DIVERSIFICATION STRATEGY AND PERFORMANCE OF KENYA COMMERCIAL BANK GROUP

BY

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DECLARATION

This research project is my original work and has not been submitted to any other university for award of a degree.

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To the Kenya Commercial Bank staff on availing the information I needed.

DEDICATION

I dedicate this work to the almighty God who has blessed me with life and good health. Also to my loving husband Stephen and my daughters Cynthia, Valerie and Nelly for their moral support, tolerance and encouragement. Also to my loving Mum for her support of my academic pursuits, prayers and encouragement.

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ABSTRACT

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. The purpose of this study was to establish the effect of the diversification strategy on the performance of Kenya Commercial Bank group. Both primary and secondary data were collected by the researcher. Primary data was successfully collected from five senior managers of the bank, whereas secondary data was collected from the audited financial reports of Kenya Commercial Bank group limited. The study took the form of a case study of KCB group. Trend and content analysis were used to establish the effect of diversification on performance. The findings revealed that Kenya Commercial Bank group has adopted three main diversification strategies. The first form of diversification is geographical which involves opening of wholly owned subsidiaries in the region. The other is product diversification where the bank has managed to unveil several products to its customers to meet their needs. The bank also engages in unrelated diversification such provision of insurance services through agency. Diversification has a positive effect on the performance of KCB group. As the income from diversification increases, the total profits of the banks have also registered significant increment. 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 in time due to their busy schedules. Some of the recommendations for further research proposed were that, the bank should explore more ways and forms of diversification in order to enhance its performance. It too recommended a similar study to be done on other organizations in the banking industry.

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

In the contemporary competitive business environment, business organizations need to embrace new ideas in order to stay ahead of the competitors. Diversification is one of the strategies that have been used by several organizations across the globe in order to enhance their business objectives. Marinelli (2011) asserts that most organizations around the world consider diversification as one of the ways of value creation. Business organizations are also operating in environments that are increasingly uncertain, complex, competitive, dynamic and unpredictable. The changes in environments are not only rapid and bewildering; they also appear to be in a state of constant flux. Development arising from these forces and the need for organizations to survive in today's fiercely competitive market are causing many organizations to rethink the way they are doing business in order to remain relevant to their stakeholders in the unfolding dispensations (Dawley *et al.,* 2008).

Several theoretical perspectives have been suggested to explain why diversification is favored by business groups. These include portfolio theory and the industrial economics theory. The portfolio theory seeks to explain how firms make investment decisions based on the assets they seek to invest in. The theory provides the basis upon which firms arrive at decisions to invest in assets they consider less risky (Cochrane, 2007). The industrial economics theory also seeks to explain why corporate firms choose to conduct themselves the way they do in the market. It suggests that firms choose the form of

diversification that can counter competitor actions and provide sustainable profitability (Alexis, 2000).

Diversification among commercial banks in Kenya is one of the strategies that are becoming popular. Kenya commercial Bank Limited is among the banks that have implemented the diversification strategy over a long period of time. There is need to establish whether diversification has an effect on the performance of KCB.

1.1.1 Diversification Strategy

There are several definitions that have been provided in an effort to define diversification as a strategy. According to Ansoff (1965), a diversification strategy is the entry into new markets with new products, whereas Kamien and Schwartz (1975) define it as a firm's degree of product and market involvement. Martin and Sayrak (2003) also define diversification as the degree of relatedness among various product segments. Most scholars use the definition provided by Rumelt (1974) who refers to diversification as the strategy of adding related product or service lines to existing core business, either through acquisition of competitors or through internal development of new products or services, which implies increase in available managerial competence within the firm.

From the above definitions, diversification is a matter of degree of relatedness among the activities carried out by a firm. Product relatedness is defined as the extent to which a firm's different lines of business are linked by a common skill, market, purpose, or resource (Luo, 2002). In practice, diversification is normally measured as the number of activities a firm undertakes in different sectors.

Firms diversify in response to environmental changes; search for market power and to spread risk. Grossmann (2007) argue that the other reason why firms consider diversification as a strategy is because it may be an avenue to extend the boundaries of a firm in the presence of internal coordination problems, which naturally arise in large firms. Foss and Christensen (2001) also indicate that the reason why firms diversify relates to creation of positive spillovers since the value of resources in one industry increases due to investment in another industry. Diversification should enable enterprises to obtain economies of scale or scope of economies by sharing resources and diffusing capacity (Chen & Ho 2004). Imperfections in the financial markets that force managers to allocate funds more efficiently may also lead to diversification (Klein & Lien, 2009).

There are different types of diversification that firms can pursue when they consider to head this direction. There is horizontal diversification where the firm may consider acquiring, developing new products or offering new services that could appeal to the company´s current customer groups. In this type of diversification the firm relies on sales and technological relations to the existing product lines. The other form of diversification is vertical. This occurs when a firm engages in the production of goods that are more related to the ones already in the market. A firm may also engage in conglomerate diversification. This form of diversification involves embarking on the production of goods or provision of services that have no technological or commercial relatedness to the current products or distribution channels (Sohl, 2012).

1.1.2 Organizational Performance

Brealey et al., (2009) define organization's performance as a measure of how well a firm uses its assets from its core operations and generates revenues over a given period of time. Richard Et al. (n.d.) also define organizational performance as a portion of organizational effectiveness that encompasses three areas of performance which include financial, market performance and shareholder value. They further define organizational effectiveness as a broader concept that captures organizational performance plus the excess of internal performance outcomes normally associated with more efficient or effective operations and other external measures that relate to considerations that are broader than those simply associated with economic valuation such as reputation.

