

**DIVERSIFICATION STRATEGY AND THE
PERFORMANCE OF KENOLKOBIL LIMITED IN
KENYA**

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DECLARATION

This research project is my original work and has not been submitted for examination in any other university.

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Date.....

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This research project has been submitted for examination with my approval as university supervisor.

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DEDICATION

This research project is dedicated to God, to my wife and daughter Karen Karanja.

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ABBREVIATIONS

KK	KenolKobil
LPG	Liquified Petroleum Gas
MNC	Multinational Corporation
PESTEL	Political, Economic, Social, Technological, Environmental and Legal Framework
OTS	Open Tender System

ABSTRACT

Organizations in the course of their business face numerous and diverse challenges. In order to survive in the turbulent and uncertain world of business, the management of these organizations craft appropriate strategies. One such strategy crafted at the corporate level is diversification strategy. Organizations adopt diversification strategy for several reasons. Some include increasing their profits to supplement their income and to take advantage of emerging opportunities in other markets and regions. Diversification takes on three forms: related diversification, unrelated diversification and multinational diversification. When diversification is implemented, it affects the performance of an organization. As to whether its influence is positive or negative is a matter that management must investigate as time progresses. This is important since it forms the basis of identifying whether it is worth to continue with the diversification strategy or divest from some businesses. A measure of the performance of an organization can be in form of profits and return on equity. The purpose of this study was to determine the diversification strategy adopted by KenolKobil Ltd and the influence of this diversification strategy on the performance of KenolKobil in Kenya. KenolKobil being a Kenyan indigenous oil company has in the recent past faced several challenges due to changes in the oil industry. Such changes include the liberalization of the oil industry in 1994, increased competition from other oil companies, unfair business practices, reduced margins and exit of major oil companies from the African markets hence leaving a supply gap in those markets. Therefore it became important for the management of KK to diversify. In as much as KK has diversified into different products, business lines and different markets, it is important to investigate whether this strategy has had an influence on its performance. This research was done using a case study design and the object of the case study was KenolKobil Ltd. A case study was chosen because it offered the opportunity to do an in-depth analysis of KK. It offered an opportunity to establish the diversification strategy adopted by KK and what influence it had on its performance in Kenya. Data was collected from both primary and secondary sources. The primary source was an interview with senior management of KK and secondary source was obtained from published information on KK. The data was analyzed using content analysis and discussed to determine the diversification strategy adopted by KK and its performance. The findings were summarized and presented in this research project. It has been established that KK has adopted related, unrelated and multinational diversification strategies. The study also established that this diversification has increased the sales, net profits and shareholder equity of KK. Some of the recommendations for further research proposed were that it is important to establish reason for the decline in return on equity. In the course of conducting the research, limitations encountered were inability to access some financial information since the respondents considered it very confidential. In addition, some of the respondents did not provide some information on time due to their busy schedules.

CHAPTER ONE: INTRODUCTION

1.1 Background of the study

The business environment is highly characterized by a dynamic environment full of rapid changes and uncertainty (Ansoff, 1957). Today's firms are faced by environmental forces such as intense local and global competition, economic liberalizations, expanding markets, globalization, political and social changes. In order to understand the macro-environmental factors that affect organizational performance, the PESTEL framework provided by Johnson, Scholes and Whittington (2008) can be adopted to explain these actors. This framework categorizes environmental actors into political, economic, social, technological, environmental and legal. In considering political influences, factors such as government stability, taxation, regulations and social welfare policies have an effect on an organization's operations. Economic factors under play are various business cycles, economic growth rates, inflation rates, interest rates, level of money supply in the economy, level of disposable income, and level of employment. Social factors in play are demographics, lifestyle, education levels, lifestyle changes, consumerism and income distribution. Technological factors that affect organizations are level of spending on research, new technological discoveries, speed of technology transfer and rates of obsolescence. On environment, environment protection laws, energy consumption and waste disposal regulations can affect an organizations performance. Finally the legal factors that affect organizations are competition laws, employment laws, health, safety and product safety.

All these affect a firm's operations and in particular its profitability. It is therefore important for organizations to be able to adopt the appropriate strategies to survive in

such turbulent times. The context of this study is KenolKobil Ltd which is a Kenyan indigenous oil company. The company has been confronted by various environmental actors mentioned above. The main one has been the liberalization of the oil industry in Kenya that resulted in the entry of other players hence increased competition. Secondly, the Kenyan government introduced price control of petroleum products resulting in diminished profit margins. Thirdly, the economy of Kenya and other East African countries have been growing tremendously and this coupled with the exit of multinational oil majors such as ExxonMobil, Agip and Chevron has presented KenolKobil with opportunities for expansion and growth. To take advantage of these opportunities, the firm has adopted diversification as a corporate strategy.

1.1.1 Concept of Strategy

Managers in different organizations face three important realities of trying to identify their present situation, identifying where they want to go and how to get there. The action plans that define “how to get there” make up an organization’s strategy. Several writers have defined strategy. Johnson et al., (2008) define strategy as “the direction and scope of an organization over the long term, which achieves advantage in a changing environment through its configuration of resources and competencies with the aim of fulfilling stakeholder expectations” (p. 9). Thompson, Peteraf, Gamble and Strickland (2012) define a company’s strategy as “management’s action plan for competing successfully and operating profitably, based on an integrated array of considered choices” (p. 52).

Strategies exist at different levels. According to Johnson et al. (2008), strategy exists at the corporate level, business level and operational level. The corporate level

strategy is concerned with setting the vision and mission of the organization. This strategy is set by top management of an organization. They determine which businesses a firm should be involved in. The business level strategy exists at the strategic business unit level. These are decisions made by the business level managers and they determine how the firm will compete in the selected markets for that business unit. They convert objectives set out at the corporate level into objectives and strategies for the individual business units. The operational level strategies exist at the functional areas. These are strategies developed by the functional heads of areas such as finance, production operations, research and marketing. Their main task is to implement and execute the firm's strategic plans. They address issues such as efficiency in their functional areas.

1.1.2 Diversification Strategy

One such corporate level strategy is diversification. Johnson et al (2008) define diversification as a strategy that takes an organization into both new markets and products or services. There are several reasons why organizations adopt diversification. First, diversification brings in efficiency gains. These are made by applying organization's existing resources or capabilities to new markets and products or services. It brings in economies of scope where there are economies to be gained by extending the scope of the organization activities. It brings in synergy which means activities or assets are more effective when used together than apart. Secondly, it stretches corporate parenting capabilities into new markets and products or services. This is realized by applying existing competences in the new areas. This competence can be applied in managing a range of different products and services which do not share resources at the operational unit level. Thirdly, it helps organizations to cross-

subsidize one business from the surpluses earned by another in a way that competitors may not be able to and this gives the organization a competitive advantage for the subsidized business.

There are three forms of diversification strategies: related diversification, unrelated diversification and diversification into new markets. According to Thompson et al (2012), related diversification involves building a firm around businesses whose value chains possess valuable strategic fits and those fits present the businesses the opportunities to perform better than if they were operating as standalone entities. These fits are in the area of sales and marketing activities, management and administrative support activities and economies of scope. Therefore related diversification enables organizations to transfer skills and capabilities from one business to another, share facilities and resources to reduce costs, use of a common brand, and also to combine resources to create new strengths and capabilities. Unrelated diversification is the development of products or services beyond the current capabilities or value network. The goal of unrelated diversification is primarily to acquire businesses that meet the corporate parent's targets of profitability and return on investment. Managers pursuing this strategy emphasize on the business prospects of good performance. Other factors considered in this strategy are whether the business has an attractive growth potential. International (multinational) diversification is whereby an organization diversifies into national markets or markets in different countries. The operating scope ranges from one country to several countries and eventually globalization. International diversification offers a firm the opportunity to acquire additional businesses and also to extend operations of existing businesses into new markets in new countries.

1.1.3 Diversification and Performance

The management of an organization must choose a winning strategy whether at the business or corporate level. Thompson et al (2007) argue that a winning strategy must improve the firm's performance and it does this in two ways.

