

**CHALLENGES OF IMPLEMENTATION OF DERIVATIVES
RELATED STRATEGY CONCEPT AT THE NAIROBI SECURITIES
EXCHANGE IN KENYA**

BY

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DECLARATION

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

Signature..... Date.....

Lucy Nyanjugu Muchiri

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

This research project is dedicated to my family and friends. Thank you for the love, support and always being there for me.

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First and foremost, I thank the almighty God for granting me good health and strength to undertake this project.

I thank my Supervisor, Mr. Eliud Mududa for his guidance and direction throughout the entire project.

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ABSTRACT

In today's ever changing environment, the major determinant of an organisation's success is the implementation of its strategic plans. Strategy implementation is the process that turns plans and strategies into actions to accomplish objectives. For effective strategy implementation, the strategy must be supported by decisions regarding the appropriate organization structure, organizational culture, resource allocation, organisation's policies and leadership. The objective of this study was to determine the challenges facing NSE in the process of implementation of derivative related strategy and to determine how the NSE has addressed such challenges. This was a case study design where primary data as collected using an interview guide. The data collected was analysed using content analysis. The findings of the study suggest that NSE has a lot to do in terms of restructuring its workforce and creating an appropriate atmosphere for the successful implementation of the derivatives related strategy.

Abbreviations and Acronyms

CMA: Capital Market Authority

NSE: Nairobi Securities Exchange

CFA: Chartered Financial Analyst

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CHAPTER ONE

INTRODUCTION

1.1 Background

Great strategies are worth nothing if they cannot be implemented (Okumus and Roper 1999). Strategy implementation is the manner in which an organization should develop, utilize, and combine organizational structure, control systems, and culture to follow strategies that lead to competitive advantage and a better performance. Strategy implementation challenges include poor leadership and management, inadequate resources, the lack of fit between strategy and organization structure and culture, unhealthy organization politics, lack of motivation of staff, the lack of involvement and participation of staff, the negative perception and resistance emanating from staff and other stakeholders (Okumus, 2003).

Strategy implementation is informed by various theories. These include Contingency theory of leadership effectiveness, resource-based theory of the firm and the Institutional theory. The contingency theory of leadership effectiveness explains the management behaviours and characteristics of leaders that ultimately affect the outcome of a group charged with the successful implementation of strategy. Resource-based theory explains the resources of a firm and utilization of the resources to achieve competitive advantage in the market. The institutional theory explains why institutions behave the way they do and the internal challenges that inhibit strategy implementation.

NSE has been the trading platform for traditional financial instruments, these being equities and bonds issued by the government and by both private and publicly listed institutions. In the year 2014, NSE was licensed to launch the platform allowing for trading of derivative products in the financial market in Kenya. The derivatives strategy requires allocation of resources and development of policies necessary for the successful operation. The derivatives related strategy has not been implemented a year since the NSE was licensed and it is therefore necessary to find out the reasons that have led to the delay in the implementation.

The purpose of this study is to identify challenges that are faced by the NSE in the process of implementation of the Derivatives strategy concept. The study will seek to propose solutions to the challenges of strategy implementation based on the unique requirements of the NSE. The study will rely on existing literature on the implementation of strategy and related theories. The study will also rely on data collected from the NSE which will be gathered from managers responsible to executing strategy.

1.1.1 Concept of Strategy

Strategy is the direction and scope of an organisation over the long-term which achieves advantage for the organisation through its configuration of resources within a challenging environment, to meet the needs of markets and to fulfill stakeholder expectations (Johnson & Scholes, 2002). Strategy is the broad formula for how a business is going to compete, what its goals should be, and what policies will be needed to carry out those goals and the combination of the goals for which the firm is striving and the means by which it is seeking to get there (Porter, 1980). Strategy is a plan, a pattern, a position, a

ploy and a perspective (Mintzberg, 1998). Strategy is about the long term direction of the business; the markets the business compete in and the kind of activities involved; how the business can perform better than the competition; the resources required by the business to be able to compete; the external factors that would affect the business's ability to compete and the values and expectations of the stakeholders. Strategies exist at different levels in any organisation ranging from the overall business through to individuals working in it.