The common measures of the organizational performance are effectiveness, efficiency, quality, timelines and productivity (Robbins, 2000). Effectiveness and efficiency might look synonymous but according to Mouzas (2006), each of these terms have their own distinct meaning. Most organizations assess their performance in terms of effectiveness. Their main focus is to achieve their mission, goals and vision. At the same time, there is plethora of organizations, which value their performance in terms of their efficiency, which relates to the optimal use of resources to achieve the desired output (Chavan, 2009). The question is, whether there is a difference if the organization is effective yet inefficient and visas versa. Effectiveness oriented companies are concerned with output, sales, quality, creation of value added, innovation, cost reduction. It measures the degree to which a business achieves its goals or the way outputs interact with the economic and social environment. Usually effectiveness determines the policy objectives of the

organization or the degree to which an organization realizes its own goals (Zheng, 2010). Meyer and Herscovitch (2001) analyzed organizational effectiveness through organizational commitment. Efficiency on the other hand measures the relationship between inputs and outputs or how successfully the inputs have been transformed into outputs (Low, 2000).

Kirkendall (2013) also asserts that there are many other measures for organizational performance measurement. One of these measures includes the use of financial measures such as profitability of the organization. Under this measure the outcome to input ratio is determined using ration such as the Return on Assets (ROA). An organization can also use quality in measuring performance. In this case the actual quality and its timeliness are measured against the expected. The level of productivity and innovation of an organization can also be used to measure performance. Innovation measures the ability of the organization to create change whereas productivity focuses on the ratio of output to input (Kirkendall, 2013).

1.1.3 Banking Industry in Kenya

Banks are profit making financial institutions that play a significant role in the financial system. Commercial banks offer a wide range of corporate financial services that address the specific needs of private and public enterprise. They provide deposit, loan and trading facilities. Banks are also differentiated from retail banks that cater to individual clients only (Central Bank of Kenya, 2013). Banks in Kenya play a number of roles in the financial stability and cash flow of the country's private sector. They process payments

through a variety of means including telegraphic transfer, internet banking and electronic funds transfers. They also issue bank cheques and drafts, as well as accept money on term deposits. They act as moneylenders, by way of instalment loans and overdrafts. Loan options include secured loans, unsecured loans and mortgage loans (Central Bank of Kenya, 2013).

As at December 2013 there were forty three banking and non-bank institutions, fifteen micro finance institutions and one hundred and nine foreign exchange bureaus. According to the Central bank of Kenya (2013), there are a total of forty three licensed commercial banks in the country. Over the last few years, the banking sector in Kenya has continued to grow in assets, deposits, profitability and products offering.

There are several important functions that are provided by banks in Kenya. These functions range from provision of letters of credit, performance bonds, security underwriting commitments and various types of balance sheet guarantees. Banks also take the responsibility for ensuring that the documents they provide are appropriately secured. In today’s competitive banking environment, exemplary customer service is one of the distinguishing characteristics that commercial banks can exploit to establish a competitive edge. The banking industry in Kenya is facing very high competition from both local and foreign banks and the need for alternative strategies to enhance performance is eminent (Rajan & Zingales, 1998).

1.1.4 Kenya Commercial Bank Group

The history of KCB dates back to 1896 when its predecessor, the National Bank of India opened an outlet in Mombasa. Eight years later in 1904, the Bank extended its operations

to Nairobi, which had become the Headquarters of the expanding railway line to Uganda. The next major change in the Bank's history came in 1958. Grindlays Bank merged with the National Bank of India to form the National and Grindlays Bank. Upon independence the Government of Kenya acquired 60% shareholding in National and Grindlays Bank in an effort to bring banking closer to the majority of Kenyans. In 1970, the Government acquired 100% of the shares to take full control of the largest commercial bank in Kenya. National and Grindlays Bank was renamed Kenya Commercial Bank (www.kcbgroup.co.ke). In the most recent rights issue, the government has gradually reduced its shareholding to 17.7% (KCB Press release, Q1 2010 Group Financial Results).

In 1972, savings and loans (K) Ltd was acquired to specialize in mortgage finance. The bank has over the years expanded and opened subsidiaries in Tanzania, Uganda, Southern Sudan, Rwanda and Burundi. In May 2006, KCB extended its operations to Southern Sudan after getting a license by the bank of Southern Sudan and it operates six branches. In 2007 the group opened a branch in Kampala Uganda and has 14 branches in the country now. In 2008 it expanded to Kigali Rwanda where it operates nine branches. The bank opened its first branch in Tanzania the year 2006 where it is currently operating eleven branches. In 2013 the bank extended its operations to Burundi where it currently operates two branches. The group has over 280 branded ATM machines in the country. There are plans to open branches beyond East Africa.

The KCB has an asset base of more than Ksh. 202 Billion. The bank has grown over the years and has had increase in its profitability, posting a profit of 23 Billion for the

financial year ending December 2013. It has a wide network of correspondent relationships totaling to over 200 banks across the globe. KCB offers a wide range of banking services that have been tailor made based customer demands and type. The shares of KCB Group stock are traded Nairobi stock exchange, Uganda securities exchange, Rwanda stock exchange and Dar es Salaam Stock Exchange (www.kcbgroup.co.ke).

Over the years Kenya commercial bank has adopted a number of diversification strategies in its bid to achieve the vision of becoming the leading financial institution in the region. The company has also introduced several new products that were previously not being offered by the bank. This is an indication of diversification strategy implementation by the bank in order to remain competitive in the banking industry (www.kcbgroup.co.ke).

1.2 Research Problem

The issue of diversification has assumed a position of centrality and universality in the management process. Diversification has become an increasingly important aspect of doing business in the world today (Elango & Ma, 2003). The relationship between diversification and firm performance has been the subject of abundant research in several fields. However, many researchers (Marinelli, 2011; Campa & Kedia 2002; Klein and Lien, 2009) concurred on the fact that there is no agreement on the precise nature of the relationship between diversification and performance.

KCB Group has implemented a number of diversification strategies. The strategies range from product diversification to geographical diversification in order to remain competitive. The aim of this diversification was to enhance the performance of the bank and to improve on its efficiency and effectiveness. However there is no evidence yet whether the diversification strategy has enhanced the efficiency and effectiveness of the bank.