First is the gain in profits and financial strength and secondly is the gain in the firm's competitive strength and overall market position. McGuigan, Kretlow and Moyer (2009) state that the objective of a firm is to maximize the value of the firm for its owners or in simple terms to maximize shareholder wealth. A good form of return takes the form of periodic dividend payment or proceeds from sale of common stock. Therefore the goal of a firm's management is to maximize its shareholders wealth and adopting diversification as a strategy is one way to achieve this goal.

1.1.4 Oil Industry in Kenya

For many years since Kenya's pre independence days and after independence, Kenya's oil industry has been dominated by multinational oil companies such as Royal Dutch Shell, Total, BP, Esso, Agip, and Exxon Mobil, and Kenyan oil firm Kenya oil co. Ltd (Kenol). These firms with their head offices abroad over the years built up individual infrastructure made up of petrol stations, depots and loading facilities. In 1994, the Kenyan government liberalized the petroleum industry and this enabled a number of smaller firms to enter into the industry. These small players set up their own retail outlets and this led to increased competition. The increased competition led to lower margins as companies lowered their prices in order to safeguard their volumes. Other challenges such as fuel adulteration also emerged. As a result, the multinational oil companies started exiting Kenya's oil market. Agip sold its assets to Shell International, later Shell and BP merged their Kenyan operations,

Esso sold its assets to Mobil and Caltex to Total Kenya. In the recent past Shell international has sold its assets to Vitol and Helios.

1.1.5 KenolKobil Ltd

KenolKobil was set up in May 1959 by Sir Alexander as Kenya Oil Company Ltd (Kenol). It initially started as a small outfit selling domestic Kerosene before venturing into other products. It was listed in the Nairobi Stock Exchange in the same year. It continued to operate as a separate entity until January of 1986 when it signed a joint operations and management agreement with Kobil Petroleum Ltd (Kobil). The agreement meant that, the two firms would have a joint management structure but maintain their individual identity. Kenol principally operated under the Kenol brand while Kobil operated under the Kobil brand. The two firms operated in the Kenyan market and their core business was in the downstream petroleum business. In 2007, Kenol acquired 100% shareholding in Kobil and hence Kobil became a subsidiary of Kenol. Consequently the firm changed its name to KenolKobil (KK) Ltd. The company operates 147 stations across the country. The firm sells a wide range of products which include fuels, lubricants, liquified petroleum gas(LPG) and has also diversified into real estate by building restaurants, office blocks and shops at its petrol stations. KK is an active player in the retail, energy, agricultural, mining, transport and manufacturing sectors of the economy. In addition, the company operates subsidiaries in Uganda, Tanzania, Rwanda, Burundi, Zambia, Ethiopia, Mozambique, Zimbabwe and Democratic Republic of Congo.

KenolKobil has adopted the three categories of diversification strategies: Related diversification, unrelated diversification and international diversification. As

explained earlier, Kenol started by selling Kerosene but with time acquired stations and started selling other products such as petrol and diesel at its stations. In 1996 it signed an exclusive agreement with Castrol International one of the leading lubricants manufacturer and marketer in the world to market and distribute the Castrol brand of lubricants in Kenya, Uganda and Tanzania. In 2003, KK launched its own two brands of lubricants; Kenol and Kobil (which is marketed in its subsidiaries only). The main reason was to diversify on its range of products. In order to shore up its income, KK launched its brand of LPG called K-gas in 2004. The firm has continued to extend its product portfolio and in 2011, it rolled its fuel card called K-card which enables motorist to fuel at its petrol stations without paying cash.

In order to increase its income streams KK has continued to diversify its product portfolio. It decided to venture in non fuel related products that included selling mobile phones lines and airtime, bottled water, car batteries and tires. It signed a distributorship agreement with Safaricom, Airtel (originally Kencell) and Telkom Kenya to sell mobile phones lines and airtime at a commission. It also signed a distributorship agreement with Aquamist to sell bottled water and with Sameer Africa to sell tires and tubes. All these products are distributed through KK's extensive retail station network. Overtime, KK decided to build restaurants, shops, banking halls and Automatic Teller Machines (ATM) points at its retail stations which it rented out to various clients. All these different income streams have continued to improve KK's bottom line.

With the continued exit of multinationals in parts of Africa, KenolKobil saw an opportunity to fill the gap in the petroleum industry left by these MNC's. The management decided to set up operations in the countries that these MNC's were

exiting. In 2000 the company set up its first subsidiary Kobil Tanzania. The company has continued to set up subsidiaries in the countries around the eastern and southern Africa and currently operates in 9 African countries that include Uganda, Tanzania, Rwanda, Burundi, Zambia, Ethiopia, Mozambique, Zimbabwe and Democratic Republic of Congo. This multinational diversification has made the firm increase its retail stations from initially 85 to the current 276 stations in the last 12 years.

1.2 Research Problem

As a consequence of the environmental pressures affecting organizations, and the need for these organizations to achieve their objectives, it has become important for them to craft appropriate strategies to survive. Some have adopted diversification as a strategy to survive in this turbulent business environment. While firms have diversified, the biggest question is whether their performance has improved in terms of growth in revenues and return to shareholders. It is therefore important to determine if there is any tangible benefit to be derived from diversification.

Several environmental changes have affected the oil industry in Kenya and as a result this has forced the players to respond to these changes. Some of these changes are increased competition due to increased number of competitors which has led to reduced profit margins in this industry. Unfair competition whereby some players sold adulterated fuel. Increased opportunities in Kenya and the East African region due to the exit of MNC's such as Agip, Esso, BP, Mobil and Caltex. Another reason is to increase high returns for the shareholders of these organizations and to spread risk across a range of businesses.

KenolKobil decided to respond to the above environmental changes by adopting diversification as a strategy. This study focused on KK as its context and the purpose was to identify how it has implemented this strategy and whether it has achieved the results intended. Several studies have been conducted on KenolKobil and various strategies adopted by it. Musyoka (2011) studied the competitive strategies adopted by KenolKobil in developing sustainable competitive advantage. He observed that KenolKobil has managed to develop sustainable competitive advantage by adopting focus differentiation strategy. Njoroge (2006) did a study on how KK has derived competitive advantage through diversification in the African market. Oganga (2006) studied how KK has responded to changes in the environment. While all these studies have in one way or another focused on strategies adopted by KK, none had really focused on the influence of diversification strategy on its performance in detail, especially in regards to financial performance and return to shareholders. What is the influence of diversification strategy on the performance of KenolKobil Ltd in Kenya?

1.3 Research Objective

This study had two objectives.

- i). To establish the diversification strategy adopted by KenolKobil Ltd.
- ii). To determine the influence of this diversification strategy on the performance of KenolKobil in Kenya.

1.4 Value of the study

This study will be useful to several stakeholders and for academic purposes. To the shareholders and management of KK it will help to shed more light on whether diversification has improved its financial performance and return to shareholders. It

will also help management to understand whether their strategies have worked and act as a basis for improving their strategies if need be. To the policy makers in the government, it will enable them adopt workable policies and strategies that will enhance shareholder value. It will also enable them develop policies that will encourage diversification by business organizations which in the process will add value to their customers.

To the oil industry, this study will be important in helping the various stakeholders in this industry to interrogate their strategies especially diversification to establish whether they are getting any value out of it. It will also enable them to understand the extent of this value. This study will also act as a basis for further research especially in determining the relationship between diversification and organizational performance especially financial performance. This will particularly be important for business strategy formulators today whereby many Kenyan firms are adopting diversification to improve their performance and spread their risks.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter discusses various literatures available on definition of diversification, various forms of diversifications, why firms diversify and the relationship between diversification and performance.

