizations receive inputs from the environment, process them and in turn return the final products to the environment, it is therefore correct to say that these two are interdependent. In order to secure organizations from environmental surprises, it is therefore important for the organizations to embrace strategic management. Ansoff and McDonnell (1990) argues that increased competition has created fundamental shifts in

economic whereas no organization can opt to stay afloat if it fails to come up with proper strategy responses.

Strategic managers are frequently frustrated at their attempts to anticipate the competitive environments changing influences. Due to high unpredictability of the competitive environment many managers, particularly in small firms minimize long term planning which requires a commitment of resources. They instead favor flexibility allowing managers to adapt to new pressures from the environment. The business environment has been found to influence modern competitiveness of the firms within it. The government can influence and be influenced by the determinants of competitiveness (Pearce and Robinson 2005).

2.3 Competitive Strategies

They are a set of decisions and actions that result in the formulation and implementation of plans designed to achieve a firm's objectives, Pearce and Robinson (2010). The management system adopted by an organization is a determining component of the firm's responsiveness to the environmental changes as discussed by Ansoff and McDonnell (1990). Strategic responses are mainly concerned with decisions and actions meant to achieve business objectives and purpose, (Johnson and Scholes 2006).

Firms operate in different industries and different environments will obviously react differently to competitive forces in assessing strategic choices, alternatives are strategic managers attitudes toward risk, flexibility, stability, growth, profitability and diversification. Other factors included in the decision making process are the volatility of the external environment, life cycle stages of the evaluated products and company's

current level of commitment to its organization structure, access to need resources as well as competitive advantages (Pearce and Robinson 2005). According to Porter's generic strategies, cost leadership strategy, involves the firm winning market share by appealing to cost-conscious or price-sensitive customers. This is achieved by having the lowest prices in the target market segment, or at least the lowest price to value ratio (price compared to what customers receive). To succeed at offering the lowest price while still achieving profitability and a high return on investment, the firm must be able to operate at a lower cost than its rivals (Porter, 1985).

Products differentiation strategies refer to those strategies that strive to create unique products that cannot be easily matched or duplicated by other competitors. This can only be achieved if firm's have a resource-based view strategy (Porter 1985). This implies that the firms should have the resource capability to carry out product differentiation. This can only be achieved through innovation and faster speed of services offered to customers. Focus strategies, concentrates on a narrow segment and within that segment attempts to achieve either a constant advantage or differentiation. The premise is that the need of a group can be better serviced by focusing entirely on it. A firm using a focus strategy, often enjoys a high degree of customer loyalty and this loyalty discourages other firms from competing directly (Porter, 1985). This gives a firm an advantage over its competitors by ensuring that they give quality service hence loyalty by customers.

Ansoff (1965) suggested a matrix with four response strategies to competition. The first strategy is penetrating the market strategy where the aim is to increase the sales volume

for a product that is already in the market. The strategic objective consists of obtaining an important market share or position of the market leader. This ensures that a firm operates at a profit due to strategic positioning and the large number of customers which will ensure stability of the firm. The second strategy of Ansoff (1965) is the product development strategy where a firm wants to increase sales by improving an existent product or by creating a new product which fits a big innovating potential. With a new organizational structure or which use human resources through project teams or interdisciplinary teams. This leads to attraction of more customers and even providing choice for the existing customers, increases in number of customer's leads to more sales hence high chances of huge profits as compared to competitors.

The third strategy is the market development strategy which wants to increase the sales volume for an existent product by penetrating new markets. This strategy aim at not only the geographical expansion of the company but also at conquering new market segments by creating new uses or adding new characteristics to the products according to consumers' needs (Ansoff, 1965). The fourth strategy according to Ansoff (1965) is the diversifying strategy which aims to extend the existent business portfolio by adding new products, by using new technologies, new distribution ways to the ones the company already has. This strategy can offer the firm the advantage to use emergent or distinctive competencies.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter highlights the methodology that was adopted by the researcher in order to execute the study and realize its objectives. It includes research design, data collection and data analysis.

3.2 Research Design

The study used a case study research design focusing on National Bank of Kenya. This involved sampling National Bank branches and carrying out an interview on their staff.

According to Young and Kothai (1960), case study is a very powerful form of qualitative analysis that involves a careful and complete observation of a social unit be that unit a person, a family, an institution or entire community. Case study method is a fairly exhaustive study by which an institution or group is analyzed in relationship to any other in the group Odum and Jochar (1929).

3.3 Data Collection

This study relied on both primary and secondary data. The primary data was collected from managers, general managers and directors through in-depth interviews using an interview guide, which was developed in line with the objectives of the study. Secondary data was obtained from the National Bank library as contained in the banks strategic plan. The interview guide has been used previously in other studies Rhoda (2011) and Cheboi (2008).

The objective of the study required most of the departmental heads to participate because they are responsible for the planning, directing, coordinating change management and evaluation of all the policies on behalf of the board of trustees. Some of the managers

who were interviewed included head of strategy, head of projects, head of performance management, head of corporate banking, head of sales, head of trade, head of human resource and also selected branch managers.

3.4 Data Analysis

Data was analyzed using content analysis guided by the objectives of the study to establish the responses used by National Bank of Kenya to changes within the environment. Content analysis has been defined as “a research technique for the objective, systematic, and quantitative description of the manifest content of communication” (Berelson, 1952).

The research specifically used issues of reliability and validity. The reliability of a content analysis study refers to its stability, or the tendency for codes to consistently re-code the same data in the same way over a period of time; reproducibility, or the tending for a group of codes to classify the extent to which the classification of a text corresponds to a standard or norm statistically (Berelson, 1952). Advantage of content analysis is that it looks directly at communication via texts or transcripts, and hence gets the central aspect of social interaction. This method of data analysis also allows for both quantitative and qualitative operations which can provide valuable historical/cultural insights over time through analysis of texts. Limitation with this method is that it can be extremely time consuming.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

This chapter presents the findings of the study whose main objective was to determine the competitive strategies that National Bank of Kenya has adopted to deal with changes in the financial environment.

4.1 Profile of National Bank of Kenya

National Bank was formed to help Kenyans get access to credit and control their economy after independence. National Bank is a major player in Kenya's banking industry. It is one of the largest banks in the country giving financial services to all sectors of the economy. National Bank of Kenya is able to provide a secure and professional service to a number of customers in both the Retail and Corporate market sectors. NBK has one of the biggest networks in the country. The bank's head office located at Nairobi, and has thirteen branches in the Nairobi, and 45 branches country wide. The bank has 129 ATM machines all over the country.