Studies conducted have revealed mixed findings on the effect of diversification strategy on organizational performance. Karanja (2013) established that Kenolkobil has applied diversification strategy over the years to become a huge oil company in the last eleven years. Achuti (2012) found out that Safaricom has applied product diversification strategies over the years to become the leading telecommunications company in the country. Mutahi (2010) proved that the Standard Media group adopts diversification strategies to maximize profits and compete effectively in the media market. Santarelli and Tran (2009) established that diversification only improves the profits of the firm to a certain level before it begins to decline. Hsu and Liu (2008) found out that product and customer diversity are positively related to firm performance whereas geographical diversity has a negative relationship with firm performance. On the other hand Ojo (2009) revealed that geographical diversification has a positive relationship with firm performance.

It is evident from the studies above that there are contradicting findings on the relationship between diversification and firm performance. This is an indication that different companies have different outcomes as far as diversification and firm

performance are concerned. This means that the effect of diversification on the performance of Kenya Commercial Bank Group may also have totally different results from what is already known. The fact that diversification has varying results among organizations leaves a research gap that need to be filled. What is the influence the influence of diversification strategy on the performance of Kenya Commercial Bank Group?

1.3 Research Objective

The objective of this study was to determine the influence of diversification on the performance of Kenya Commercial Bank Group.

1.4 Value of the Study

The study has a number of benefits to the policy makers at the Kenya Commercial Bank Group as they have more insights concerning the benefits on diversification and thus pursue the strategy in order to improve their firm performance and gain more competitive advantage.

The management of Kenya Commercial Bank Group have something beneficial from the findings of this study. They have a better understanding how diversification impacts on their performance. This assists them to come up with better management alternatives that assist them in proper and effective implementation of diversification strategies.

The study serves as a basis of further research to academicians who are interested in furthering their knowledge on organization diversification as the results to be obtained

are capable of adding new insight to the present state of knowledge in the field and may therefore be found useful for teaching and for developing a body of management theory

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter presents a review of the relevant literature on diversification and organizational performance. The main issues reviewed include: the theoretical foundations of diversification strategy; the various forms of diversification; diversification and organizational performance as well as a summary of the literature review and research gaps.

2.2 Theoretical Foundation

The portfolio theory seeks to address investment challenges that are faced by firms that must evaluate alternative decisions (Cochrane, 2013). The theory argues that firms are often faced with situations where they must choose between assets in order to invest and make optimum returns. The theory provides a basis upon which to measure the risks associated with investing in each type of asset. According to the theory, assets that exhibit high return volatility are considered to be very risky and may not be appropriate for investment whereas assets with low return volatility are thought to be safe to invest in (Cochrane, 2013).

Atzberger (2013) also suggests that the portfolio theory deals with the problem of constructing for a given collection of assets an investment with desirable features. A variety of different asset characteristics can be taken into consideration, such as the amount of value, on average, an asset returns on over a period of time and the riskiness of reaping returns comparable to the average. He further argues that the financial objectives

of the investor and tolerance of risk determine what types of portfolios are to be considered desirable. In these notes I shall discuss a quantitative approach to constructing portfolios. In particular, I shall use the methods of constrained optimization to construct portfolios for a given collection of assets with desirable features as quantified by an appropriate utility function and constraints (Atzberger, 2013.). Applied in diversification of firms, the theory assists firms to choose the best form of diversification that enables them to reap optimum returns from the chosen form of diversification.

The other theory that also explains the concept of diversification among firms is the industrial economics theory. Alexis (2000) asserts that the theory of industrial economics seeks to explain how industrial corporate organizations behave in the market. The theory assumes that an industrial organization examines the number of competitors who operate in the relevant market and the distribution of market shares, the conditions of entry and exit, product standardization and its proximity to substitutable goods, the interdependence between upstream and downstream activities, and the quality of information controlled by partners and the degree of risk involved. Once all the above have been examined, the firm will them choose a conduct that should determine the respective role of price and non-price strategies, the level of cooperation which has been established over time among the various agents and the use of strategies of differentiation and diversification that can assist the firm to make substantial and sustainable profits (Alexis, 2000). Applied in diversification, the theory enables firms to choose the form of diversification that can produce sustainable profitability.

2.3 Diversification Strategy

There are three main forms of corporate diversification that have been practiced by a number of organizations around the world. The first type of diversification is the limited diversification. This form of business diversification occurs when a firm has all or most of its business activities under the same geographical area or industry. Companies that produce and sell a single line of products are most likely to fall into this category of diversification. Firms that pursue limited corporate diversification strategy do not leverage their resources and capabilities beyond a single product or market. In this case therefore, limited corporate diversification is less similar to business level strategic planning (Geringer, Tallman & Olsen, 2000).

The other form of corporate diversification is related corporate diversification. This form of diversification usually happens when a firm starts to engage in more than one product or single market. This means that the company starts to produce more than one product and also ventures into other markets. If less than 70% of the revenue earned by a company comes from one product market and the multiple business lines are linked. The multiple businesses that a business firm pursues can be related in two ways. The first relationship may happen when most of the businesses operated by the company share inputs, production technology, distribution channels and even customers. Corporate managers are more likely to pursue business opportunities in new markets or industries if such industries share numerous opportunities and resources (Patricia, 2004).

The last form of corporate diversification is unrelated diversification. Under this form of corporate diversification, a firm pursues a number of business activities that are not

totally related and may not be sharing any resources, production technology or even customers. In this case, less than 70% of the revenue of the company may come from a single product market but few business activities share any or no attributes. A number of companies across the globe engage in the production of a number of products that are different and require different inputs. Most companies that engage in unrelated diversification normally manage each and every business as if it were a standalone entity (Geringer, Tallman & Olsen, 2000).