2.2 Concept of Strategy

Managers in different organizations face three important realities of trying to identify their present situation, identifying where they want to go and how to get there. The action plans that define “how to get there” make up an organizations strategy. Several writers have defined strategy. Johnson et al., (2008) define strategy as “the direction and scope of an organization over the long term, which achieves advantage in a changing environment through its configuration of resources and competencies with the aim of fulfilling stakeholder expectations.” (p. 9). Thompson, et al., (2012) define a company’s strategy as “the management’s action plan for competing successfully and operating profitably, based on an integrated array of considered choices”. (p. 52). Several characteristics of strategy arise. First, strategy tends to be complex in nature. This is because organizations today are faced by complexities from different issues such as rapid technological change, intense competition among others. Secondly, strategy is made in situations of uncertainty since it is difficult to predict the future with accuracy. Thirdly, strategy affects operational decisions since it involves aligning the organization towards one direction. From above, strategic management consists of the decisions and actions that lead to the formulation and implementation of plans for the sole purpose of achieving a company’s objectives (Pearce & Robinson, 1997).

Strategies exist at different levels. According to Johnson et al. (2008), strategy exists at the corporate, business level and operational level. The corporate level strategy is concerned with setting the vision and mission of the organization. This strategy is set by top management of an organization. They determine which businesses a firm should be involved in or not. The business level strategy exists at the strategic business unit level. These are decisions made by the business level managers and they determine how the firm will compete in the selected markets for that business unit. They convert objectives set out at the corporate level into objectives and strategies for the individual business units. The operational level strategies exist at the functional areas. These are strategies developed by the functional heads of areas such as finance, production operations, research and marketing. Their main task is to implement and execute the firm's strategic plans. They address issues such as efficiency in their functional areas.

2.3 Concept of Diversification

Johnson et al (2008) define diversification as a strategy that takes an organization into both new markets and products or services. Diversification is a corporate-level strategy. It is developed by the top executives of an organization with an objective of improving the overall performance of the organization across its all businesses. Thompson, et al (2012) state that this task of creating a diversified strategy involves four facets which include first, selecting the new industries to enter into and selecting the mode to use to enter this industry. The executives must decide on which industries or markets offer attractive opportunities to enter into. They must select the best entry mode; whether starting a new business, acquiring an already existing firm, forming a

joint venture or strategic alliance. Second, pursuing opportunities that leverage cross business value chain relationships that utilize resources that have strategic fits and consequently deriving benefits such as cost reduction leveraging on existing brands to spin new products and services. Third, establishing the investments that need to be prioritized and allocating resources to the most attractive business units. The top management of a firm must critically evaluate each business unit and decide where to allocate more money and even where to divest. Fourth, initiating actions and strategies that boost the performance of the combined businesses. All the business units must contribute positively to the performance of the total organization and those that do not must be divested.

2.3.1 Reasons for Diversification

There are several reasons why organizations adopt diversification. First, organizations diversify in response to environmental changes. Examples of such changes are when an organization is in a mature or declining industry characterized by diminishing profitability and intense competition. Another change could be the organization's product being unattractive due to shifting buyer preferences or emergence of alternative technologies. Secondly, when firms identify opportunities where they can expand into industries or markets whose products complement its present offerings. Third, when diversifying offers the firm an opportunity to reduce costs through sharing or transferring resources and capabilities. Fourth, when it has a powerful and well-known brand that can be used to spin other products or business that will drive up the sales and profitability of an organization. Other reasons firms diversify are to spread risk across a range of businesses and also due to pressure from powerful stakeholders such as shareholders and the top management.

Some potential benefits to be derived from diversification are, first, diversification brings in efficiency gains. These are made by applying organization's existing resources or capabilities to new markets and products or services. It brings in economies of scope where there are economies to be gained by extending the scope of the organization activities. It brings in synergy which means activities or assets are more effective when used together than apart. Secondly, it stretches corporate parenting capabilities into new markets and products or services. This is realized by applying existing competences in the new areas. This competence can be applied in managing a range of different products and services which do not share resources at the operational unit level. Thirdly, it helps organizations to cross- subsidize one business from the surpluses earned by another in a way that competitors may not be able to and this gives the organization a competitive advantage for the subsidized business. (Thompson et al., 2012).

2.3.2 Forms of Diversification Strategies

There are three forms of diversification strategies: related diversification, unrelated diversification and diversification into new markets. According to Thompson et al, related diversification involves building a firm around businesses whose value chains possess' valuable strategic fits. These strategic fits present the businesses the opportunities to perform better than if they were operating as standalone entities. The necessary strategic fits are in the area of supply chain activities, research and development, sales and marketing activities, management and administrative support activities and economies of scope. Therefore related diversification enables organizations to transfer skills and capabilities from one business to another, share

facilities and resources to reduce costs, use of a common brand, and also to combine resources to create new strengths and capabilities. Thompson et al (2012) state that related diversification is an attractive strategy to many firms because it offers them an opportunity to convert strategic fits into a competitive advantage over competitors.

Related diversification can take several forms. The first one is vertical integration which can either be backward or forward integration. In backward integration, a firm develops into activities related to inputs that are required by the firm's business. For example raw material production and supply in a manufacturing entity. Forward integration is when a firm develops into activities related to its outputs such as distribution, repairs, and servicing. Horizontal integration is whereby a firm develops into activities that complement its present activities such as dealing with its by-products and selling complementary products.

Unrelated diversification is the development of products or services beyond the current capabilities or value network. The goal of unrelated diversification is primarily to acquire businesses that meet the corporate parent's targets of profitability and return on investment. Managers pursuing this strategy emphasize on the business prospects of good performance. Other factors considered in this strategy are whether the business has an attractive growth potential. The success of this strategy depends a lot on whether the firm has strong corporate parenting abilities. This means that the firm must have a strong ability to guide, nurture and provide management to its diverse businesses. It also depends on the corporate parent's ability to allocate financial resources to the deserving businesses. This is particularly so when some businesses are cash cows and the surplus can be channeled to other businesses that deserve capital injection.

International (multinational) diversification is whereby an organization diversifies into national markets or markets in different countries. The operating scope ranges from one country to several countries and eventually globalization. International diversification offers a firm the opportunity to acquire additional businesses and also to extend operations of existing businesses into new markets in new countries. Some economic benefits of international diversification include enabling a firm to reap economies of scale by having a large market size for its products. It also enables a firm to stabilize its earnings across markets whereby a drop in earnings in one region is offset by increased earnings in another region. (Johnson et al., 2008)

2.3.3 Diversification and Performance

The management of an organization must choose a winning strategy whether at the business or corporate level. Thompson et al., (2012) argue that the ultimate justification for diversification is building shareholder value. They state that “Creating added value for shareholders via diversification requires building a multibusiness company where the whole is greater than the sum of its parts-an outcome known as **synergy**.” (p. 296). Diversification must produce a $1+1=3$ effect where the business units of a diversified firm must perform better when combined rather than produce a performance that is a sum of their performance when operating as independent units. Thompson et al., (2008) argue that a winning strategy must improve the firm’s performance and it does this in two ways (i) gain in profits and financial strength and (ii) gain in the firm’s competitive strength and overall market position.

McGuigan et al., (2009) further state that the objective of a firm is to maximize the value of the firm for its owners or in simple terms – to maximize shareholder wealth. They further say that a firm's management should seek to maximize the present value of expected future returns to the shareholders. A good form of return takes the form of periodic dividend payment or proceeds from sale of common stock. A firm's owner's wealth is represented by market price of a firm's common stock. While one of the objectives of diversification is to maximize profits, but there are disadvantages to this goal being the primary goal of the firm. First, with increased profits, there is increased risk. Secondly, timing is important in profits since at different periods profits would be different if measured using earnings per share.

Block, Hirt and Danielsen., (2009) state that while profits are important, the most important thing is how to use the profits. They state further that the ultimate measure of performance of a firm is how its profits are valued by investors. Therefore the goal of a firm's management is to maximize its shareholders wealth. This is achieved by obtaining the highest possible value for the firm. Brigham and Ehrhardt (2005) argue that it is just not enough to win market share and show profit, but the profit must be high enough to adequately compensate investors. Several studies have been conducted to determine whether diversification has indeed led to improved performance of diversified organizations. Johnson et al., (2008) state that a generalized finding is that the diversification-performance relationship follows an inverted U-shape. Therefore, diversification is important but to a certain level only. With regards to international diversification and performance, diverse businesses in diverse location lead to high levels of complexity beyond which costs exceed the benefits derived from diversification. Secondly cultural diversity in the different markets present some

challenges of deriving benefits of diversification. Some markets remain tightly regulated and restricted and hence full benefits of diversification are not derived. Mwindi (2003) in his study concluded that unrelated diversification by oil companies tended to improve customer satisfaction than improving financial performance. Njoroge (2006) studied building competitive advantage through diversification. He studied how KenolKobil has built competitive advantage through diversification with a concentration on geographic diversification.