Corporate Strategy is concerned with the overall purpose and scope of the business to meet stakeholder expectations. Business Unit Strategy is concerned more with how a business competes successfully in a particular market. Operational Strategy is concerned with how each part of the business is organised to deliver the corporate and business-unit level strategic direction. Strategic management is about making strategic decisions. A thorough strategic management process has three main components namely strategic analysis, strategic choice and strategy implementation.

Strategic Analysis is about analyzing the strength of the business's position and understanding the important external factors that may influence that position. Strategic Choice involves understanding the nature of stakeholder expectations, identifying strategic options, and then evaluating and selecting strategic options. Strategy Implementation is the translation of the strategy it into organizational action.

1.1.2 Strategy Implementation

Strategy implementation is the process of translating of strategic policies into organizational actions in order to achieve strategic goals and objectives. Strategy

implementation process involves the allocation of resources to support the chosen strategies. Various management activities are necessary to put strategy in action, introduce strategic controls to monitor progress and achieve organizational goals. Strategy implementation involves allocating tasks and timelines to individuals to enable an organization reach its goals. Strategy implementation process covers the entire managerial activities including such matters as motivation, compensation, management appraisal, and control processes (George Steiner, 1979). The primary benefit of the planning process is the process itself and not a plan. Planning is more a way of thinking than a set of procedures. There are different preferred approaches to completing the many stages of the planning process. The basic objective of planning is to develop appropriate strategies to adapt an organization to its environment and then make current decisions to implement the strategies.

Almost all the management functions: planning, controlling, organizing, motivating, leading, directing, integrating, communicating, and innovation are applied in the implementation process (Higgins, 2005). Strategy implementation follows the “8S” framework according to Higgins. This includes strategy and purposes structure, resources, shared values, style, staff, systems and processes, and strategic performance. The “8S” approach enables senior management to enact, monitor, and evaluate the execution of strategies. Strategic performance helps to focus the strategy execution process. If there isn’t a good alignment among these factors, performance in strategy implementation will suffer.

Traditionally, organizations begin strategy formulation by carefully specifying their mission, goals, and objectives, and then they engage in SWOT analysis to choose appropriate strategies. The traditional way of thinking about strategy implementation focuses only on deliberate strategies (Henry Mintzberg, 1985). According to Mintzberg some organizations begin implementing strategies before they clearly articulate mission, goals, or objectives. In this case strategy implementation actually precedes strategy formulation. Mintzberg calls strategies that unfold in this way emergent strategies. Implementation of emergent strategies involves the allocation of resources even though an organization has not explicitly chosen its strategies. Most organizations make use of both deliberate and emergent strategies. Whether deliberate or emergent, however, a strategy has little effect on an organization's performance until it is implemented.

1.1.3 Derivatives Strategy Concept

A derivative is a financial instrument, whose value depends on the value of basic underlying asset or variable. Underlying assets include treasury bills, treasury bonds, crude oil, precious metals, agricultural commodities and listed stocks. Underlying variables include interest rates, stock Index, bond Index and exchange rates movements. The value of a derivative is linked to the risk of a financial asset, transaction, market rate, or contingency, and creates a product. Derivatives have several features namely; they are traded on an exchange, there is no compulsory physical trading of underlying assets, all transactions take place in future specific dates, they are used for hedging purposes to reduce risk and they have low transaction costs.

There are four types of derivative contracts namely: forwards, futures, options and swaps. Forwards are customized contracts between two entities. Futures are standardized financial contracts obligating performance of the contract terms at a predetermined future date and price. Swaps are private agreements between two parties to exchange cash flows in the future according to a pre-arranged formula. Options are contracts where the owner of an option has the right but not the obligation to buy or sell the underlying asset on or before a given date.