In 1994, the Government reduced its shareholding by 32% (40 Million Shares) to members of the public. Again in May 1996, it further reduced its Shareholding by 40 million Shares to the public. The current Shareholding now stands at: National Social Security Fund (NSSF) 48.06%, General Public - 29.44% and Kenya Government 22.5%. During the 34th AGM held on 25th April 2003 the bank increased its Share Capital by Kshs. 6 Billion i.e. from Kshs. 3 Billion to Kshs. 9 billion through the creation of 1,200,000,000 non-cumulative preference Shares of Kshs. 5 each. These Shares are at the disposal of the NBK Board who will offer them in accordance with the Bank's articles, the CMA rules and the Companies Act.

The bank will continue to cover the financial landscape and respond positively to the needs of its customers, Shareholders and the economy besides offering traditional financial services and products. National Bank has taken a leading role in the issuance and promotion of modern delivery and payment systems. The Bank has also been involved in the stock market playing multiple roles as an arranger, underwriter and placing agent. The Bank is an appointed fiscal agent, registrar and market maker in the secondary market. National Bank operates one subsidiary Company; NatBank Trustee and Investment Services Limited incorporated in Kenya on 21st July 1995 with a Share Capital of Ksh.10 Million. On 24th May 2013, the bank rebranded and changed its logo and colours from the predominately green to yellow. The new slogan is “Bank on Better”. This is a brand promise to customers, shareholders as well as stakeholders.

4.1.1 Business Growth and Performance of the National Bank

In the year 2012, the Bank’s business registered growth over the prior year in terms of income generated as well as in total assets, as a result of which the Bank made a profit after tax of Ksh. 730 million. This growth is particularly significant considering the difficult trading environment presented by the high interest rates for most of the year which has had particular adverse impact on the Bank due to its retail banking bias. However we are confident of the Bank’s overall growth momentum is sustainable and the capitalization is adequate.

Therefore the Board has recommended payment of dividends to the shareholders out of the profits generated in the year, marking the 3rd year in row that NBK will continue the

trend of paying dividends. However, in spite of this growth of the business, it is noteworthy that overall net profit after tax declined below the previous year's. This decline in net profit was largely attributable to the difficult trading environment in most of 2012 which resulted in higher interest cost on deposits which could not all be passed to the borrowers, and the high operational costs due to inflation and investments in branch expansion.

The business grew interest income to KSh. 8,430 million in 2012 from KSh. 6,458 million in the same period in 2011, representing a 31% increase. This is a clear indication that the top line business of the Bank is growing. However, interest expense increased significantly by 165% from KSh. 1,377 million in 2011 to KSh. 3,655 million in 2012 largely due to the high cost of funds that began in the fourth quarter of 2011. Additionally, the Bank opted to shield its customers from some of the increase in interest rates resulting in the overall decline in net interest income. Total operating expenses also increased by 21% to KSh. 6,463 million in 2012 from KSh. 5,351 million over the same period in 2011. This is attributable to the costs of investments in upgrading the Bank's technology platform and capital expenditure incurred in the branch expansion program. It is however important to appreciate the costs associated with investing in a robust technology platform and new branches are, on the other hand, investments upon which future growth in profitability will be hinged. 2012 saw a rapid increase in interest rates across the industry.

Loans and advances to customers increased marginally to KSh. 28,347 million in 2012 from KSh. 28,068. The sluggish growth in retail lending is to be expected in high interest

rate regime experienced in the period. Overall the Bank made total profits after tax for the year of Ksh. 730 million which is lower than 2011 profit due to the reasons explained above.

4.2 Environmental Changes

The study investigated the changes that have taken place in the banking industry in Kenya. The competition in Kenyan financial sector is getting tougher. The competition is mainly brought about by financial intermediation and the increase in microfinance institutions. During the year 2012 the Banking sector remained resilient to the challenging economic environment and continued to register growth in all aspects be it asset growth, deposits and profitability. Commercial banks and mortgage finance companies remained at 43 and 1 respectively while deposit taking Microfinance institutions increased from 6 to 8. Foreign exchange bureaus reduced from 118 to 112 and credit reference bureaus remained two.

The banking sector remains competitive and the trend shows that this will intensify in the coming years with competition for market share based on customer service quality, cost efficiency and distribution reach. Increasing competition for talent, rebranding and regionalization are also trends that characterize the competition in a crowded field. National Bank of Kenya remain alert to this increasing competition and hence have come to the conclusion that the bank must take decisive actions to ensure we not only survive the competition but actually grow our business significantly at double digit rates over the next five years.

4.3 Competitive Strategies adopted by National Bank of Kenya to Changing Environment

The main objective of the study was to determine the competitive strategies that National Bank of Kenya has adopted to deal with the changes in the environment. The following subsections present the findings of the study.

4.3.1 Strategic Transformation

Over the financial year 2011/2012 the Board of National Bank of Kenya recognized that the bank had not been performing at par with its peers or realizing its full potential to meet the rightful expectation of its investors. The Board also noted that the Bank has been steadily losing market share for the last two decades. Despite turning profitable and successful implementation of the first phase of restructuring that exited the Non-Performing Loans from its balance sheet, the Bank required to undertake its next phase of its transformation journey into a high performing organization. This required hiring talent with the necessary experience and background to drive this phase.

The Board thus hired a new Managing Director through an international competitive process and also approved the recruitment of senior management team to drive the transformation program. The Board also enlisted a leading international consultancy firm that has helped the Bank develop a turnaround strategy.

The transformation program entails a number of projects that broadly include: Organizational structure changes to create new divisions of Corporate and Institutional and Retail and Business Divisions to drive the business, and rationalization of the support

divisions and departments. Innovation and development of products and customer value propositions for the target segments and markets NBK chose to participate in developing an effective sales model that achieves market share growth through building up business volumes and accelerating customer numbers growth.

NBK has embarked on a program to expand its distribution network throughout the country and into regional markets. This entails establishing 20 additional branches at the county level and deploying a full range of non-branch channels including agent banking, offsite ATMs, mobile banking, electronic banking and other innovative channels. The bank intends to expand into regional markets where opportunities exist that will add value to the Bank. NBK has leveraged investments in technology to centralize and automate service delivery. This will help deliver superior customer service cost effectively and manage down the wage bill while growing the business. The bank has also enhanced risk management capabilities and diversified its portfolios and businesses. Moreover, NBK has introduced a rigorous performance management framework to ensure management performance is stewarded appropriately to achieve the business goals.

Driving the strategic initiatives requires investing in training the existing staff and in some cases bringing in new talent to fill skills gaps. NBK has hired experienced and skilled bankers to lead the new business divisions, drive business growth, manage customer relationship, steward business growth and effectively control all enterprise risks. To have a new and better focused bank, NBK has undertaken a major rebranding

exercise that has transformed not only its corporate logos, tagline and colors but also the look and feel of its branches to make them more customer friendly and promote service efficiency.