In measuring the financial performance of a firm various financial ratios are used. These are profitability ratios, liquidity, debt, and asset ratios. The value of a firm is determined using profitability ratios. (Brigham and Houston, 2004) The profitability ratios measure the ability of a firm to earn adequate return on sales, return on equity and return on invested capital. The most important of these ratios is return on equity (ROE). This is because investors put their money in an investment so that they get a return and this ratio helps to determine how they are doing in this sense. Another important group of ratios is the market value ratios. These ratios primarily relate a firm's stock price to its earnings, cash flow and book value per share. They provide an indication of what stockholders and other investors view a firm's past performance and future prospects. In evaluating the performance of a firm it is also important to conduct trend analysis of a firm's ratios. In trend analysis, ratios are plotted over a period of time. Profitability ratios indicate how liquidity, management of assets and debt all combined affect the bottom line. The ratios to be considered under this project are the Profit Margin and Return on Common Equity, (ROE). This ROE ratio is important because it measures the return investors get from putting their money in a certain firm.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

The purpose of this section is to explain how the research was done. It gives the research design that was adopted, the data sources and how the data was collected. It will also give an overview of how the data was analyzed.

3.2 Research Design

The research design for this project was a case study. The research object in this case study was KenolKobil Ltd and its focus was to understand how this firm has adopted the diversification strategy as its corporate strategy and what influence this strategy has had its performance. The case study examined in detail the various forms of diversification adopted by KenolKobil and their execution.

Research design is defined as a master plan that specifies the methods and procedures that will be used for collecting and analyzing the needed information during research. A case study is an exploratory research technique that deeply researches one or a few situations similar to the researcher's problem situation. A case study has two advantages. First it enables an entire organization to be investigated in depth which requires attention to detail. Secondly, it enables a researcher to fully concentrate on events and study their relationships among functions and individuals. Case studies are important since they place more emphasis on full contextual analysis of a few events and their relationships.

3.3 Data Collection

The data collection instrument was an interview guide with structured questions so as to ensure uniformity and consistency in the data collected. The respondents were the Chief Executive Officer (CEO), Finance Director, Mergers and Acquisition Manager and Exports Manager. These are senior managers of KenolKobil who are involved in strategy formulation, planning and implementation at the firm.

For the purpose of this case study, the type of data that was required to be collected was diversification strategy KK has adopted and the financial reports of KenolKobil for the period year 2004 to year 2011. This data formed the basis of establishing the relationship between the diversification strategy and KK's performance.

This project adopted both primary and secondary sources of data. The primary sources were mainly through the interviews. Additional data was gathered from analysis of information collected from secondary sources which included published KenolKobil's annual reports; industry data obtained from Petroleum Institute of East Africa (PIEA) publications, Ministry of Energy data, and published information from various websites. Data collection was preceded by first contacting the respondents to gain their corporation and explain the purpose of this study. This was done through a formal letter of request. At this stage also the financial reports were also formally requested while others were retrieved from KK's internet website.

3.4 Data Analysis

Data analysis was done through content analysis of the information obtained from both primary and secondary sources. Data analysis is the act of transforming raw data

into a form that is easy to understand and interpret. In a case study, content analysis is a qualitative description of the information obtained during the study. It is normally selected in order to analyze the information obtained in order to explain the influence of factors in a given phenomenon.

Responses obtained from the interview process were listed to arrive at the main strategy adopted by KK. Then financial results for each year were tabulated per year. From this data, the analysis was done in form of financial ratios over a period of time. The ratios that were done were the Profit ratios and Return on Common Equity, (ROE). From these ratios, a trend was established over the selected period of time. Interpretation of the results was then conducted. Interpretation is the step of making inferences and from these inferences, drawing conclusions in regards to the meaning and implications of the research process. Interpretation of the data analyzed will be done by making a comparison between diversification and performance to arrive at an appropriate result.

CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This section details the findings of this research project and is guided by the research design of this project. The senior management including the Chief Executive Officer (CEO), Finance Director, Mergers and Acquisition Manager and Exports Manager were interviewed to obtain the information required. Additional information was obtained from primary and secondary sources of information.

4.2 Diversification strategy adopted by KenolKobil Limited

Kenol was set up in May 1959 by Sir Alexander as Kenya Oil Company Ltd (Kenol). It was listed in the Nairobi Stock Exchange in the same year. It initially started as a small outfit selling domestic Kerosene branded SAFI kerosene before venturing into other products. Its main focus then was to sell bulk petroleum products to agricultural firms and industries. Later the firm opened two service stations one in Nairobi and another one in Mombasa. Over the years, the firm continued expanding by opening more stations and depots mainly in Nairobi and Central Kenya. It later expanded into new business lines such as export and aviation. It continued to operate as a separate entity until January of 1986 when it signed a joint operations and management agreement with Kobil Petroleum Ltd (Kobil). The agreement meant that, the two firms would have a joint management structure but maintain their individual identity. Kenol principally operated under the Kenol brand while Kobil operated under the Kobil brand. The two firms operated principally in the Kenyan market and their core business was in the downstream petroleum business. In 2007, Kenol acquired 100% shareholding in Kobil and hence Kobil became a fully owned subsidiary of Kenol. Consequently the firm changed its name to KenolKobil (KK) Ltd.

Due to the liberalization of the oil industry in 1994, competition in this industry increased which led to reduced margins. Due to increased competition, the firm decided to adopt diversification as a corporate strategy. The company decided to adopt related, unrelated and multinational diversification strategies.

4.3 Related Diversification

KenolKobil has over the years introduced various products in its portfolio. In 1999, KenolKobil introduced lubricants among its products when it signed a distribution agreement with Castrol International to supply its Castrol range of lubricants. The distribution was to cover automotive, industrial, marine and agricultural products. The agreement also gave KenolKobil the right to distribute products in Kenya, Uganda and Tanzania. KenolKobil continues to distribute the Castrol brand of lubricants to date. In 2000, KenolKobil signed an agreement with Holt Lloyd International (UK) to market and distribute Car Care and Fuel additive products in East Africa. These products were mainly car polish, car interior cleaning products and car air fresheners under the Simoniz brand. These products were to be sold through KK's service stations. It has continued to sell these products. In year 2001, KK introduced its own brand of lubricants into the Kenyan market called Kenol. In addition, it rebranded some of its Kenol brands of lubricants into Kobil brand which it sold in its subsidiaries and some export markets.

KenolKobil decided to introduce its own brand of liquefied petroleum gas (LPG) which it did in 2002 but officially launched it in February 2003. It branded its LPG 'K-gas' which it bottled into 6 kg, 13 kg and 35 kg cylinders. The target market for K-gas was mainly the domestic consumer. KK planned to use its extensive network of retail stations to distribute its brand of LPG. In 2004 it introduced the K-gas brand in

Uganda and in 2005 in Rwanda. Later KK started selling LPG in bulk to commercial customers such as hotels, industries and hospitals. KK also sells LPG accessories which include gas burners, regulators, cooking grills, lanterns, cookers, poles and gas hoses.