2.4 Organizational Performance

Organizational performance stimulation has always been a priority in private as well as in public sectors, since it is directly associated with the value creation of the entity. Organizations are constantly striving for better results, influence and competitive advantage. However, most organizations are struggling to enhance their performance. The main reason why this struggle exists is because management is not always aware of the adequate assessment of their organizational performance. Several models, frameworks or methods for conducting entities valuation create unnecessary stress for management to select the path that is congruent with organizations believes and cultural philosophy (Richard, 2009).

Robbins (2000) indicates that efficiency and effectiveness are the most common measures of organizational performance. If a company is inefficient but effective it might survive, but the cost of operational management, processes and inputs will be too high. Cost inefficient organizations do not have proper resource allocation management. From

the accounting perspective they might break even or have very little profit. Although, such organizations have excellent long term perceptions of the degree of the overall success, market share, profitability, growth rate, and innovativeness of the organization in comparison with key competitors (Zokaei, 2006). Inefficient-effective organizations should consider the assessment of their recourse allocation. Usually, the morale in such entities is high. Delicate changes brought in the operations and introduced in a subtle manner should result the increase in the efficiency, which would lead organization to desired competitive advantage.

High effectiveness and high efficiency organizations are well known as high performance entities. They demonstrate excellence in their operational performance as well as strategic planning. Their outcome is productive, cost management is under control, tasks distributed and completed in a timely manner. Usually such organizations have high morale and staff commitment, which also results the highest quality of the outcome. Employees are well aware of the tasks they have been delegated to perform, they are also well informed of the indicators, which are used to assess their outcomes. Their performance and their attitudes lie along company's long term goals and vision (Zokaei, 2006).

2.5 Diversification and Firm Performance

The relationship between diversification and shareholder value is not causal but attributable to factors other than diversification. We base our research assumptions on one of the key fundamental pieces of empirical evidence in industrial organization

economics and strategic management literature: the existence of persistence of abnormal return, defined as a statistically significant above or below average performance relative to a reference set such as an industry that persists over the long term (Maruyama & Odagiri, 2002). In other words, if the competitive advantage from a specific position in the industry or because of strategic assets) had been sustainable only in the short term, it would have triggered a serious reconsideration, especially in the field of strategic management science.

Some diversified firms persistently perform above industry average, while others persistently perform below. We find that the persistence of abnormal return explained the relationship between diversification and performance although we find evidence of the impact on performance according to the degree of efficiency of the internal capital market and the degree of un-relatedness of the firm's business segments. In addition, without arguing the statistical validity of the existence of the diversification discount, we believe that looking for a diversification discount or premium would be an extremely relevant indicator if the firm's performance did not follow any specific pattern over time. But because of firms' outstanding performance heterogeneity, finding an average indicator of discount or premium might not unambiguously indicate whether diversification is negative for the firm (Cardinal & Miller, 2000).

According to Sarv and David (2007) assert that recognizing opportunities on a worldwide basis requires managers to hold a much broader view of their relevant market than is typically the case with managers in firms that are organized to promote administrative

efficiency. However, the administrative efficiency comes at the cost of the firms' ability to recognize opportunities on a worldwide basis because the information gathered, exchanged and processed in such organizations are for the most part contained within the geographic or product units. In addition, the data collected and processed tend to reflect the parochial perspectives of either the geographic organizations or the global product units and therefore opportunities that may otherwise be evident may not be seen. Murali et al. (2007) further argue that performance's impact on international diversification is a positive function of the level of IT investment. The performance impact could be significantly positive for firms with high IT investment and significantly negative for firms with low IT investment or neutral for the average internationally diversified firm or firms with average level of IT investment.

Marineli (2007) also indicates that firms with related diversification have lower performance and thus conclude that there is a negative relationship between diversification and firm performance. Marinelli (2011) also argues that the relationship between diversification and the performance of a firm arises from the larger concern on how the boundaries of a firm should be set. He further indicates that conglomerate production constitutes more than 50% of the total production in the United States of America. He further concludes that the relationship between diversification and firm performance is not a causal type of relationship but rather one that is dependent on other factors other than the degree of relatedness among business units and the degree of internal market efficiency. Some diversified firms consistently create shareholder value and have lower market volatility than those firms that are less diversified.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter discusses the methodology that the researcher employed in the study. The methodology includes the research design, data collection methods which include the data collection instruments and the way they were structured, and data analysis techniques that was employed in analyzing the qualitative and quantitative data that was collected. It also provides information on how the findings were presented after the analysis was completed.

3.2 Research Design

The study adopted a longitudinal research design in establishing the influence of diversification on the performance of Kenya Commercial Bank Group Limited. According to Verbeke and Molenberghs (2000) a longitudinal survey research design is one where participant outcomes are collected at multiple follow-up times. A longitudinal survey design yields multiple responses for each subject.

Longitudinal research design was appropriate for this study since it focused on the performance of Kenya Commercial bank group over duration of a number of years since diversification was adopted. It enabled the researcher to conduct a trend analysis over time from the data collected on various years.

3.3 Data Collection

This study made use of both primary and secondary data. The primary data was collected from the respondents using an interview guide which was semi-structured so that some

questions could be omitted or added if some new and useful information came up through the whole procedure, which were face to face interviews. Before embarking on the interviews, the researcher booked appointments with the respondents to ensure availability. The respondents interviewed were seven senior managers from the nine divisions of the bank. They were considered to be key informants for this research since they were involved in the formulation and implementation of policies and strategies that were geared towards the achievement of corporate objectives. The interviews were carried out by the researcher and the findings were written down.

The researcher also collected secondary data on various forms of diversification and the financial performance of Kenya commercial bank group for duration of five years. Data from 2009 to 2013 was collected using a data collection schedule. Most of the secondary data was obtained from published financial statements of the bank for the period 2009 to 2013.