4.3.2 Corporate Governance as Strategic Orientation

The bank has embraced corporate governance as toll to enhance service delivery and improve performance. NBK has a board of directors that is committed to ensuring that the business of the Bank is run in a professional, transparent and equitable manner so as to protect and enhance shareholder value and also satisfy the interests of other stakeholders. The principles and standards adhered to by the Board have been developed considering the internationally accepted good corporate governance principles and practices. In this regard the Board ensures that the Bank complies with all relevant legislation including provisions of the Banking Act and Prudential Guidelines issued by the Central Bank of Kenya. The Board fulfills its fiduciary obligations to the shareholders by providing policy direction and maintaining oversight over strategic, financial, operational and compliance risks of the Bank. In carrying out the above responsibilities the Board delegates its authority to the Managing Director to oversee the day to day business operations.

4.3.2.1 Board Composition of the Board, Committees, Meetings and Evaluation

Seven out of the ten members of the Board including the Chairman are non-executive directors. Of these the Permanent Secretary to the Treasury and National Social Security Fund are institutional directors of the Board. The other five non-executive directors are considered by the Board to be independent and free from any business interest or other

relationship that could influence the exercise of their personal independent judgment. The Board has seven standing committees which meet regularly under the terms of reference set by the Board. The committees meet and make recommendations to the Board on matters falling under their respective mandates. The committees include:

The bank has an audit and risk committee whose responsibility is to ensure proper administration of systems of internal controls and effective risk management. Through this committee the Board is able to discharge its supervisory and good corporate governance responsibilities. These include among others the Bank's relationship with the independent external auditors, the reliability of the financial statements, external communication and maintenance of an effective risk management framework including compliance and internal controls. Finance and ICT committee is responsible for review of financial performance of the Bank as well as the ICT systems supporting the Bank's business. The committee also reviews interim as well as annual results prior to publication. Credit, Legal & Remedial Committee which meets monthly is responsible for the credit function in the Bank. The committee reviews credit growth, administration and any legal issues arising thereon. Human Resources, CSR & Administration Committee; is largely responsible for human resources policies, staff remuneration and welfare. The committee is also responsible for the Corporate Social Responsibility function in the Bank.

An operation, marketing and business development committee which meets quarterly is responsible for review of the Bank's business growth, marketing as well as the brand

image. Tender, supplies and premises committee is responsible for all tenders referred to the Board for consideration as well as review of the status of the Bank's projects and procurement policies. Last is the Nominations committee which is responsible for board appointments and which meets once a year or more should a need arise. The Board holds regular meetings and on occasions special meetings as and when the need arises. The meetings deal with business and operational issues referred to the Board by management and also review monthly performance against targets. The Central Bank of Kenya inspection reports and audit reports are reviewed at some of these meetings and appropriate actions taken.

The Board carries out a peer evaluation exercise as part of good corporate practice and in order to comply with the Central Bank requirement. The results of the evaluation are submitted to the Central Bank of Kenya. All the directors apart from the one who retired during the year 2012 and therefore was not subjected to evaluation scored above average individually.

4.3.2.2 Communication with Shareholders

The Bank is committed to ensuring that shareholders, financial markets and other stakeholders are provided with adequate and timely information about its performance. This is achieved by the distribution of the Bank's annual report, the release in the media of its quarterly and annual results as well as any other pertinent disclosures. The Bank also uses its website to make available pertinent information to shareholders, potential

investors and the general public. The Bank therefore complies with its obligations as contained in the Nairobi Stock Exchange rules and Capital Market Act.

4.3.2.3 The role of Directors in Achievement of NBKs Strategic Plans

The Kenyan Companies Act requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the bank as at the end of the financial year and of the operating results of the bank for that year. It also requires the directors to ensure that the bank keeps proper accounting records which disclose with reasonable accuracy at any time the financial position of the bank. They are also responsible for safeguarding the assets of the bank. The directors are responsible for the preparation of financial statements that give a true and fair view in accordance with International Financial Reporting Standards and the requirements of the Kenyan Companies Act, and for such internal controls as directors determine are necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

The directors accept responsibility for the annual financial statements, which have been prepared using appropriate accounting policies supported by reasonable and prudent judgments and estimates, in conformity with International Financial Reporting Standards and in the manner required by the Kenyan Companies Act. The directors are of the opinion that the financial statements give a true and fair view of the state of the financial affairs of the bank and of the bank's operating results. The directors further accept responsibility for the maintenance of accounting records which may be relied upon in the

preparation of financial statements, as well as adequate systems of internal financial control.

The aggregate of emoluments paid to Directors for services rendered during the year is disclosed in the notes to the financial statements. Since the last Annual General Meeting of the Company, no director has received or become entitled to receive any benefit other than the directors' fees and allowances and amounts received under employment contracts for Executive Directors of the Bank.

4.3.2.4 Monitoring and Evaluation

The National Bank of Kenya upholds monitoring and evaluation as a pillar towards the achievement of its strategic plans. The bank outsources audit services from Deloitte & Touche Certified Public Accountants (Kenya). Deloitte and Touche audits the accompanying financial statements of National Bank of Kenya Limited, which comprise the statement of financial position, the statement of comprehensive income, statement of changes in equity and statement of cash flows, and a summary of significant accounting policies and other explanatory notes. The auditor's responsibility is to express an opinion on these financial statements based on the audit. The auditor's conducts audit in accordance with International Standards on Auditing. Those standards require that auditors comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor's considers the internal controls relevant to the bank's preparation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstance. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements. According to Deloitte & Touche, the National Bank of Kenya has complied with all legal requirements by Kenyan Companies Act. The bank's statement of financial position and statement of comprehensive income are in agreement with the books of account.

4.3.3 Strategic Business Growth and Development plan

During the last quarter of 2012, the Board and the Executive Management team began a deep review of the mid and long term strategy of the business with the assistance of a leading global consultancy firm, Deloitte & Touche. It became clear that a new strategy was required to transform the bank into a high performing institution. The objective of the new strategy is to transform the Bank into one of the top banks in Kenya by 2017. This requires long term strategic initiatives to be implemented and internal organization changes undertaken while at the same time ensuring short term profits are not adversely impacted.

The National Bank of Kenya replaced its core banking system in March 2012 and has upgraded or introduced new systems and applications in various business segments in order to support the planned growth of the business and improve customers experience through fast and efficient service delivery. The new systems will deliver enhanced capabilities and functionality requirements for the various products and businesses of the Bank, including deposits, lending, payments, international trade, treasury, cards, Islamic banking, and custody, among others. The implementation was through a phased approach and was largely completed by December 2012.

NBK is determined to ensure the significant investment in technology platform will result in improved service delivery, support growth of new business segments, reduce our operating costs and thereby yield higher profit dividends to the shareholders of the Bank.

The new banking system has enabled the Bank fully automate its Trade Finance and Treasury services as well as offer our customers the ability to apply for international trade services from the comfort of their homes or offices. More recently, NBK replaced card systems with a new system, Tranzware, to address credit cards, debit cards and agent banking. This project will also provide the Bank with a platform to enhance its card product portfolio, enhance customer service and enable the Bank to address card frauds that has increasingly been on the rise.