In 2002, KK decided to venture into trading activities. This involved buying petroleum products in bulk mainly crude oil, refined petroleum products and LPG from oil producers in the Arab-Gulf region and selling it to other petroleum companies and governments. It therefore set up the African Trading desk based in Nairobi. The focus of this desk was also to develop business in other African countries without refining capabilities and petroleum products. These countries include Kenya, Djibouti, Uganda, Tanzania, Mozambique, Sudan, Ethiopia, Malawi, Mauritius and Zambia. The trading activities have involved tendering and winning tenders to supply crude oil and refined products to Kenyan market under the Open Tender System (OTS). In 2006, the trading desk won 47% of crude tenders and 13% of refined products tender under the OTS. It has also won tenders to supply fuel to Mozambique. In 2010 it set up a trading desk in Harare, Zimbabwe to handle the trading business in southern Africa region.

In 2007 Kenol decided to acquire Kobil Petroleum Ltd. Kobil was an oil company incorporated in USA and its core business was the importation of crude oil, refining, trading, storage of refined products in Kenya. At the time of its acquisition, it was operating 90 retail stations in Kenya which operated under its own brand. Kobil also owned storage facilities around the country and had access to others through hospitality arrangements with other oil companies that had excess storage capacity. While Kenol and Kobil were separate legal entities with separate and distinct brands,

both were managed and operated jointly under an agreement signed in 1986. Under the terms of the 2007 acquisition, Kenol was to acquire 100% issued share capital of Kobil and in exchange, the owners of Kobil were to receive 45,480,000 shares of Kenol. In essence there was no cash exchange and Kobil became a fully owned subsidiary of Kenol. With this acquisition, Kenol's name changed to KenolKobil Ltd. The main reasons for acquiring Kobil was that Kenol would access Kobil's Kenyan assets and businesses hence result in increased profits. Secondly, Kenol would have more negotiating power with its overseas fuel suppliers and thirdly the large asset base would enable Kenol have more negotiating power with its financiers hence allow it to access better financing options.

4.4 Unrelated Diversification

In order to increase its income, KK decided to diversify into Non-fuel business. According to KK, Non-fuel is concerned with the marketing and selling of products and services that are not fuel in nature but can be sold through its service stations. Therefore KK decided to lease space at its service stations to companies that wanted to offer services and products such as fast foods, banking services, ATMs, pharmacies, convenience stores, tyre sellers. Over the years it has rented space for restaurants to franchises such as Kengeles Restaurants, Kula Corner, Friday Corner and Maggies. Currently KK has an agreement with Inscor Kenya Ltd who have set up several fast food restaurants at KK's service stations around Nairobi. These franchise owners pay KK rent on use of the facilities. KK has also offered rental space to banks such as Chase Bank, I&M Bank, Standard Chartered bank, Equity Bank, PesaPoint among others who have set up banking halls and ATM facilities there. It has also entered into an agreement with Sameer Africa the manufacturer of Yana brand of

vehicle tyres to set up tyre centers. At these tyre centers, Sameer sells and fits tyres, does wheel balancing and wheel alignment for customers. It has also recently offered space to Bata Shoe Co. to set up a shoe shop at one of its stations in Nairobi. One other non-fuel business KK has is a partnership with Safaricom Ltd, Airtel Ltd and Telkom Kenya to sell their airtime and SIM cards at a commission at its service stations. This has contributed immensely to KK's income due to the rapid growth of the telecom sector in Kenya. KK continues to develop its facilities in Kenya and in its subsidiaries in order to continue to increase its income from Non-fuel business.

4.5 Multinational Diversification

In 1999, the management of KK decided to diversify geographically by setting up operations in other east African countries. This was informed by the fact that the Eastern African economies were growing rapidly and hence there was increased demand for petroleum products in these countries. Secondly, some MNC's such as Esso, Agip, BP, Chevron, Mobil started pulling out of these countries due to intense competition and this led to a huge supply gap that KK wanted to take advantage of and fill.

The first subsidiary that KK established was Kobil Uganda in 1999. The subsidiary has its head office in Kampala. The firm began with an acquisition of 26 stations and it has grown to 61 stations. This subsidiary sells all the petroleum products, Castrol and Kobil brand of lubricants, K-gas brand of LPG and has various non-fuel facilities. In 2011, KK acquired the assets Phoenix Uganda Petroleum Ltd which consisted of 1,800 m³ fuel terminal, three fuel stations and an office block. The purpose of this acquisition was to increase KK's storage capacity to ensure adequate fuel supply. It

also planned on using this new depot to offer fuel storage to other oil companies at a fee and hence earn additional income.

KK's second subsidiary was Kobil Tanzania established in 2001. The subsidiary began with 11 stations up to the current 21 stations. The head office of this subsidiary is situated at Dar-es-Salaam. It mainly deals with fuels and lubricants. It has few non-fuel facilities. KK plans on setting up a modern LPG filling plant to fill its K-gas brand of LPG for the Tanzanian market. In order to strengthen its operations in Tanzania, KK in 2011 acquired a depot complex in Dar-es-Salaam. The depot acquired under lease terms for 25 years has a capacity of 33 million litres, warehouses, an office complex and a paved yard. This depot is connected to Dar-es-Salaams jetty which enables it to receive fuel directly from ships at the port. This depot will enable Kobil Tanzania serve its local market adequately and also the export markets of Uganda, Burundi, Rwanda, and Congo (Lubumbashi area).

The third subsidiary of KK was Kobil Zambia. It was established in 2002 when KK bought Jovenna Zambia Ltd, a local petroleum company. The company began with 11 stations and it currently has 28 stations. As at 2011, its market share in Zambia was 6%. The company supplies fuels and lubricants to retail and commercial customers. The firm is also working at improving its non-fuel business. Since 2003, Kobil Zambia was sourcing its Kobil brand of lubricants from Mombasa in Kenya. However, in 2008, KK acquired a 15% shareholding in Lubblend, a Zambian lubricants blending facility based in Ndola. This enabled Kobil Zambia to start producing its own lubricants locally and this enhanced its supplies in the country especially to its commercial customers in the mines. It also reduced the cost of the

lubricants since it eliminated the long trucking distance from Mombasa. It also ensured reliable supply of the lubricants. In 2010, KK increased its shareholding in Lubblend by 10.5% to 25.5%. The acquisition was also intended to strengthen its control in the blending plant and also earn some income from it.

The fourth subsidiary KK established was Kobil Petroleum Rwanda. KK started operations in Rwanda in 2003 by focusing sales in the commercial, export and reseller markets there. Later it opened its first retail station in Kigali which it had acquired from CITIEX. To strengthen its operations in Rwanda, KK in 2006 acquired 100% assets of Shell Rwanda SRL as a going concern. This acquisition brought with it 17 retail stations and a 16 million litres storage terminal based in Kigali leased from the Rwandan government. In 2007, KK acquired KLSS Rwanda that had 20 service stations. With this acquisition KK increased the number of retail stations from 18 to 38. In 2008, KK made another acquisition when it acquired six service stations from STIPPAG a Rwandese petroleum company bringing its service station count to 44. This acquisitions further strengthened KK's position in Rwanda pushing its market share to over 35% currently. It also enabled it to consolidate exports to Eastern DRC and Burundi and larger Central Africa region. In 2009 KK commissioned a new LPG filling plant in Kigali to enable it serve the Rwandan, Burundi Eastern DRC and western Tanzania markets with its K-gas brand of LPG. This was a move to widen revenue streams for the group and also take advantage of the growing use of LPG in these markets.

In 2005, KK established its Ethiopian subsidiary by acquiring a service station in Semera, along the Addis Ababa Djibouti route. This station was principally focused on marketing lubricants in the Ethiopian market. In 2007 KK made a major

investment in this market when it acquired 81 service stations and two terminals from Shell Ethiopia Ltd. The acquired assets also included an office block, a plot of land, a major restaurant and warehouses. With this acquisition, KK hoped to consolidate its position in the Ethiopian market and especially the sale of LPG and lubricants. The subsidiary hopes to introduce the K-gas brand of LPG, expand sales of bitumen and petroleum based solvents. KK by setting up Kobil Ethiopia also hoped to use it as a launching pad into the North African market.