3.4 Data Analysis

The researcher collected both qualitative and quantitative data that was analyzed using content and trend analysis. Qualitative data was analyzed using content analysis. Nachmias and Nachmias (1996) define content analysis as any technique to make inferences through systematic and objective identification of specified characteristics of messages. Kothari (2004) also explain content analysis as the analysis of the contents of documentary and verbal material and describes it as a qualitative analysis concerning the general import of message of the existing documents and measure pervasiveness. Before

embarking on content analysis, the researcher assessed the written material’s quality to ensure that the available material accurately represent what was written or said. The researcher then listed and summarized the major issues contained in the interview guide responses.

The secondary data was analyzed using trend analysis. This showed how performance of KCB has been influenced by diversification over the five years that are covered in this study. Percentages were used to show whether diversification has had any significant effect on performance of the KCB between the years 2009 to 2013. The findings were presented in tables and graphs.

CHAPTER FOUR: DATA ANALYSIS, FINDINGS AND DISCUSSION

4.1 Introduction

The purpose of this study was to establish the effect of the diversification strategy on the performance of Kenya Commercial Bank group. To achieve this objective, both primary and secondary data was collected by the researcher. Primary data was successfully collected from seven senior managers from the nine divisions of the bank, whereas secondary data was collected from the audited financial reports of Kenya Commercial Bank group limited.

This chapter presents the findings of the study as well as discussions. First the chapter presents findings on diversification as it is carried out in Kenya commercial bank group. The chapter further provides findings on the relationship between diversification and the performance of the bank. Finally the chapter presents discussions that relate the findings of this study to prior findings by other authors.

4.2 Diversification in Kenya Commercial Bank

The study findings reveal that Kenya Commercial Bank Group has adopted a number of diversification strategies over the last decade. One of the most prevalent diversification strategies that have been adopted by the bank is that of geographical diversification. The study findings confirm that the bank has been able to open fully owned subsidiaries within the region. It was further clear that the bank still intends to continue with its geographical diversification into other countries where it does not have subsidiaries.

Among the countries where the bank has managed to open subsidiaries include: Uganda, Rwanda, Tanzania, South Sudan and Burundi and there are plans to open subsidiaries in Ethiopia once plans are complete.

It was also established as noted by interviewees that KCB group has also adopted the product and service diversification strategy. Over the last decade, the bank has introduced several new products that are aimed at widening its market share. It was revealed that KCB group has introduced products that never existed initially such as microfinance loans to its customers. The microfinance loans have also assisted in improving the performance of the bank as well as increasing the customer base of the bank. The study reveals that KCB group has also adopted mobile banking service as one of the newest products to its customers. It was evident from the findings that mobile banking is one of the products that have been made possible through technological innovations. The findings also reveal that the bank has introduced several other products aimed at meeting the needs of customers in various sectors within the economy.

The interviewees further noted that KCB group has also diversified into other businesses that are related to banking although they are not in the mainstream banking. It was clear that KCB group has also diversified into the provision of mortgages and also provision of insurance services through agency. The study confirmed that the bank currently runs its own insurance agency that has enabled it to provide fast and efficient insurance services to its customers and other clients who are in need of the services. It was further evident that the bank has commanded a substantial market share of the mortgage market where

the ban finances for the purchase of complete housing units or for the construction of housing units.

It was confirmed by most of the interviewees that KCB group made the decision to adopt various diversification strategies due to a number of reasons. The findings reveal that the bank has been facing stiff competition from its competitors hence the need to look for new strategies of gaining core competence. It was also evident from the study that the bank has a vision of becoming the preferred provider of financial services within the region. It was established that the diversification strategies are part of the implementation of the corporate strategy of the organization that will enable the bank to achieve its vision of becoming the preferred provider of financial services in the region. The findings further reveal that KCB group is the largest bank in asset base and many other aspects. It was therefore established from the study results that the diversification strategies adopted by the bank were aimed at ensuring that the bank also retains its position in the banking industry in Kenya.

The senior manager Francis K Komen in mobile banking unit under retail division said that the Kenya Commercial Bank group was driven into diversification due to the prevailing technological innovations. The findings of the study confirm that some of the products availed by the bank such as mobile banking services and others that are dependent on the telecommunication technology were made possible due to technological innovations. The bank found it necessary to take advantage of the existing technological developments to gain competitive advantage over its competitors. It was also confirmed that the bank has a wider branch network that has made it possible to diversify into

several products since its has the ability to reach out to millions of customers in the region.

"Kenya Commercial Bank Group has exhibited consistency in the mode of entry into international markets", said Daniel Chepkong'a, Head of international businesses. It was clear that in all the four countries where the bank has established branches, it initially started as a wholly owned subsidiary. All the KCB subsidiaries in Uganda, Rwanda, Tanzania and South Sudan are wholly owned subsidiaries accountable to the main KCB group that has its headquarters in Nairobi. The study established that this mode of entry was considered over the others because it could cost less for the bank to open up a wholly owned subsidiary with one branch and expand afterwards as business grew. It was also considered over the others due to the fact opening up a wholly owned subsidiary could provide KCB group with the opportunity to control the operations of its subsidiaries.

It was evident from the study findings that KCB has a consultative process of crafting its diversification strategy. All the stakeholders are involved in crafting the bank's diversification strategy. The input from various stakeholders is considered when the bank crafts its diversification strategy. It was further established that the bank's corporate strategy document is the main reference point in developing the bank's diversification strategy. It was further clear from the study results that the bank has various mechanisms of measuring the effect of diversification on its performance. One of these mechanisms is through specific financial reporting such as reporting of financial results from the subsidiaries before amalgamating the results to form the KCB group results. The study

also established that the bank has in place a department that will be accounting for revenue that is earned from new products the bank has diversified into.