There are two types of markets where derivatives may be traded. These are Over-The-Counter (OTC) markets and in organized Exchange markets. Over-the-Counter derivatives are contracts that are traded between two parties directly without going through an exchange. Exchange-traded derivatives are Contracts that are traded in regulated exchanges. The regulated exchange acts as a clearing house that guarantees the performance of the participants. Futures, forwards and option are traded in the regulated derivatives markets.

Derivatives are mainly traded in the developed markets but there is low penetration in emerging markets. In the USA, derivatives first appeared in response to uncertainties in prices of agricultural commodities. Farmers and millers would meet prior to harvests and agree upon the quantities and prices of goods to be delivered at a future date. In this case, the derivative would be the agreement to deliver certain quantity of goods at a price agreed upon on the contract date. The value of the future contract would depend upon the fluctuation of prices between the contract date and the delivery date. Financial risk later emerged as a primary concern for businesses as currency exchange rates were allowed to

fluctuate based on market demand and supply. Derivatives were created whose values depended upon interest rates and exchange rates. Derivatives are also classified according to the nature of the asset underlying the derivatives contract. These categories are commodity, interest rates, currency, credit and equity derivatives.

Development of a successful derivative market depends on the level of development of a country. Legal, regulatory, political and economic conditions determine the level of development of a country. Political and regulatory policies will ensure stability of the financial system. A stable legal structure will enable formation of derivatives contracts that can be enforceable. Weak legal framework will leave the investors vulnerable as some market participants may not fulfill their obligations especially when the contracts do not favour them. A strong legal and regulatory framework will also enable supervision of the financial market where participants will report accurate reports.

1.1.4 Challenges of Strategy Implementation

It is important for managers to understand and identify the challenges that can occur during the process to improve the effective implementation of strategy. Knowledge of the challenges could prevent them and lead to a more proactive approach. Identification of the challenges is important to enable solutions. The following are some of the challenges faced by organizations in the process of implementation of strategy.

Different business units within the same corporation often pursue different strategies. The consistency of strategy is vital; meaning that strategy throughout the company should be in line with the overall direction of the company and its goals (Slater and Olson, 2001).

An organization should move together in one direction and cooperation and harmony will help to implement strategy more efficiently.

Lack of effective leadership by top management. Leaders must have a combination of technical and interpersonal skills for them to be seen as competent, capable and effective. The role of the leader is important if an organization wants to implement a new strategy. Leaders have a substantial impact on performance (O'Reilly et al, 2010). Leadership is “a person’s ability, in a formally assigned hierarchical role, to influence a group to achieve organizational goals”. Thus in the implementation process the leader has to ensure that the rest of the organization is committed to the strategy, by convincing the employees that a new strategy is important and also create a meaning of strategy, so that the employees support this strategy. The leader has to deal with resistance, allocate resources and create consensus among all the employees.

Strategy and structure not being in harmony. Formalization, centralization and specialization are three structural dimensions that influence communication, coordination and decision making which are key to strategy implementation (Olsen et al, 2005). Formalization is the degree to which decisions and working relationships are governed by formal rules and procedures. Centralization refers to whether decision authority is closely held by top managers or is delegated. Specialization refers to the degree to which tasks and activities are divided in the organization. The type of strategy being implemented must be in harmony with the structure of the organization.

Organizational culture results from a complex process of individual and group learning through history, circumstances and management. Implementation of a new strategy starts with an understanding of organizational culture and ends with a change in this culture to facilitate and embrace the strategy. Strategy not aligned to organizational culture will meet with resistance and opposition and therefore communication must be employed to inform all affected. Certain characteristics of an organization's culture can foster strategy implementation while others may need to be considered as a barrier (Pryor et al, 2007).

1.1.5 Nairobi Securities Exchange

The Nairobi Securities Exchange Limited (NSE) is a company licensed by the Capital Markets Authority (CMA) to facilitate the trading of financial products through the provision of a trading platform for listed securities. Securities currently listed in the NSE are Government Bonds, Corporate Bonds and Equities (Ordinary and Preference Shares). In 2011, the NSE launched a strategic plan to evolve into a full service securities exchange which supports trading, clearing and settlement of equities, debt, derivatives and other associated instruments. In the same year, NSE also launched the FTSE NSE Kenya 15 and FTSE NSE Kenya 25 Indices. The launch reflected a growing interest in new domestic investment and diversification opportunities. NSE and the Capital Markets Authority undertook to reform the Kenya financial market in the early 2000s.