KK's sixth subsidiary was Kobil Burundi SA. It was set up in 2009 and in August of the same year, it bought the entire shareholding of Oil Burundi SA which was owned by Engen International Holdings (Mauritius) Ltd. The acquired company was at that time a leading supplier of lubricants and white petroleum products to independent retail stations in Burundi. It also at around the same time acquired three stations from SONITRA, a local petroleum company. In 2010, KK acquired 10 retail stations from a Burundian petroleum company called Societe d'Importation et de Commercialisation de Produits Petroliers (SICOPP). In addition to another acquisition of a station from an independent company, Kobil Burundi's total number of station rose to 14. These acquisitions also pushed Kobil Burundi's position in the market to the number two position. In 2011, KK acquired a depot complex comprising of a fuel terminal, warehouses and office block in Bujumbura Burundi. It also started selling the K-gas brand of LPG supplied through its Rwanda LPG filling plant.

In 2010 KenolKobil decided to venture into Southern Africa region where it registered a company called Kobil Mozambique Limitada in Mozambique. Its intention was to serve the Mozambique market which was showing huge growth potential. It therefore set up an office in Harare, Zimbabwe which was handling the sales in both Mozambique and Zimbabwe. On the plans of setting up operations in

Mozambique, KK intends to use the Mozambique port of Beira to serve the southern African market. While the firm has not opened any retail stations in this region it keeps on looking for investments in those two countries. In March 2011 KK acquired a 4 million litres fuel depot in Lubumbashi Congo DR from World Oil Congo SPRL. This marked the start of fuel business in Congo for KK. The firm intended by acquiring this depot to serve the greater Katanga region of Southern Congo that has huge mining activity. It also intends to use this depot as launch pad for its retail and commercial activity in DRC.

4.6 Influence of diversification strategy on performance of KenolKobil Limited

The diversification strategies adopted by KenolKobil over the years has had several outcomes. First local acquisitions and geographical expansion has led to increased number of stations for KK. As shown in the table below, the number of stations has increased from less than 99 before the first subsidiary was acquired to 398 retail stations as at the end of 2011.

Table 1: KK number of stations per year

	Country	2000	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
1	Kenya	73	82	65	68	69	64	69	160	155	155	158
2	Uganda	26	42	52	52	58	60	61	61	61	61	61
3	Tanzania	-	11	15	15	15	18	18	19	23	25	25
4	Zambia	-	11	14	15	16	20	20	24	28	28	28
5	Rwanda	-	1	1	1	18	38	38	43	46	46	46
6	Ethiopia	-	-	-	-	1	1	50	59	64	64	64
7	Burundi	-	-	-	-	-	-	-	-	4	14	16
8	Mozambique/ Zimbabwe	-	-	-	-	-	-	-	-	-	-	-
9	DRC	-	-	-	-	-	-	-	-	-	-	-
	Total	99	147	147	151	177	201	256	366	381	393	398

Source: KK records

Secondly the market share of KK has continued to increase especially with the acquisition of Kobil Petroleum Ltd in 2007. These acquisitions more than doubled KK's market share in Kenya as indicated in the table below.

Table 2: KK market share per year

Year	Total Inland Market Share(%)
2000	7.48
2001	8.51
2002	9
2003	8.8
2004	9.93
2005	10.36
2006	12.23
2007	10.72
2008	26.12
2009	21.9
2010	18.3
2011	25

Source: KK company reports and Petroleum Institute of East Africa (PIEA)

Thirdly, the sales volume in litres sold by KK has been increasing year on year. The acquisition of the subsidiaries, acquisition of Kobil in 2007 and the setting up of the African Trading desk has contributed greatly to the increase in sales volumes. The subsidiaries have also increased KK's sales volumes and the table below shows the subsidiaries contribution to the group.

Table 3: Subsidiary volume contribution to KK group

Subsidiary	Stations	Volume Contribution to Group
Uganda	60	2%
Tanzania	21	5%
Zambia	25	3%
Rwanda	44	2%
Ethiopia	80	4%
Burundi	19	1%
Zimbabwe	-	Incorporated in Kenya Figures
Mozambique	-	Not Active
Congo DR	-	Not Active

Source: KK company reports

Fourthly, the annual sales, gross profit and sales profit has over the years increased. The diversification into various business lines such as trading, lubricants LPG, non fuel and multinational diversification has ensured that KK has had increased sales and profits. With the acquisition of Kobil in 2008, the sales and profits more than doubled as shown in the table below. Before the acquisition, in 2007, the profits were Kshs. 593.434 million. In 2008 after the acquisition, the profits were Kshs. 1,522.876 million. As at the end of 2011, the subsidiaries and other business lines contribution to profitability before taxation is shown in the table below.

Table 4: Subsidiary percentage contribution to profits

Country	% Contribution to Profits
Kenya	68.17
Subsidiaries	31.83

Source: KK company reports

Table 5: Business line percentage contribution to profits

Product	% Contribution to Profits
Retail	14
Commercial	7
Aviation	17
Export	14
Fuel oil & Bitumen	20
Trading	11
LPG	8
Non-fuel	5
Lubricants	4

Source: KK company reports

Therefore the subsidiaries contribute 31.83 % of the net profits. Taking the net profits of 2011, the subsidiaries hence contributed Kshs. 558.358 million. Therefore the combined contribution of the added business lines due to diversification is 28%.

4.7 Discussion

After many years of operating in Kenya, KK management decided to adopt diversification strategy. The main reasons for KK adopting this diversification were first, to increase revenue streams for the organization. In 1994, the Kenyan government liberalized the petroleum industry and this enabled a number of smaller firms to enter into the industry. These small oil companies (called independents) set up their own retail outlets and this led to increased competition in the downstream petroleum sector. With the increased competition profit margins started to decrease and this trend continued as companies lowered their prices in order to safeguard their volumes. The management of KK had the foresight to see that they needed to look for

alternative businesses to shore up the profits. The increased competition, unfair trade practices and reduced margins in Kenya and other parts of Africa forced the multinational oil companies to start exiting Kenya's oil market. In Kenya, Agip sold its assets to Shell International, later Shell and BP merged their Kenyan operations, Esso sold its assets to Mobil and Caltex to Total Kenya. In the recent past Shell International has sold its assets in Africa (except South Africa) to Vitol and Helios. The same has been happening in other eastern and Southern African countries. For example, BP sold its oil business in countries such as Zambia, Tanzania and Namibia. Shell sold its business in Rwanda and Ethiopia to KK. Caltex sold its business in Uganda and Kenya to the oil giant Total. The exit of these MNC's created a gap in oil products supply and the management of KK saw an opportunity to fill this gap hence its decision to expand into these countries. Thirdly KK saw an opportunity to create more value out of the physical assets that it had acquired over time. These assets in particular were its service stations and hence KK decided to put up non-fuel businesses there. It built restaurants, shops, banking halls and Automatic Teller Machines (ATM) points at its retail stations which it rented out to various clients. It also decided to venture in non fuel related products that included selling mobile phones lines and airtime, bottled water, car batteries and tires. It signed a distributorship agreement with Safaricom, Airtel (originally Kencell) and Telkom Kenya to sell mobile phones lines and airtime at a commission. It also signed a distributorship agreement with Aquamist to sell bottled water and with Sameer Africa to sell tires and tubes. All these products are distributed through KK's extensive retail station network. Income from the non-fuel business supplemented the income it was getting from sale of its core products which were fuel products. Fourthly, KK saw an opportunity of obtaining better prices from its Arab-gulf suppliers of fuel products

due to increased sales volumes. With more retail stations in the region, it would increase the number of litres it sold and hence use the high volumes to bargain higher discounts from its suppliers and consequently reduce its costs and increase its margins. The reduce prices would also enable it offer better prices to its customers and hence increase its competitive advantage. Fifth, it saw an opportunity to utilize the resources it had in form of human resource, operation capabilities and finances in the new markets it was venturing into.