The findings also established that diversification has been very significant in enhancing the performance of Kenya Commercial Bank group. The study results confirm that the improvement that has been registered on the profitability of the bank for the last decade and its turnaround from a loss making bank to what it is now can be attributed to aggressive diversification and implementation of diversification strategies.

4.3 Diversification Strategy and Performance of Kenya Commercial Bank G roup

The study also sought to establish the relationship between diversification strategy and the performance of KCB group. The main areas of diversification considered are geographical and product diversification. Here trend analysis through the percentage contribution of each of the diversification forms was used to reflect its contribution to the profitability of the KCB group.

The effect of geographical diversification on performance was measured using the profits from the KCB group subsidiaries over duration of five years from 2009 to 2013 using trend analysis. Product diversification was also measured using the revenue that was earned from new products from 2009 to 2013.

4.3.1 Geographical Diversification and Performance

The study sought to establish the effect of geographical diversification on the performance of KCB group. The bank's profit after tax and the profits from subsidiaries

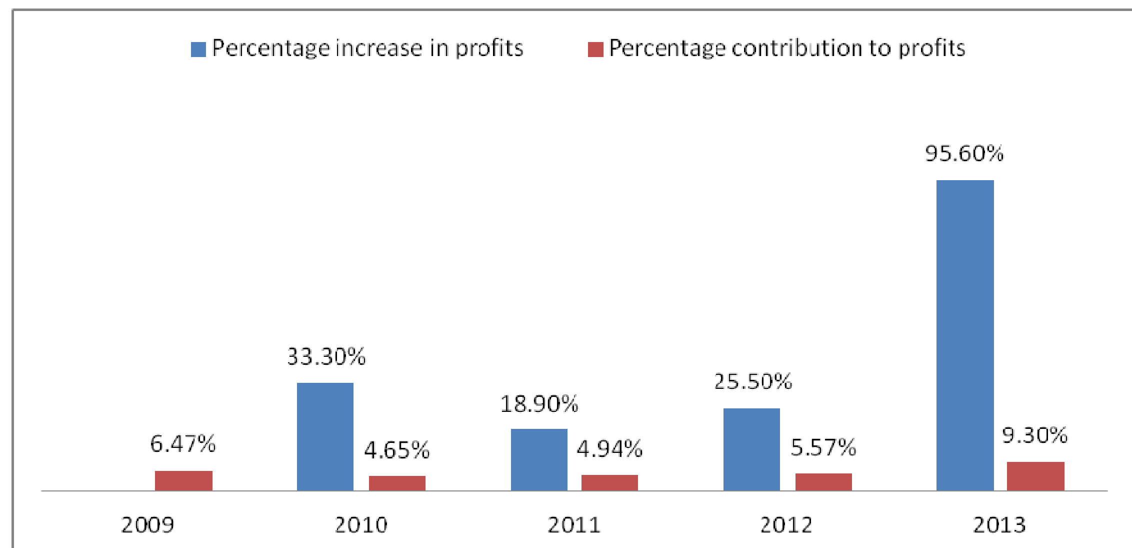
were obtained from annual audited and published financial statements from the year 2009 to 2013. The percentage increase in profitability and the percentage contribution made by the profits from subsidiaries for the five years were calculated as shown in Table 4.1 and Figure 4.1

Table 4.1: Effect of geographical diversification on performance

Year	Profit after tax (In Ksh.)	Profit from subsidiaries	Percentage increase in profitability	Percentage contribution to Profitability
2009	5.28 billion	342 Million	_	6.47%
2010	9.8 billion	456 Million	33.3%	4.65%
2011	10.98billion	542 Million	18.9%	4.94%
2012	12.2billion	680 Million	25.5%	5.57%
2013	14.3billion	1.33billion	95.6%	9.30%

Source: Research Data (2014)

Figure 4.1: Effect of geographical diversification on performance



Source: Research data (2014)

The study findings presented above reveal that from the year 2009 to the year 2010 profits from subsidiaries increased from 342 million to 456 million. This was a percentage increase of 33.3%. It was also confirmed that in the year 2009 profits from subsidiaries constitute 6.47% of the total profits of the entire KCB group. This is an indication that profits from the subsidiaries had a significant effect on the performance of the bank in the year 2009. The findings also reveal that in the year 2010, profits from subsidiaries amounted to 456 million but increased to 542 million in the year 2011. This reflects an 18.9% percent increment on the profits from subsidiaries. In the same year 2010 the profits from subsidiaries constitute 4.65% of the total profits of the KCB group. Between 2011 and 2012, the results from the study reveal that there is a 25.5% increment in the profits from subsidiaries owned by KCB in other countries and in the year 2011 the profits from subsidiaries constitute 4.94% of the total profits of the bank.

The findings illustrated in Table 4.1 also confirm that in 2012 the profits from subsidiaries amount to 680 million and this is 5.57% of the total profits of the KCB group. In the year 2013, it can be observed that the profits from subsidiaries amount to 1.33 billion. There was also an increase in the profits from subsidiaries from 680 million in 2011 to 1.33 in 2012. This represents a 95.6% increment in the profits from subsidiaries. The results exhibit an increasing trend in the profits from subsidiaries and their contribution to the profitability of the bank. It is clear that as the profitability of the subsidiaries increase, the profitability of the KCB group also continues to increase. This implies that geographical diversification has a positive effect on the performance of Kenya Commercial Bank Group Limited. This form of diversification has the potential to

further improve the performance of the bank if more emphasis is given to the geographical diversification.