As part of the reform, NSE was reorganized into four segments. These segments are: Main Investments Market Segment; Alternative Investments Market Segment; Fixed Income Securities Market Segment; and the Futures and Options Market Segment. The

Futures and Options Market Segment was meant to drive growth of the derivatives market but has been unsuccessful due to regulatory and policy environment, level of investor awareness, inadequate risk management and inadequate liquidity. To set the legal framework for derivatives market, the Capital Markets Act was amended through an Act of parliament in year 2013, Kenya Gazette Supplement No. 182 (Act No. 48). This was to set the groundwork for the proper functioning of the derivatives market and to define various terms that are applicable.

It is therefore possible to draw financial contracts based upon the rule of law. The NSE set up derivatives rules to ensure business is carried out in an orderly manner with due regard to the object of the Capital Markets Act and to establish and regulate fair and efficient derivatives market. At present, the NSE is in the process of appointing the board of the Derivatives Market Oversight Committee to govern operations of the newly licensed derivatives market. NSE will act as an intermediary between buyers and sellers of derivatives contracts. As the central clearing house, NSE will take on the credit risk of counterparties to derivative transactions. To manage the credit risk posed by counterparties, NSE will have to put in place mechanisms to mitigate risks. These are: requirement for counterparties to post initial margins to cover daily market variations and establish participation constraints to prevent dealing with counterparties that have high probabilities of default.

1.2 Research Problem

Although formulating a consistent strategy is a difficult task for any management team, implementing the strategy throughout the organization is even more difficult (Hrebiniak, 2006). Strategy implementation is often seen as something of a craft, rather than a science, and its research history has previously been described as fragmented and eclectic (Noble, 1999). Thompson & Strickland (2003) have stressed that the implementation of strategy is the most complicated and time-consuming part of strategic management. All organisations face various challenges in the process of implementation of strategy, which range from strategy formulation and planning, coordination, resource allocation, communication, commitment by workforce, leadership by managers and cultural context.

NSE has and continues to be the trading platform for traditional financial instruments, bonds, notes and equities, in the secondary market. In the year 2014, NSE announced plans to start trading derivatives and real-estate investment funds in order to increase its market capitalization and attract a broader range of investors. A system for trading derivatives was already installed and rules on trading of derivatives sent to the CMA for approval. Despite the above, the trading of derivatives has not been implemented and this study will investigate some of the factors affecting the implementation.

Nutt (1999) studied strategic decisions in organisations located in the USA and Canada and concluded that half of the strategic decisions failed to attain their initial objectives mainly because of the problems encountered during strategy implementation. Wernham (1985) identified the challenge of goals and strategies pursued by the top management

not been clearly perceived by the unit managers based at the periphery. Allio (2005) found that a discouraging 57 percent of firms were unsuccessful at executing strategic initiatives over the past three years, according to a survey of 276 senior operating executives in 2004. Allio noted that good implementation naturally starts with good strategic input. Al-Ghamdi (1999) states that there are several benefits of Strategy implementation including it will aid in identifying the implementation problems, coming up with solutions to the problems, it may signal a need to formulate strategic plans that are more easily implementable, this could also help in identifying facilitative mechanisms and solutions that reduce challenges to implementation of strategies and finally it will provide guidelines on how to cope and counter with implementation challenges.

Local studies on strategic implementation include Aosa (1992) who conducted an empirical investigation on aspects of strategy formulation and implementation within large private manufacturing companies in Kenya. Awino (2001) investigated the effectiveness and problems of strategy implementation of financing Higher Education in Kenya. Kiplagat (2008) researched on challenges of strategy implementation at Kenya Revenue Authority. Nduva (2011) conducted a study on Strategy implementation challenges facing Kenya Bureau of Standards. Awino et al (2012) investigated the challenges facing the implementation of differentiation strategies in the sugar industry in Kenya. Different researches on strategy implementation reveal that there is no one universal approach to strategy implementation and that different organisations implement strategy differently. There has not been a research done on the challenges faced by NSE in the implementation of derivatives strategy concept. This constitutes a knowledge gap which this research study intends to fill.