KK has adopted the following three forms of diversification strategies: Related diversification, unrelated diversification and multinational diversification. On related diversification, Kenol started by selling Kerosene but with time acquired stations and started selling other products such as petrol and diesel at its stations. In 1996 it signed an exclusive agreement with Castrol International one of the leading lubricants manufacturer and marketer in the world to market and distribute the Castrol brand of lubricants in Kenya, Uganda and Tanzania. In 2000, KenolKobil signed an agreement with Holt Lloyd International (UK) to market and distribute Car Care and Fuel additive products in East Africa. In 2003, KK launched its own two brands of lubricants; Kenol and Kobil (which is marketed in its subsidiaries only). It introduced its own brand of liquefied petroleum gas (LPG) in 2002 but officially launched in February 2003. It branded its LPG 'K-gas' which it bottled into 6 kg, 13 kg and 35 kg cylinders. In 2002, KK decided to venture into trading activities. This involved buying petroleum products in bulk mainly crude oil, refined petroleum products and LPG from oil producers in the Arab-Gulf region and selling it to other petroleum companies and governments. It therefore set up the African Trading desk based in Nairobi. In 2007 Kenol acquired Kobil Petroleum Ltd. Kobil was an oil company

engaged in the importation of crude oil, refining, trading, storage of refined products in Kenya.

On unrelated diversification, it decided to venture in non fuel related products that included selling mobile phones lines and airtime, bottled water, car batteries and tires. It signed a distributorship agreement with Safaricom, Airtel (originally Kencell) and Telkom Kenya to sell mobile phones lines and airtime at a commission. It also signed a distributorship agreement with Aquamist to sell bottled water and with Sameer Africa to sell tires and tubes. All these products are distributed through KK's extensive retail station network. Overtime, KK decided to build restaurants, shops, banking halls and Automatic Teller Machines (ATM) points at its retail stations which it rented out to various clients.

On multinational diversification, KK set up operations in nine African countries. It started with Uganda in 2000 and the latest country to start operations is in DR Congo. The countries are located around the eastern and southern Africa and include Uganda, Tanzania, Rwanda, Burundi, Zambia, Ethiopia, Mozambique, Zimbabwe and Democratic Republic of Congo. This multinational diversification has made the firm increase its retail stations from initially 73 to the current 398 stations.

KK has adopted the following modes of entry when implementing its diversification strategy. First when setting up operations in the subsidiaries, it has chosen mainly acquisition of existing businesses. For instance when setting up operations in Zambia it started by acquiring an existing oil company called Jovenna Zambia Ltd. When setting up operations in Ethiopia, it started by acquiring the assets of exiting Shell. It also acquired Kobil Petroleum Ltd on a going concern basis. Secondly, KK has

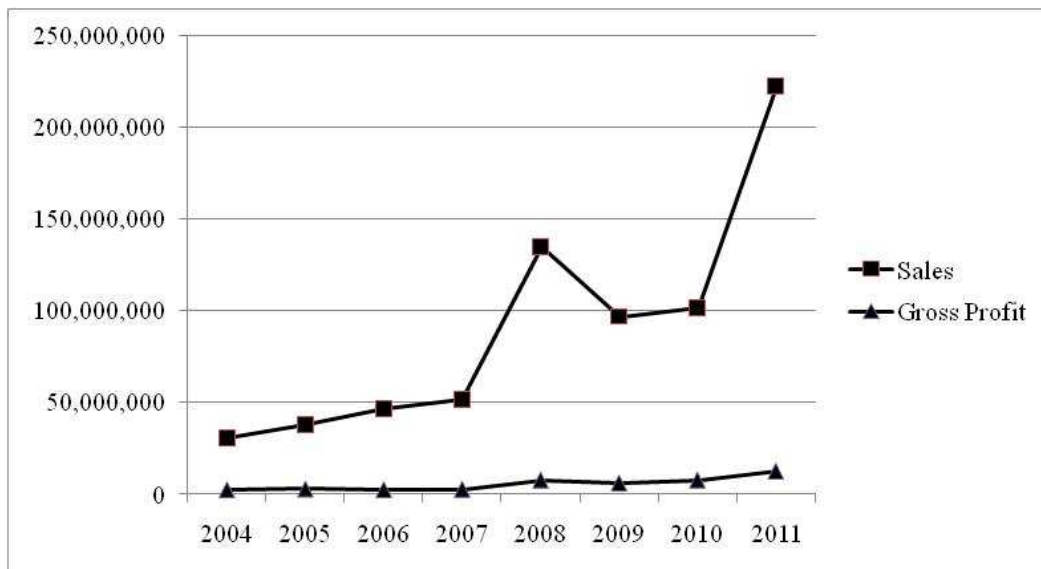
adopted internal development as a strategy for diversification. This is evident when it developed its own brand of LPG; the K-gas brand. It focused on growing the brand by developing this product and putting it into the market. Over the years the K-gas brand has proved to be a popular brand in Kenya. KK also developed its own brand of lubricants called Kenol and another brand called Kobil. The Kenol brand is sold in Kenya while the Kobil brand is sold in its subsidiaries. In addition KK has developed its non-fuel business from scratch using its own internal resources. Thirdly, KK chose franchising as another strategy for diversification. In 1996 it signed an agreement with Castrol International to market its brand of lubricants in Kenya. The terms of the agreement were that KK would manufacture, market Castrol lubricants under licence. It also signed similar agreement with Holts of UK. The main factors management considered when choosing the mode of entry was first whether it had critical resources and capabilities to make the acquisition. KK had the required resources in terms of finances and human resources and this is the reason it decided to develop its brand of LPG and lubricants. It also realized that it required to move with speed in setting up operations in the target countries so that it can take advantage of the emerging opportunities there. This is the reason they chose acquisitions in the target countries since it is a faster way of gaining foothold in those countries.

4.7.1 Influence of diversification on performance

Diversification has affected the performance of KK in the following ways. First, it has increased the sales volumes of KK group. Over the years, as KK has been making acquisitions, the volumes have increased and as at 2011 the total volumes were kkkk litres. Secondly the business it has diversified into has reduced its reliance on Kenya's sales of fuel as a source of profit. The contribution of alternative business lines to KK's profits was 28% as at 2011. Thirdly, diversification has increased both gross

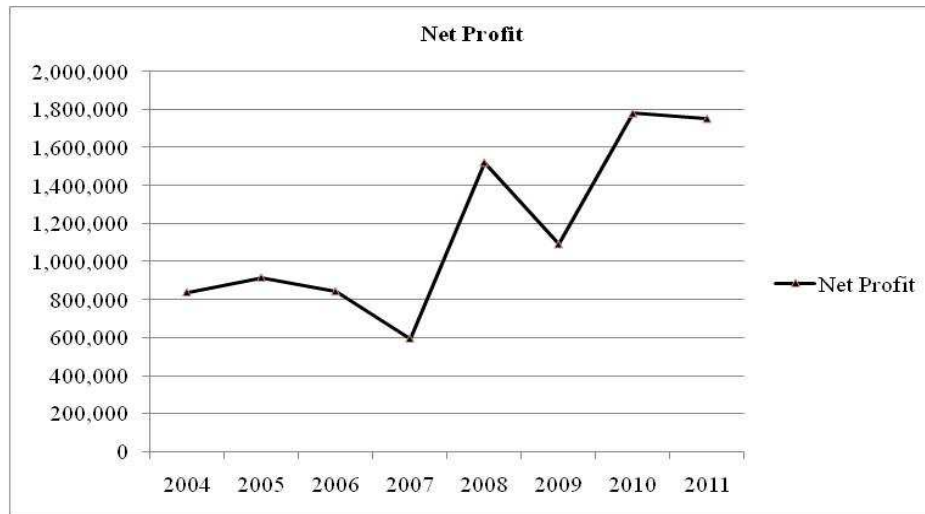
profits and net profits of KK over the years. As shown in the table below, the profits of KK has more than doubled over the years since it started pursuing the diversification strategy. Therefore the shareholders have earned more as the years went by in terms of net profits. We have seen above that 28% of these profits were obtained from alternative business that KK has diversified into. Fourthly, the shareholders wealth has grown threefold over the years. The acquisition of Kobil in 2008 doubled the owner's equity in absolute terms. In addition the owner's wealth has also been growing because KK has been retaining most of the profits it has been generating over the years.