4.3.2 Product Diversification and Performance

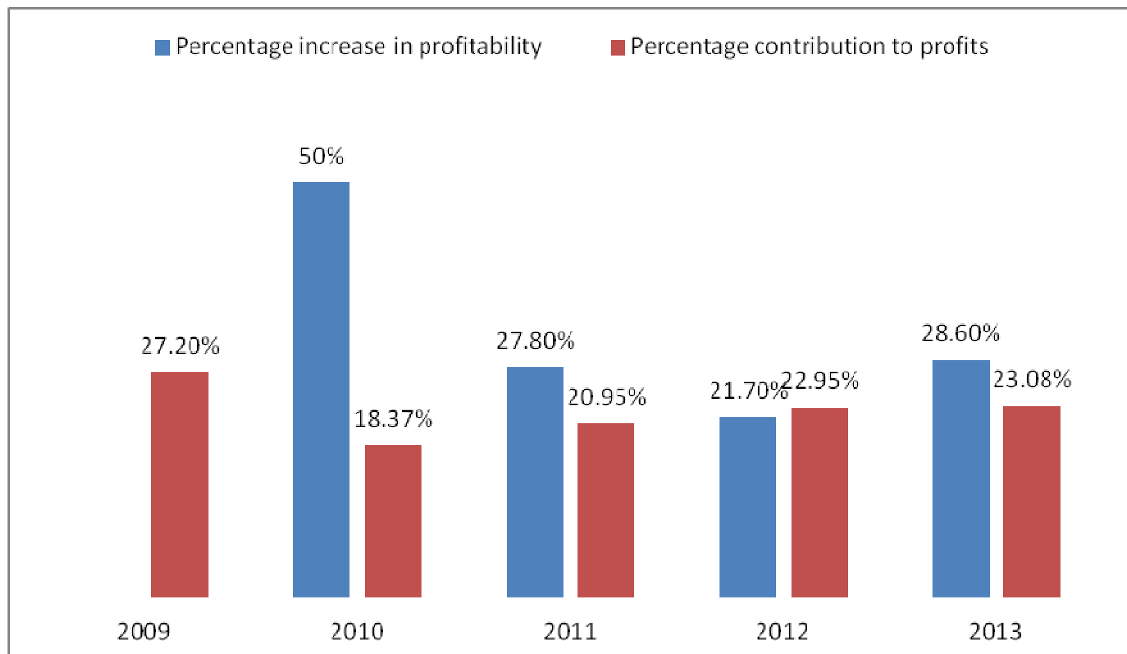
The researcher wanted to find out the effect of product diversification on the performance of KCB Group. The performance of the bank was measured using annual bank profitability and product diversification was measured using aggregate income from new products. The percentage increase in profit after tax due to increase in income from new profits was calculated and the percentage contribution of the income from new products to profitability was also calculated. The results are presented in Table 4.2. and Figure 4.2.

Table 4.2: Product diversification and performance

Year	Profit after tax (In Ksh.)	Revenue from other new products	Percentage increase	Percentage contribution to profits
2009	5.28 billion	1.2 billion	_	27.2%
2010	9.80 billion	1.8 billion	50%	18.37%
2011	10.98billion	2.3 billion	27.8%	20.95%
2012	12.20billion	2.8 billion	21.7%	22.95%
2013	14.30billion	3.6 billion	28.6%	23.08%

Source: Research data (2014)

Figure 4.2: Product diversification and performance



Source: Research data (2014)

It is evident from the study findings presented above that in the year 2009 the revenue from new products was 1.2 billion and it constitutes 27.2% of the profits of the bank. In the year 2010 the revenue from new products is 1.8 billion and this contributes 18.37% of the revenue of the bank. It is also observed that there was an increase in the revenue from new products from 1.2 billion in 2009 to 1.8 billion in 2010. This is a 50% increase in the revenue from new products during the same duration. In the year 2011 it is clear from the study findings that revenue from new products amounts to 2.3 billion and this constitutes 20.95% of the profits of the bank. Observed from the findings is also an increase in the revenue from 1.8 billion in 2010 to 2.3 in 2011 which represents a 27.8% increment.

The findings in Table 4.2 above also reveal that revenue from new products is 2.8 billion in 2012 representing 22.95% of the total profits of the bank. This was an increase of 21.7% from 2010. In 2013 the revenue was 3.6 billion representing 23.08% of the total

profits of the bank. There was also an increment of 28.6% of the revenue from 2012. The findings reveal an upward trend in the revenue earned from product diversification. It is also clear that revenue from new products constitutes a significant portion of the profits of the bank. This implies that product diversification has a significant effect on the performance of KCB group.

4.4 Discussion of Findings

The study reveals that Kenya Commercial bank group engages in a form of diversification where it ventures into new markets within the region. The bank has since managed to open up wholly owned subsidiaries in a number of countries within the region. It was also clear that the bank has introduced a number of products that are aimed at meeting the needs of its customers. The findings agree with Patricia (2004) who argues that there is a form of corporate diversification known as related corporate diversification. This form of diversification usually happens when a firm starts to engage in more than one product or single market. This means that the company starts to produce more than one product and also ventures into other markets. If less than 70% of the revenue earned by a company comes from one product market and the multiple business lines are linked. The multiple businesses that a business firm pursues can be related in two ways.

The study also established that Kenya Commercial Bank has several business that share several resources in order to provide the banking services. This is an indication that the bank engages in related diversification as established by Patricia (2004) who asserts that

this relationship may happen when most of the businesses operated by the company share inputs, production technology, distribution channels and even customers. Corporate managers are more likely to pursue business opportunities in new markets or industries if such industries share numerous opportunities and resources.

The study also established that KCB ventured into new markets within the region as one way of meeting its corporate strategic objective of becoming the most preferred financial services provider in the region. This is a confirmation of a strategy to allocate resources towards achieving its vision of becoming the leading bank in the region. This is in line with Robbins (2000) who indicates that efficiency and effectiveness are the most common measures of organizational performance. If a company is inefficient but effective it might survive, but the cost of operational management, processes and inputs will be too high. Cost inefficient organizations do not have proper resource allocation management.