In 2012, NBK continued to expand distribution channels and opened six new branches namely: Changanwe, Thika, Garissa, Technical University of Mombasa, Mtwapa and

Bomet. The bank plan to open 10 more branches in the year 2013 to enable it have better representation across all the counties in the country.

In NBK's continuous efforts to increase convenience to the customers, the bank has also extended its operating hours across the branch network. In addition, the bank launched a Call Centre to enable customers communicate with the Bank on a 24 hour 365 days basis. The Bank also enhanced its mobile banking capability and functionality by upgrading the SIM-ple mobile banking channel to integrate with M-pesa money transfer service to provide our customers with the convenience that comes with this service. NBK has also launched SMS alerts to enable our customers monitor transactions on their accounts. The bank continues to build on the technology platforms to enhance services standards in order to make them current and most competitive to meet the need of the customers.

4.3.4 Information Communication Technology

The bank prioritizes information communication technology as mean to achieve great competitive advantage in the banking industry. The bank has adopted various electronic platforms to enable it provide efficient and quality services.

4.3.4.1 Technology and Banking in National Bank

The bank provides an online banking portal through which customers can log in and access their accounts information. The bank has a portal that enables new clients to open accounts online and a loans portal for details on loan acquisition. Other online portals are loan calculator, E-pay for electronic money transactions and Talk To Us portal that enable customers to contact the bank, careers portal, mortgage portal.

The banks website enable customers and the public to access information on corporate banking (opening bank accounts, premium banking, payment services, finance, investments, treasury services, custodial services , electronic solutions-ATM services, mobile and internet banking), personal banking (current accounts, savings accounts, children accounts, chama accounts, cards, foreign currency, loans), business banking (working capital solution, business expansion, deposit products) investor information (exchange rates, share registry, shareholder annual general meeting, custodial services, annual reports, investor downloads, CDS account), latest financial news, about us portal (registration , history social responsibility, board of directors, senior management, ATM locator, contacts, feedback), National Amanah accounts which is a new product geared towards boosting the bank's penetration of retail and corporate market segments. The launch of National Amanah is part of the bank's strategy to provide its clients with greater choice. Bank customers also enjoy online access to the available bank branches; sit map, and customer support.

4.3.4.2 E-Banking Services

Internet Banking: allows customers to conduct financial transactions on a secure website operated by the Bank. This service is available for our personal and business customers. NBK offer a wide range of online services which include: online viewing of recent transactions, funds transfers between a customer's own accounts, funds transfer to third parties, paying bills.

Simple Banking: a service that allows customers to perform the following via mobile phone: account information enquiry, balance enquiry, mini-statement enquiry, transfer of funds between accounts, transfer of funds from NBK account to M pesa and vice versa, funds transfer to third party accounts within NBK, airtime purchase.

Western Union: a money transfer service that enables customers to send and receive money locally and internationally, pay bills online in person or by phone. Money Gram: an international money transfer where a customer is able to transfer money fast and conveniently to friends and family and add a personal message for every transaction made. M-Pesa: a mobile -phone based money transfer service. Through M pesa a customer can receive /send money from mobile phone from/to other mobile users, withdraw or deposit cash from/to the mobile phone, transfer money from bank account to M pesa account, transfer money from M pesa account to bank account, purchase e-float from the bank if offering M pesa agency services.

4.3.5 Corporate Social Responsibility

Corporate Social Responsibility (CSR) is now an integral part of National Bank's Business culture. Guided by an existing policy and deep commitment to making a difference in people's lives, the Bank commits a substantial budgetary allocation each year to CSR initiatives. The institution supports CSR programmes in the areas of health, education, sports, vulnerable groups and environment.

4.3.5.1 Health services initiatives

The high cost of providing specialized treatment further makes access to such health care by majority of Kenyans to be a major challenge. It is in recognition of the above that the Bank has continued to support initiatives aimed at improving health care. In the year 2012 the Bank donated six Dialysis machines to three hospitals namely: - Coast General Hospital (Mombasa) Rift Valley Provincial General Hospital (Nakuru) and Moi Teaching and Referral Hospital (Eldoret) at a total cost of about Sh. 10 million. This intervention by the Bank has been highly appreciated by the recipient health institutions as it went along away to alleviate the suffering of the patients with Kidney ailments. It has also reduced the waiting period for patients who require dialysis and who at times had to travel to Kenyatta National Hospital, Nairobi which too has limited facilities being a national referred hospital.

In 2012 the Bank also supported Operation Smile mission in Kenya (OSMIK) through a donation of Sh. 2.5 million towards treatment of persons born with cleft lips and related facial deformities. Other initiatives included provision of a blood storage facility to Elburgon Nyayo Hospital in Molo, donation of mosquito nets to Malindi District Hospital and sponsorship of medical camps in various locations in the country.

4.3.5.2 Education Projects

The Bank recognizes the importance of education in fostering social, cultural and economic development in the country. In this regard National Bank supported various initiatives across the country aimed at promoting education. These initiatives included

donations towards construction of classrooms, laboratories, sanitation facilities and purchase of equipment of various types.

The Bank supported initiatives aimed at promoting quality education for the girl child and to this end donated Sh. 1 million to St Paul's ACK Mother's Group Ratta in Kisumu for construction of a kitchen as part of Ratta Girls Hostel Project. In Kianjai and Mituntu Girls Secondary School in Meru the Bank supported the construction of a dormitory and laboratory respectively at a cost of Sh. 5 million. A donation of Sh. 500,000 was given towards the construction of a classroom in Matumbufu Baptist Girls Secondary School in Bungoma. St Cecilia Namanya Girls Secondary School in Busia also received a donation of Sh. 569,000 towards construction of a laboratory. Other support to educational institutions included donation of reconditioned computers and sponsorship of various school trophy-award programmes aimed at promoting excellence in learning and sporting activities.

4.3.5.3 Sports Activities

National Bank has for a number of years been closely associated with sporting activities and especially athletics. Kenyans have on many occasions proved to the world that the country is a home of talent when it comes to athletics and nurturing these talents has been a special area of interest for the Bank. Sports have a unique way of promoting social cohesion among communities besides becoming a source of livelihood for many successful sportsmen and women. In 2012, the Bank continued supporting sporting activities through its annual sponsorship of Athletics Kenya which amounted to Sh. 33 million. Through this sponsorship Athletics Kenya has been able to produce very

successful athletes who have done the country proud from their participation in various international sporting competitions.

The Bank also continued with its sponsorship of sports personality of the year Awards (SOYA) in the sum of Sh. 3 million. For the third year running the Bank sponsored the annual Tegla Lorupe Peace Race which this time was organized to foster peace in the clash torn regions of Tana delta. Other beneficiaries of sports sponsorship by the Bank included, Deaf Athletics Kenya, the Special Olympics Team, Mwea Classic Marathon, the Moi forces Academy annual Open ball tournament, the Kisii University College Culture Week & Peace Decathlon, the Tudumu Ngong half Marathon and St. Teresa Table Tennis Club Exchange Programme.