Figure 1: KK Sales and Gross Profit trend



Source: KK company reports

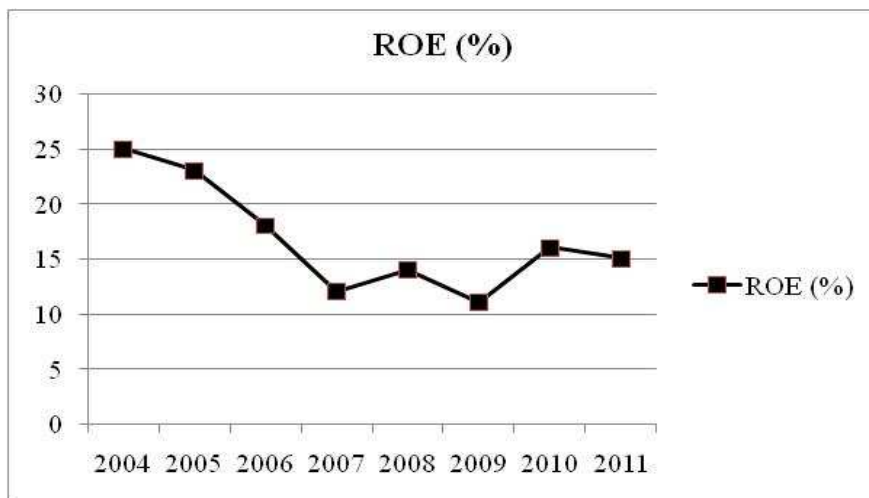
Figure 2: KK Net Profit trend



Source: KK company reports

In regards to the Return on Equity of the owners of KK, this has been reducing over the years. This is because the net profits have not been growing as fast in comparison to the owner's equity in the KK business. In essence it means that for every shilling that the owners of KK have invested there have been earning less and less returns as time has progressed in as much as KK has been diversifying aggressively.

Figure 3: KK Return on Equity (ROE) trend



Source: KK company reports

Table 6: Sales, Profit, Equity and Return on equity (ROE) per year

Year	2004	2005	2006	2007	2008	2009	2010	2011
Sales (Kshs. '000)	30,414,739	37,536,818	46,381,292	51,621,436	134,518,341	96,692,834	101,649,560	222,440,715
Cost of Sales (Kshs. '000)	(28,090,022)	(34,753,886)	(43,919,737)	(48,956,164)	(126,909,694)	(90,654,847)	(94,052,548)	(210,107,493)
Gross Profit	2,324,717	2,782,932	2,461,555	2,665,272	7,608,647	6,037,987	7,597,012	12,333,222
Net Profit (Kshs. '000)	838,484	915,878	842,947	593,434	1,522,876	1,091,162	1,781,613	1,754,189
Owners Equity (Kshs. '000)	3,392,935	4,015,844	4,672,903	4,984,434	10,915,860	9,818,411	11,209,204	11,650,461
Return on Equity(ROE)	25%	23%	18%	12%	14%	11%	16%	15%

Source: KK company reports

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This section gives the summary of the findings of this project. It gives a brief of the diversification strategy adopted by KK and the influence of this strategy on the performance of KK. It also gives the conclusion and recommendations for further research.

5.2 Summary

Kenol was set up in May 1959 by Sir Alexander as Kenya Oil Company Ltd (Kenol). It was listed in the Nairobi Stock Exchange in the same year. It initially started as a small outfit selling domestic Kerosene branded SAFI kerosene before venturing into other products. Later it acquired and set up various service stations around the country.

This study found out that KK has adopted diversification strategy as a corporate strategy. The main reasons for this strategy were to increase the profits of KK in the face of intense competition in the oil industry, to take advantage of the emerging opportunities in Kenya and other Eastern and Southern African countries occasioned by the exit of major oil MNC's and to increase its competitive advantage in the industry by increasing its sales volumes hence have a better bargaining power with its suppliers. KK has adopted the following three forms of diversification strategies; related diversification strategy and this it did by venturing into selling LPG, lubricants, trading business and acquiring an existing oil company to increase its sales volumes. It has adopted unrelated diversification strategy by venturing into non-fuel business whereby it has developed facilities such as restaurants, banking halls, shops which it rents out to other business, and selling non-fuel related products such as mobile phones airtime, tyres, batteries and drinking water. It also adopted

multinational diversification by venturing into other eastern and southern African countries whereby it set up subsidiaries by acquiring existing oil companies and growing the business organically in these countries.

The study also found out that the diversification strategy has influenced the performance of KK by first increasing its sales in terms of volumes and in Kenya shillings, by increasing its net profits and has increased the shareholder value of the company. The study established the addition of other products and business lines and the subsidiaries has increased the profits due to the shareholders of KK. Diversification has increased the wealth of the owners of KK. However, the study has established the Return on Equity of the shareholders of KK has decreased over the years in spite of accelerated diversification.

5.3 Conclusion

KK has grown into a huge regional oil company in the last eleven years driven mainly by corporate diversification strategy. KK has adopted related, unrelated and multinational diversification strategies. This diversification has influenced the performance of KK to the extent that it has increased its sales volumes, net profits and shareholder's equity. However, in regards to Return on Equity of the owners, the diversification has not had positive influence.

5.4 Recommendations

This study recommends that the management and shareholders should investigate further on the reasons as to why the Return on Equity has been decreasing every year. The owners have been investing in the company over the years but the returns have been decreasing. Consequently the management should institute proper corrective

measures to correct the decline and ensure that the shareholders Return on Equity increases.

5.5 Limitations of the study

Some of the information that was required to undertake this study was financial hence the management felt that it was very confidential to make available for this study. Therefore their response to some questions was very poor and this made it impossible to get all the financial information that was required in order to make a more detailed study. Consequently, some general conclusions had to be made in regards to this study. Secondly, the respondents were busy senior managers and due to their schedules it was not possible to obtain some information in good time.

5.6 Recommendation for further research

Based on this research, it is recommended that further research be conducted to determine the reason for the decline in return on equity in as much as the sales and profits have been growing. It is also recommended that a further study be done on other oil companies in Kenya and compare it with the KK study to establish if there is a similar effect on performance.

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Appendix A: Questionnaire

Robinson G. Karanja
University of Nairobi
School of Business
P. O. Box 30197
NAIROBI

The Respondent

Dear Sir/Madam,

RE: REQUEST FOR YOUR SUPPORT IN MY RESEARCH WORK

I am a student in the School of Business, University of Nairobi pursuing a Master of Business Administration (MBA) degree program. In order to fulfill the degree requirements, I am currently undertaking a research project on **‘The influence of diversification strategy on the performance of KenolKobil Limited in Kenya’**.

The purpose of the study is to investigate the diversification strategies adopted by KenolKobil and what influence the strategies have had on its performance

I am therefore requesting that you fill the attached questionnaire as completely as possible. The research project is purely for academic purposes and no confidential information nor names of the respondents will be published in the final project.

Your assistance is greatly appreciated.

Yours faithfully,

Robinson G. Karanja

INTERVIEW GUIDE

1. What is your position at KenolKobil (KK)?
2. For how many years have you worked at KK?
3. What are your main functions at KK?
4. Has KK adopted diversification as a strategy?
5. If yes to question (4), what are the main reasons for KK choosing diversification as a corporate strategy?
6. If No to question (4) above, please give reasons?
7. If yes to the above question, what form of diversification has KK adopted?
8. If KK has chosen new products, what products that it has diversified into?
9. If KK has chosen new markets, what are the markets that it has diversified into?
10. If KK has chosen international markets, what are these international markets?
11. What modes of entry into new business has KK adopted in its diversification strategy?
12. What are the main factors considered when choosing the modes of entry?
13. Who is responsible for crafting diversification strategy at KK?
14. How has been the performance of KK as a result of its diversification strategy?
15. What performance measures do you use to when gauging the outcome of the diversification strategy?
16. Are there instances that KK has divested from a business or market?
17. If yes, what are the reasons?
18. How does KK manage its diversified business?

Thank you very much for your time and cooperation.