This study will seek answers from the management of NSE and attempt to identify the challenges being faced in the process of implementing the derivatives related strategy. Further research will include more intensive qualitative research from secondary sources which includes published reports and NSE library sources. This study seeks to answer the question; what are the challenges faced by the NSE in the process of the implementation of derivatives related strategy?

1.3 Research Objectives

The objectives of this study are:

- i. To determine the challenges of the implementation of derivatives related strategy at the NSE.
- ii. To determine how the NSE has addressed such challenges.

1.4 Value of the Study

This study will be of value to the management of the NSE in identifying the possible responses to challenges faced in the implementation of the derivatives strategy based on studies of the experiences of other emerging economies. It will also help the management of NSE find strategic solutions to enable them overcome the challenges and successfully implement the derivatives strategy.

This study will make significant contribution to the government of Kenya, a key stakeholder in the Nairobi Security Exchange. The study findings will help the policy makers in addressing the challenges facing the NSE in the implementation of the derivatives strategy. The CMA, which is the oversight body for the financial market in

Kenya, will use the findings of the study in drafting applicable policies to ensure the derivatives market has adequate rules governing the trading of derivatives products.

The findings of this study will be valuable to scholars as it goes into the depth of the area of strategic implementation of the derivatives market in Kenya, an area not covered in depth in the past. The study will be useful in theory building as it will offer insights into implementation of derivatives strategy in a developing market in Africa.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

Strategy implementation is an interactive process of working on strategies, policies, programs and action plans that allows a firm to utilise its resources to take advantage of opportunities in the competitive environment (Harrington, 2006). Effective implementation of any strategy occurs when there exists a good link between the strategies being implemented and the action plans put in place.

2.2 Theoretical foundation

The theoretical foundation for this study is informed by the contingency theory of leadership effectiveness, the resource based theory and the Institutional theory. The three theories provide the foundation for the concepts used in the study of strategy implementation.

2.2.1 Institutional Theory

According to Kraft's Public Policy (2007) Institutional Theory is Policy-making that emphasizes the formal and legal aspects of government structures. Institutional theory is a widely accepted theoretical posture that emphasizes rational myths, isomorphism, and legitimacy. Institutional theory focuses on the deeper and more resilient aspects of social structure. It considers the processes by which structures, including schemes; rules, norms, and routines, become established as authoritative guidelines for social behavior (Scott, 2004). Different components of institutional theory explain how these elements are

created, diffused, adopted, and adapted over space and time; and how they fall into decline and disuse. Although the ostensible subject is stability and order in social life, students of institutions must attend not just to consensus and conformity but to conflict and change in social structures.

The basic concepts and premises of the institutional theory approach provide useful guidelines for analyzing organization-environment relationships with an emphasis on the social rules, expectations, norms, and values as the sources of pressure on organizations. This theory is built on the concept of legitimacy rather than efficiency or effectiveness as the primary organizational goal (McAdam and Scott, 2004). The environment is conceptualized as the organizational field, represented by institutions that may include regulatory structures, governmental agencies, courts, professionals, professional norms, interest groups, public opinion, laws, rules, and social values. Institutional theory assumes that an organization conforms to its environment. There are, however, some fundamental aspects of organizational environments and activities not fully addressed by institutional theory that make the approach problematic for fully understanding NGOs and their environment: the organization being dependent on external resources and the organizations ability to adapt to or even change its environment (McAdam and Scott, 2004)

Researchers such as Meyer and Rowan (1991), DiMaggio and Powell (1983) are some of the institutional theorists who assert that the institutional environment can strongly influence the development of formal structures in an organization, often more profoundly than market pressures. Innovative structures that improve technical efficiency in early-

adopting organizations are legitimized in the environment. Ultimately these innovations reach a level of legitimization where failure to adopt them is seen as "irrational and negligent" (or they become legal mandates). At this point new and existing organizations will adopt the structural form even if the form doesn't improve efficiency.