4.3.5.4 Vulnerable Groups

In 2012 the Bank participated in a number of initiatives aimed at impacting positively the lives of the less endowed members of the society. These initiatives included donations of basic amenities such as foodstuff and linen to various institutions among them Bishop Luigi Locati Children's home, Joyland special Secondary School, Soweto Good Samaritan orphans & Destitute Children's Centre and Mama Fatuma Goodwill Children's Homes.

4.3.5.5 Environment Concerns

The Bank is committed to conserving the environment in all its dealings with its customers and communities within which it carries out business activities. In this regard the staff of the Bank participated in various environmental conservation activities by

partnering with the local communities and schools to plant trees and carry out cleanup exercises.

4.3.6 Risk Management

The bank's activities expose it to a variety of financial risks and those activities involve the analysis, evaluation, acceptance and management of some degree of risk or combination of risks. Taking risk is core to the bank's business, and the operational risks are an inevitable consequence of being in business. The bank's aim is therefore to achieve an appropriate balance between risk and return and minimize potential adverse effects on its financial performance. The most important types of risk include: Credit risk, Liquidity risk, and Market risk which includes currency, interest rate and price risk.

The Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework. The board has established a Board Audit and Risk Committee and a risk department to assist in the discharge of this responsibility. The board has also established the Credit, Finance, Information & Technology Committee, the tender committee and operations and marketing committees which are responsible for developing and monitoring risk management in their respective areas.

The committees comprise of non-executive members and report regularly to the Board of Directors. The bank's risk management policies are established to identify and analyses the risks faced by the bank, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed

regularly to reflect changes in market conditions, products and services offered. The bank, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

The bank's Audit and Risk Committee is responsible for monitoring compliance with the bank's risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the bank. The Audit and Risk Committee is assisted in these functions by internal audit and the risk departments. Internal audit undertakes both regular and ad-hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee. The risk department is responsible for the development of detailed risk management policies and for the day to day implementation of those policies.

4.3.6.1 Management of Credit Risk

Credit risk is the risk of financial loss to the bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the bank's loans and advances to customers and other banks and investment securities. For risk management reporting purposes, the bank considers and consolidates all elements of credit risk exposure.

The Board of Directors has delegated responsibility for the management of credit risk to its Credit, Finance, Information & Technology Committee. A separate credit department,

reporting to the Credit, Finance, Information & Technology Committee, is responsible for oversight of the bank's credit risk, including: (i) Formulating credit policies in consultation with business units, covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements. (ii) Establishing the authorization structure for the approval and renewal of credit facilities. Authorization limits are allocated to business unit Credit Officers. Larger facilities require approval by the Credit Finance, Information & Technology Committee or the Board of Directors as appropriate.

The third (iii) function of Finance, Information & Technology Committee is reviewing and assessing credit risk. The Credit department assesses all credit exposures in excess of designated limits, prior to facilities being committed to customers by the business unit concerned. Renewals and reviews of facilities are subject to the same review process.

(iv) Limiting concentrations of exposure to counterparties, geographies and industries (for loans and advances), and by issuer, credit rating band, market liquidity and country (for investment securities).

The fourth (iv) function of Finance, Information & Technology Committee is developing and maintaining the bank's risk grading in order to categorize exposures according to the degree of risk of financial loss faced and to focus management on the attendant risks. The risk grading system is used in determining where impairment provisions may be required against specific credit exposures. The current risk grading framework consists of eight grades reflecting varying degrees of risk of default and the availability of collateral or

other credit risk mitigation. The responsibility for setting risk grades lies with the final approving executive / committee as appropriate. Risk grades are subject to regular reviews by the Credit, Finance, Information & Technology Committee.

The Finance, Information & Technology Committee also participate in (v) reviewing compliance of business units with agreed exposure limits, including those for selected industries, country risk and product types. Regular reports are provided to the credit department on the credit quality of local portfolios and appropriate corrective action is taken. (vii) Providing advice, guidance and specialist skills to business units to promote best practice throughout the bank in the management of credit risk.

The bank classifies loans and advances under this category for those exposures that are upto date & in line with contractual agreements. Such loans would have demonstrated financial conditions, risk factors and capacity to repay that are acceptable. These exposures will normally be maintained largely within approved product programs and with no signs of impairment or distress. These exposures are categorized as normal accounts in line with Central Bank of Kenya (CBK) prudential guidelines and a provision at 1% is made and appropriated under statutory reserves.

The bank establishes an allowance for impairment losses that represents its estimate of incurred losses in its loan portfolio. The main components of this allowance are a specific loss component that relates to individually significant exposures, and a collective loan loss allowance established for banks of homogeneous assets in respect of losses that have

been incurred but have not been identified on loans subject to individual assessment for impairment.

Based on the write-off policy, the bank writes off a loan / security balance (and any related allowances for impairment losses) when the Credit department determines that the loans are uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the borrower's financial position such that the borrower can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure. For smaller balance standardized loans, charge off decisions generally are based on a product specific past due status.

The bank also holds collateral against loans and advances to customers in the form of cash, mortgage interests over property, other registered securities over assets, and guarantees. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and generally are not updated except when a loan is individually assessed as impaired. Collateral generally is not held over loans and advances to banks, except when securities are held as part of reverse repurchase and securities borrowing activity.

Collateral usually is not held against investment securities, and no such collateral was held at 31 December 2012 or 2011.

4.3.6.2 Settlement Risk

The bank's activities may give rise to risk at the time of settlement of transactions and trades. Settlement risk is the risk of loss due to the failure of a company to honor its obligations to deliver cash, securities or other assets as contractually agreed. For certain types of transactions the bank mitigates this risk by conducting settlements through a settlement /clearing agent to ensure that a trade is settled only when both parties have fulfilled their contractual settlement obligations. Settlement limits form part of the credit approval / limit monitoring process described earlier. Acceptance of settlement risk on free settlement trades requires transaction specific or counterparty specific approvals from the bank's risk function.

4.3.6.3 Liquidity Risk

Liquidity risk is the risk that the bank will encounter difficulty in meeting obligations from its financial liabilities-Management of liquidity risk. The bank's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the bank's reputation. Treasury department maintains a portfolio of short-term liquid assets, largely made up of short-term liquid investment securities, loans and advances to banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the bank as a whole.