It was also clear from the study findings that Kenya Commercial Bank adopted geographical diversification because the bank identified opportunities in the region that it needed to exploit. This confirms the position held by Sarv and David (2007) who asserts that recognizing opportunities on a worldwide basis requires managers to hold a much broader view of their relevant market than is typically the case with managers in firms that are organized to promote administrative efficiency. However, the administrative efficiency comes at the cost of the firms' ability to recognize opportunities on a worldwide basis because the information gathered, exchanged and processed in such organizations are for the most part contained within the geographic or product units.

The findings also reveal that there is a positive relationship between diversification strategy and the performance of Kenya Commercial bank group. It was found out that the opening of subsidiaries has made the bank enhance its profitability. The revenues earned from new products also contribute significantly to the profitability of the bank. These findings seem to contradict those of Marineli (2007) who indicates that firms with related diversification have lower performance and thus conclude that there is a negative relationship between diversification and firm performance.

CHAPTER FIVE: SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents a brief summary of the research findings on diversification strategy and performance of Kenya Commercial Bank group Limited. It also provides the conclusions that have been made by the researcher after carefully examining the findings. The chapter also provides recommendations for policy and practice, the limitations as well as suggestions for further research that can assist in bridging any existing research gaps that could not be adequately addressed by the scope of this study.

5.2 Summary of Findings

The study established that KCB group has adopted a number of diversification strategies. Geographical diversification was found to among the most prevalent diversification strategies adopted by the bank. It was evident that the bank has opened subsidiaries in a number of countries within the region in its quest to achieve its vision of becoming the preferred provider of financial services within the region. The study also found out that the bank has also engaged in product diversification where several new products have been introduced to meet the needs of customers in various sector of the economy.

The findings also confirm that the bank opts to open wholly owned subsidiaries in its geographical diversification. All the subsidiaries opened by the bank in the region are wholly owned by the bank for ease of control and accountability. The findings reveal that competition from other players in the banking industry, existing technological

innovations such as telecommunication innovations and the need to remain the market leader in asset base and other aspects are the main factors behind the diversification strategy of the KCB group. The study reveals that crafting the diversification strategy by KCB is a consultative process that brings on board all the stakeholders involved. The corporate strategy is the main reference when crafting the strategy.

It was further established that diversification has a positive effect on the performance of the bank. It was clear from the findings that as the profits from the subsidiaries grew; the profits of the entire group also grew significantly. It was also clear that as revenue from the new products grew, the profits of the bank increased significantly. This is an indication that diversification play a significant role in enhancing the performance of KCB group.

5.3 Conclusion

Kenya Commercial Bank group has adopted three main diversification strategies. The first form of diversification is geographical which involves opening of wholly owned subsidiaries in the region. The bank was found to have subsidiaries in a number of countries within the East Africa region. Among the countries where the bank has subsidiaries include Tanzania, Uganda, Rwanda and South Sudan. There are plans to expand into other countries such as Ethiopia.

The other form of diversification that KCB has adopted is product diversification where the bank has managed to unveil several products to its customers to meet their needs. The bank also engages in unrelated diversification such provision of insurance services

through agency. The bank has also started a department that addresses issues concerning new products that are introduced by the bank for the purpose of meeting the needs of its customers.

Diversification has a positive effect on the performance of KCB group. As the profitability of subsidiaries of Kenya Commercial bank increases, the profitability of the entire group also increases. Geographical diversification therefore positively affects the performance of the bank. Product diversification also indicated a positive relationship with performance of the bank since as income from product diversification increases, the total profits of the banks have also registered significant increment.

5.4 Recommendations for Policy and Practice

The study reveals that geographical diversification has a positive effect on the performance of the bank. There is need to the bank to expand its operations to other countries so that to enjoy more growth in its performance. This will assist the bank to earn more profits.

The study also revealed that product diversification has a positive relationship with performance of the bank. The bank should invest more in research in order to come up with more innovative products that can enable it earn more revenue from product diversification.

The study also revealed that the bank has engaged into other businesses that are related to banking but are not in the mainstream banking and have positively affected the bank's

performance. Thus there is need for the bank to engage in several other businesses so as to earn more profits.

5.5 Limitations of the Study

This study focused on diversification and performance of Kenya Commercial Bank group. The findings from this study may not be applicable to other banks since they relate to diversification experiences of the bank. Various companies may have different outcomes on diversification.

The study findings may not be relevant for an entire lifespan of the bank since circumstances may change. The findings can only be valid for a limited period of time since new developments may cause remarkable changes to diversification and performance of the bank. Revenue from new products has also been provided as an aggregate value since there was no breakdown of all the individual products. The findings are therefore based on the assumption that all the new products are profitable.

The study has covered duration of the most recent five years and therefore the findings do not reflect the position is it were the previous five years when geographical diversification began.

5.6 Suggestions for Further Research

A study should be carried out to establish the effect of diversification on the performance in other commercial banks in Kenya. This will assist in getting a clear overview of diversification strategy and performance of the banking industry.

There is need to have a replication of this study after some time. This will assist to establish the position since circumstances may cause significant changes to the current findings.

A duration covering other years including the previous years when geographical diversification was being introduced need to be done so that the trend can be used to show the relationship that existed then.

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APPENDICES

Appendix I: Data collection form

Year	Profit after tax (In Ksh.)	Profit from subsidiaries	Revenue from other new products
2009			
2010			
2011			
2012			
2013			

Appendix II: Interview Guide

1. What is your understanding of diversification?
4. What diversification strategies has KCB adopted?
5. Why do you think KCB decided to adopt the diversification strategies mentioned?
6. What forms of diversification has KCB adopted?
8. What new products has KCB diversified into?
9. Why did KCB diversify into new markets?
10. If KCB has chosen international markets, what are these international markets?
11. What modes of entry into new markets has KCB adopted in its diversification?
12. What are the main factors considered when choosing the modes of entry?
13. How is the diversification strategy crafted at KCB?
14. How has diversification strategy affected the performance of KCB?
15. How does the bank measure the effect of diversification on performance?

Thank you very much for your time and cooperation