2.2.2 Contingency theory of leadership effectiveness

The theory was developed by management psychologist Fred Fielder. It states that leadership effectiveness, as it relates to group effectiveness is a component of management behaviours and characteristics of the environment in which the leader works. Management behaviours are dependent upon whether the manager is able to control and affect the group's outcome. Factors that determine the group's outcome are: leader-member relations, task structure and position power.

Leader-member relations address the manager's perception of their cooperative relations with their subordinates. Task structure relates to whether the structure of the work task is highly structured, subject to standard procedures and subject to adequate measures of assessment. Position power asks if the manager's level of authority is based on punishing or rewarding behavior. Fiedler's Contingency Theory says that there are many internal and external factors that can influence the optimum organizational structure. These factors include the size of the organization, technology that is in use, leadership style, and how the organization can adapt to changes in strategy.

2.2.3 Resource based view

The Resource-based view (RBV) lies in the application of a bundle of valuable tangible or intangible resources at the organisation's disposal (Mwailu & Mercer, 1983).

According to Andrews (1971), the concept of strategy is phrased in terms of the resource position, that is strengths and weaknesses, of the firm. To transform a short-run competitive advantage into a sustained competitive advantage requires that these resources are heterogeneous in nature and not perfectly mobile (Peteraf, 1993). The valuable resources are neither perfectly imitable nor substitutable without great effort (Barney, 1991).

Resource-based view contends that the possession of strategic resources provides an organisation with a golden opportunity to develop to develop competitive advantages over its rivals. Strategic resources are those that are valuable, rare, difficult to imitate and non-substitutable. A resource is valuable to the extent that it helps a firm create strategies that capitalize on opportunities. A resource is non-substitutable when competitors cannot find alternative ways to gain the benefits that a resource provides. Resources are either tangible or intangible. Tangible resources are those that can be readily seen, touched and quantified. Intangible resources include knowledge of employees, organisation's reputation, and an organisation's culture. Intangible resources are likely to meet the criteria for strategic resources than the tangible resources. Resource-based view also stresses the merit of the saying that the whole is greater than the sum of its parts.

Organizations are open systems which draw their raw materials from the environment. Firms utilize their resources to transform the raw materials into finished products and services which they in return release back into the environment. However, while undertaking this, firms must constantly modify their resource capability requirements to be in sync with the turbulent environmental demands. Given that settings in which the

managers operate differ, environmental influence on firms is relevant to strategy implementation within and without the organization. Strategy executors should be prepared to shift resources from one area to another in support of new strategic initiatives and priorities. Changes in strategy almost always require budget reallocations (Aosa, 1992).

2.3 Implementation of strategy in Organisations

Strategy implementation is the process by which strategies and policies are put into action through the development of programs, budgets and procedures (Wheelan & Hunger, 1991). The absolute performance of a business entity depends not just on the effectiveness of its internal organisation in implementing the chosen strategy, but also on industry characteristics and choice of strategy itself (Lenz, 1981). It is essential therefore that the impact of industry and strategy related factors on performance be controlled.

Chandler (1962) defined structure as the design of the organisation through which strategy is administered. Changes in an organisation's strategy lead to new administrative problems which in turn require a new or refashioned structure for the successful implementation of the new strategy. According to Chandler, structure follows strategy. Porter (1985) argues that organisations can propose one of four strategies: cost leadership, differentiation, focus and stuck-in-middle. Structural specifications could be made for selected strategy. The information-processing proposition considers that a structure with a sound information process can be helped to implement organisational strategy more accurately (Egelhoff, 1982). Organisational structure places constraints on choosing a strategy (Bobbit & Ford, 1980).