The key measure used by the bank for managing liquidity risk is the ratio of net liquid assets to deposits from customers. For this purpose net liquid assets are considered as including cash and cash equivalents and investment grade debt securities for which there

is an active and liquid market less any deposits from banks, debt securities issued, other borrowings and commitments maturing within the next month. There are undiscounted cash flows on the bank's financial liabilities and unrecognized loan commitments on the basis of their earliest possible contractual maturity. The bank's expected cash flows on these instruments vary significantly from this analysis. For example, demand deposits from customers are expected to maintain a stable or increasing balance; and unrecognized loan commitments are not all expected to be drawn down immediately.

4.3.6.4 Management of Market Risks

Market risk is the risk that changes in market prices, such as interest rate, equity prices, foreign exchange rates and credit spreads (not relating to changes in the obligor's / issuer's credit standing) will affect the bank's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return on risk. Overall responsibility for management of market risk rests with a management committee of the bank, the Asset and Liability Committee (ALCO). The risk department is responsible for the development of detailed market risk management policies (subject to review and approval by ALCO) and for the day to day implementation of those policies.

4.3.6.5 Interest Rate Risk

The bank is exposed to the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. The maturities of asset and liabilities and the ability to replace at an acceptable cost, interest-bearing liabilities as they mature, are important factors in assessing the bank's exposure to changes in interest rates and liquidity. Interest

rates on advances to customers and other risk assets are either pegged to the bank's base lending rate. The base rate is adjusted from time to time to reflect the cost of funds. ALCO closely monitors the interest rate trends to minimize the potential adverse impact of interest rate changes. The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the bank.

4.3.6.6 Foreign Exchange Risk

The bank operates wholly within Kenya and its assets and liabilities are carried in local currency. The bank maintains trade with correspondent banks and takes deposits and lends in foreign currencies. The bank is exposed to the risk that the value of financial instruments will fluctuate due to changes in foreign exchange rates. The bank's currency position and exposure are managed within the exposure guideline of 10% (2011 - 20%) of the core capital as stipulated by the Central Bank of Kenya. This position is reviewed on a daily basis by the management.

4.3.6.7 Fair value of Financial Assets and Liabilities

The financial instruments are measured at fair value. The bank specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the bank's market assumptions.

In common with other banks, the bank conducts business involving acceptances, guarantees, performances and indemnities. The majority of these facilities are offset by corresponding obligations of third parties.

4.3.7 Market Segmentation and Product Diversification

National Bank of Kenya employs market segmentation and product diversification strategies as means to enhance competitive advantage.

4.3.7.1 Market Segmentation

National Bank of Kenya has segmentation its target market by providing accounts that target specific market segments. The accounts include the National Amanah Accounts which are shariah compliant accounts guided by Islamic law. They are packaged to meet the banking needs of all including; children, youth, women, salaried and self-employed individuals, companies etc. In compliance with the shariah law, no interest paid and no charges are levied. The bank also provides National Amanah Financing Facilities which are shariah compliant asset facilities guided by Islamic law. This is Halaal financing based on the principles of Murabaha financing and Diminishing Musharaka. The assets financed include houses, plots, vehicles, machinery to name a few.

NBK provides: Vision Account for children under the age under the age of 18 years that encourages a saving culture from a tender age. It also enables parents to save for their children`s education and future; Student Account which encourages savings by young people in the age group of 18 -25 years. It also provides an account where parents may deposit cash for children studying in learning institutions worldwide; Taifa Account which offers an affordable, secure and convenient avenue for accumulating savings as well as processing remittances e.g. salaries, pension, agricultural proceeds; Wages Account which offers an affordable, secure convenient account for salary processing for

employees of large companies e.g. security firms, flower farms, factories; National Account which has been designed to encourage customers to enhance their savings.

Other accounts includes: Current Accounts which offer fast and convenient access to cash at any time. It is suitable for individuals as well as companies; Uchuuzi Sme Current Account which offers fast and convenient access to cash at any time. It is designed to suit the needs of SMEs; Pinnacle Account designed to offer customers special attention and the exclusivity they deserve; Fixed Deposits which offers an avenue to earn interest on long term and short term deposits. It is a convenient and flexible way to save funds; Super Chama Account which targets chamas that require an avenue to save and manage their funds; Welfare Account which targets registered groups that requires an account to manage their funds. Examples of such groups include; welfare associations, churches, Non-profit organization groups, women groups, youth groups and self-help groups; and Ushuru Account which facilitate fast and convenient payment of KRA taxes.

4.3.7.2 Product Diversification

National bank of Kenya has diversified its product to cater for diverse needs of its customers. The lending products include: Asset Financing which empowers customers in the acquisition of assets e.g motor vehicles, tractors and machinery; Mortgage Facilities available for the purchase of residential and commercial properties. Financing is available to companies, Real Estate developers, salaried and self employed individuals; NBK Equity Release which is aimed at assisting property owners to obtain cash from the value of their residential or commercial property; Overdraft Facilities which help customers to meet working capital funding needs. Interest is only charged on the utilized debit balance;

School Overdraft which assists schools handle their overhead costs especially towards the end of the term; NBK Study Loan which is aimed at providing financial solutions for those investing in education at all levels of learning; Salary Advance Facilities which is available for individuals whose salaries are channeled through their accounts with NBK.

SME loan products include: Inua Biashara Sme Loan which is a facility to assist business people to develop their business; LPO Financing which is a facility to assist business people to service their LPOs; Loan To Tea Farmers which is a facility for tea farmers who deliver their tea produce to both KTDA and private factories and who are receiving their tea proceeds in their accounts with NBK; Loan To Sugar Cane Farmers which is a loan facility for the sugarcane farmers who are receiving their sugarcane proceeds in their account with National Bank; Super Chama Loan enables welfare group achieve their investment plan; Stima Loan assists individuals and businesses install power from KPLC in their commercial or residential premises; Construction Loan enables individual or corporate clients to complete building projects already under the mortgage facility.

The bank runs the Premium Banking Business Club. The Premium Banking Business Club is a club mainly for business people and operating various NBK accounts. The membership fee is sh.2,500 and a monthly subscription of sh.1,000 members enjoy the following benefits; business tours both locally and international to expand on business opportunities and gain insights on diverse business practices and operations, seminars to enable businessmen/women to build business networks and develop new business ideas, and access to concessionary loans & overdrafts.

4.3.8 Other Competitive Strategies by National Bank of Kenya

4.3.8.1 Retirement Benefit Obligations

The bank makes contributions to a defined contribution pension scheme and a defined contribution provident fund in respect of eligible non-unionisable and unionisable employees respectively. It also contributes to the statutory defined pension scheme, the National Social Security Fund. Contributions to the company plans are determined by the rules of the plan and totalled Sh. 324,950,000 in the year 2012. Contributions to the statutory scheme are determined by local statute and are currently set at Sh 200 per employee per month. For the year ended 31 December 2012, the company contributed Sh. 3,671,000 to the statutory scheme.

4.3.8.2 Fiduciary Activities

The bank holds asset security documents on behalf of customers with a value of Sh. 3,340,341,992 in the financial year ended 31st December 2012. Most of these securities are held by the custody services department. The assets held comprise deposits with financial institutions, government securities, and quoted and unquoted securities.

4.3.8.3 Assets Pledged As Security

Deposits due from foreign banks amounting to Sh. 425,259,100 in the financial year ended 31st December 2012 were under lien as collateral for the letters of credit and guarantees issued to the bank's customers.

4.3.8.4 Segmental Reporting

The bank adopted IFRS 8 Operating Segments which became effective for the periods beginning 1 January 2010. IFRS 8 requires operating segments to be identified on the basis of internal reports about components of the corporation that are regularly reviewed by the Chief Operating Decision Maker (CODM) in order to allocate resources to the segments and to assess performance. Thus, under IFRS 8, the major reporting segment is banking with other income comprising less than 10% of total income. This is the information which has been reported in these financial statements.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

This chapter presents the summary of the study findings, conclusion and recommendations of the study.

5.1 Summary

The objective of the study was to determine the competitive strategies that National Bank of Kenya has adopted to deal with changes in the financial environment , The study established that National Bank of Kenya has come up with various strategies to enable the bank remain competitive. The strategies include Strategic Transformation, Corporate Governance, Strategic Business Growth and Development, Information communication technology, Corporate Social Responsibility, Risk Management, Market Segmentation and Product Diversification, Other Competitive Strategies by National Bank of Kenya, Retirement Benefit Obligations, Fiduciary Activities, and Segmental Reporting.

The strategic transformation involved hiring talent with the necessary experience and background to drive this phase. The Board thus hired a new Managing Director through an international competitive process and also approved the recruitment of senior management team to drive the transformation program. The Board also enlisted a leading international consultancy firm that has helped the Bank develop a turnaround strategy. The transformation program entails a number of projects that broadly include: Organizational structure changes to create new divisions of Corporate and Institutional and Retail and Business Divisions to drive the business, and rationalization of the support divisions and departments. Innovation and development of products and customer value

propositions for the target segments and markets NBK chose to participate in developing an effective sales model that achieves market share growth through building up business volumes and accelerating customer numbers growth.

NBK has embarked on a program to expand its distribution network throughout the country and into regional markets. This entails establishing 20 additional branches at the county level and deploying a full range of non-branch channels including agent banking, offsite ATMs, mobile banking, electronic banking and other innovative channels. The bank intends to expand into regional markets where opportunities exist that will add value to the Bank.

NBK has leveraged investments in technology to centralize and automate service delivery. This will help deliver superior customer service cost effectively and manage down the wage bill while growing the business. The bank has also enhanced risk management capabilities and diversified its portfolios and businesses. Moreover, NBK has introduced a rigorous performance management framework to ensure management performance is stewarded appropriately to achieve the business goals

Driving the strategic initiatives requires investing in training the existing staff and in some cases bringing in new talent to fill skills gaps. NBK has hired experienced and skilled bankers to lead the new business divisions, drive business growth, manage customer relationship, steward business growth and effectively control all enterprise risks. To have a new and better focused bank, NBK has undertaken a major rebranding

exercise that has transformed not only its corporate logos, tagline and colors but also the look and feel of its branches to make them more customer friendly and promote service efficiency.

The bank has embraced corporate governance as tool to enhance service delivery and improve performance. NBK has a board of directors that is committed to ensuring that the business of the Bank is run in a professional, transparent and equitable manner so as to protect and enhance shareholder value and also satisfy the interests of other stakeholders. The Board fulfills its fiduciary obligations to the shareholders by providing policy direction and maintaining oversight over strategic, financial, operational and compliance risks of the Bank. The Board carries out a peer evaluation exercise as part of good corporate practice and in order to comply with the Central Bank requirement. The Bank is committed to ensuring that shareholders, financial markets and other stakeholders are provided with adequate and timely information about its performance.

The National Bank of Kenya replaced its core banking system in March 2012 and has upgraded or introduced new systems and applications in various business segments in order to support the planned growth of the business and improve customers experience through fast and efficient service delivery. The new systems will deliver enhanced capabilities and functionality requirements for the various products and businesses of the Bank, including deposits, lending, payments, international trade, treasury, cards, Islamic banking, and custody, among others. The implementation was through a phased approach and was largely completed by December 2012.

NBK is determined to ensure the significant investment in technology platform will result in improved service delivery, support growth of new business segments, reduce our operating costs and thereby yield higher profit dividends to the shareholders of the Bank. The new banking system has enabled the Bank fully automate its Trade Finance and Treasury services as well as offer our customers the ability to apply for international trade services from the comfort of their homes or offices. More recently, NBK replaced card systems with a new system, Tranzware, to address credit cards, debit cards and agent banking. This project will also provide the Bank with a platform to enhance its card product portfolio, enhance customer service and enable the Bank to address card frauds that has increasingly been on the rise. In 2012, NBK continued to expand distribution channels and opened six new branches. The bank plan to open 10 more branches in the year 2013 to enable it have better representation across all the counties in the country.

In NBK's continuous efforts to increase convenience to the customers, the bank has also extended its operating hours across the branch network. In addition, the bank launched a Call Centre to enable customers communicate with the Bank on a 24 hour 365 days basis. The Bank also enhanced its mobile banking capability and functionality by upgrading the SIM-ple mobile banking channel to integrate with M-pesa money transfer service to provide our customers with the convenience that comes with this service. NBK has also launched SMS alerts to enable our customers monitor transactions on their accounts. The bank continues to build on the technology platforms to enhance services standards in order to make them current and most competitive to meet the need of the customers.

Corporate Social Responsibility (CSR) is now an integral part of National Bank's Business culture. Guided by an existing policy and deep commitment to making a difference in people's lives, the Bank commits a substantial budgetary allocation each year to CSR initiatives. The institution supports CSR programmes in the areas of health, education, sports, vulnerable groups and environment.

Taking risk is core to the bank's business, and the operational risks are an inevitable consequence of being in business. The bank's aim is therefore to achieve an appropriate balance between risk and return and minimize potential adverse effects on its financial performance. The most important types of risk include: Credit risk, Liquidity risk, and Market risk which includes currency, interest rate and price risk.

The Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework. The board has established a Board Audit and Risk Committee and a risk department to assist in the discharge of this responsibility. The board has also established the Credit, Finance, Information & Technology Committee, the tender committee and operations and marketing committees which are responsible for developing and monitoring risk management in their respective areas.

National Bank of Kenya employs market segmentation and product diversification strategies as means to enhance competitive advantage. National Bank of Kenya has segmented its target market by providing accounts that target specific market

segments. National Bank of Kenya has diversified its product to cater for diverse needs of its customers.

The other competitive strategies by National Bank of Kenya include the Retirement Benefit Obligations in which the bank makes contributions to a defined contribution pension scheme and a defined contribution provident fund in respect of eligible non-unionisable and unionisable employees respectively. It also contributes to the statutory defined pension scheme, the National Social Security Fund. The bank holds asset security documents on behalf of customers. The assets held comprise deposits with financial institutions, government securities, and quoted and unquoted securities. The bank carries out segmental reporting.

5.2 Conclusion

The study concludes that NBK is aware of the competition in the banking industry and has taken measures to ensure that the bank remains competitive. The competitive strategies are in areas such as strategic transformation, corporate governance, strategic business growth and development, information communication technology, corporate social responsibility, risk management, market segmentation and product diversification, other competitive strategies by national bank of Kenya, retirement benefit obligations, fiduciary activities, and segmental reporting.

The Bank remains positive about the industry growth in the coming years given stability of the macro economy. The board of directors is committed to ensuring that National Bank becomes part of this expected growth now that the macro-economic indicators of interest rates, inflation and exchange rates are stable and positive. The board, working

with the new managing director and the management of the Bank, is implementing transformation programmes which aims at revitalizing the institution and propel it to higher level in the coming years. Refreshing the National Bank brand is also part of this transformation.

The National Bank of Kenya leverages the significant investment in upgrading the technology platform to generate efficiencies and better service delivery. The new ICT systems installed are modern and will grow the Bank's business and improve service delivery to the customers. NBK has invested in new talent, product innovation, and diversified the revenue streams of the Bank from the traditional Retail Banking on which the bank mainly relied to now include Corporate, SME and Treasury segments. The bank has introduced new business segments and enhanced others, including Insurance, Custody, Cards, and Islamic Banking.

NBK has established a new operating structure that is more business focused by introducing Retail and Business Division, Corporate and Institutional Banking Division, Treasury Department and Islamic Banking Department in addition to rationalizing the existing support divisions. Besides, customer service improvement initiatives are a key pillar of the competitive strategy at NBK and it has implemented a number of these including setting up a 24/7 customer contact center, revamping value propositions, product innovations and developing a customer centric sales and service model.

Internally NBK has strengthened risk management capabilities (Credit risk, Operational risk and Market risk) and has introduced a performance management program across the whole business. NBK has also implemented a number of cost reduction and cost control measures that makes the Bank deliver cost effective efficient service. NBK is confident these initiatives and changes will have positive impact and help the bank achieve the planned business growth which in turn will help realize the goal of transforming National Bank of Kenya into a leading bank in the coming years.

5.3 Recommendations

The study recommends that banks should have a comprehensive strategic plan that clearly stipulate how the bank intend to gain competitive advantage and enhance performance through areas such as strategic transformation, corporate governance, business growth and development, information communication technology, corporate social responsibility, risk management, market segmentation and product diversification, among others.

The study recommends that banks should analyze their target market, identify their competition and learn from your competition and your customers. Banks should use competitors as a learning tool and assess their business model. Banks should learn competitors' strengths and weaknesses then imitate their strengths, and use their weaknesses to the advantage of the bank. The business information learnt from competitors will help the bank develop the competitive edge it need to surpass them in the industry.

The study recommends that banks should gain in-depth insights about their customer portfolio. The knowledge on customer will allow the bank to maximize revenue potential, increase customer retention, and boost prospective customers. The bank can use a mix of many tools and methods to measure consumer insight and both its position in the market and the positions of the competitors. Bank should consider human resource management as a mean to gaining competitive advantage.

The human resource department should recruit the best employees, design appropriate and effective training programs and institute successful retention programs. The human resource managers should be given leadership positions by allowing the human resource department to play a role in determining appropriate recruitment pay and tactics, let you know how much it takes to recruit top talent, and how company policies can be amended to recruit the best. The study recommends that banks should continuously maintain the competitive advantage they have gained by predicting future trends in the banking industry, constantly researching and monitoring competitors, and adapting to customer's wants and needs.

5.4 Recommendations for Further Research

The study recommends further research on key success factors and barriers to competitive advantage in Kenya banking industry. The further research will complement the findings of this study by providing information on challenges faced by bank in their efforts to gain competitive advantage and solutions to the identified challenges. The further study will also provide key success factors which banks should consider when benchmarking for means to enhance competitive advantage.

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APPENDICES

APPENDIX I: LETTER OF INTRODUCTION


UNIVERSITY OF NAIROBI
SCHOOL OF BUSINESS
MBA PROGRAMME

Telephone: 020-2259167
Telegrams: "Varsity", Nairobi
Telex: 22005 Varsity

P.O. Box 30197
Nairobi, Kenya

DATE 23/8/2013

TO WHOM IT MAY CONCERN


The bearer of this letter BENJAMIN WAMBUA MUTUA
Registration No. D61/72439/2011


is a bona fide continuing student in the Master of Business Administration (MBA) degree program in this University.

He/she is required to submit as part of his/her coursework assessment a research project report on a management problem. We would like the students to do their projects on real problems affecting firms in Kenya. We would, therefore, appreciate your assistance to enable him/her collect data in your organization.

The results of the report will be used solely for academic purposes and a copy of the same will be availed to the interviewed organizations on request.

Thank you.


PATRICK NYABUTO
MBA ADMINISTRATOR
SCHOOL OF BUSINESS


UNIVERSITY OF NAIROBI
SCHOOL OF BUSINESS
23 AUG 2013
P.O. Box 30197 - 00100, NAIROBI

APPENDIX II: INTERVIEW GUIDE

**RE: INTERVIEW QUESTIONS ON COMPETITION STRATEGIES ADOPTED
BY NATIONAL BANK OF KENYA TO COPE WITH ENVIRONMENTAL
CHANGES**

TO: SELECTED DIVISIONAL HEADS OF NATIONAL BANK OF KENYA LTD

FROM: BENJAMIN WAMBUA MUTUA

C/O SCHOOL OF BUSINESS UNIVERSITY OF NAIROBI

INTERVIEW QUESTIONS

A. COMPANY DATA

1. Interviewee's position in the bank?
2. How long have you worked with the bank?
3. What is the size of the company?
4. Has the company structure changed in the last two years, if yes, what major changes have taken place?

B. ENVIRONMENTAL CHANGES

5. In your opinion who are NBK main competitors?
6. What is the company view on these competitors?
7. In your own opinion, is the competitive environment becoming tougher or weaker?
8. Please give reasons for the above answer.
9. How aggressive is company's response to;

- a) Competition
 - b) Technological changes
 - c) Economic changes
 - d) Political changes
10. How has these responses affected day to day running of the company?

C. COMPETITIVE STRATEGIES TO CHANGING ENVIRONMENT

11. Who are the main people tasked with development of strategies in the company?
12. What strategies has the company developed in response to competition if any?
13. How aggressive are strategies if any?
14. In your opinion, are the response strategies to competition working?
15. Do you think the amount of resources the bankers devoted to strategic responses is adequate?
16. Is the company considering change of strategy and if yes, why?