It is essential for leaders to understand how to ensure strategic decisions are effectively implemented throughout their organizations. In this respect, leader effectiveness in the aggregate across different levels, as opposed to individual leadership actions, has the most significant effect (O'Reilly et al, 2010). Noble (1999) describes the abilities needed by managers as a combination of technical skills, interpersonal skills and sensitivity to the needs of other functions. A manager needs to find a balance between powerful charismatic leadership and sufficient autonomy for the employees. Crittenden et al (2008) want to see a capable, contributing, competent, effective and executive leader when it comes to strategy implementation. Communication is deeply connected with strategic consensus. Management's task is to ensure that communication takes place among all levels of management, different functions and other connections in the organisation. Noble (1999) feels the significance of a common language and understanding.

When implementing a new strategy, it is necessary that separate functions of an organisation work together and not against each other. Nobel (1999) asserts that the different functions need to be coordinated and motivated to speak a common language, share common goals and put aside their natural territorialism. Tensions between the departments are common and hinder cooperation and therewith implementation. Managers need to identify those tensions and solve them by making everybody involved clear that the direction of the organisation stands above all interests of the separate functions. A strategy calling for introduction of a new product requires the combined efforts of, and thus coordination and cooperation among, the R&D, the marketing, and the manufacturing departments (Schmidt & Brauer, 2006).

Every organisation has its own culture. Organisational culture is the influences by the people in the organisation, by history, by circumstances and by management. Managers can try to shape culture by communication. Crittenden et al (2008) see organisational culture as a system of shared values of the employees. Pryor et al (2007) see the possibility to set tone, pace and character of the organisation. Certain characteristics can foster strategy implementation while others may be considered as barriers.

People are a key strategic resource and it is essential for organisations to effectively utilise the know-how of their employees at the right places (Lorange, 1998). There is also a need to choose the right people for the right responsibility. A certain degree of freedom is necessary to leave room for experiments by the employees and develop creativity to solve challenges. It is the challenge of management to allocate them to their most useful tasks as well as coordinating and integrating activities of participating employees and functions Pryor et al. (2007).

2.4 Empirical Studies and Research Gaps

Rono (2013) conducted a study on the information content of the introduction of derivative trading at the Nairobi Securities Exchange. In his MBA research, the researcher recommended that the NSE should move with speed to introduce the use of derivatives markets because this will not only be beneficial to the investors but also it will help in the growth and development of the economy. Mbithi (2011) examined the impact of introduction of financial derivatives trading on the volatility of NSE which is a developing stock market. The researcher found out that derivatives trading would reduce the volatility of the stock market and have a positive impact on the country's economy.

Owenje (2014) conducted a study on the challenges of the implementation of e-business strategy, by companies listed in the NSE. The research paper analysed the challenges and presented the results in six categories namely: financial capacity motivation and ownership, board support, organisational structure, openness to change and human resources capacity. To implement any strategy, it is necessary to have supporting information, financial capacity and organizational infrastructure and systems. Lumumba (2007) conducted a study on the challenges of the demutualization strategy of the NSF. Mutisya (2008) undertook a study on the challenges and benefits of regional cross listing: the case of eligible companies quoted at the Nairobi Stock Exchange. The aim of the study was to identify the challenges faced by companies which are eligible for cross listing in the regional exchanges, and the benefits that accrue or are realizable upon cross listing.

There have been various studies conducted on the implementation of various strategies at the NSE but there has been no study done of the Implementation of derivatives strategy by the NSE. This is a relatively new study as the derivatives market is new in the country and the NSE only recently licensed to conduct the derivatives strategy. This constitutes a knowledge gap that needs to be addressed.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This section highlights the methodology that was used in carrying out the study. It consists of the research design that was used in the study, the data collection techniques and data analysis. According to Polit and Hungler (2003) methodology refers to ways of obtaining, organizing and analyzing data.

3.2 Research Design

The research design adopted a case study approach since the unit of analysis was biased to one organisation namely the Nairobi Securities Exchange. Cooper and Schindler (2003) assert that case studies place more emphasis on a full contextual analysis of fewer events or conditions. An emphasis on detail provides valuable insight for problem solving, evaluation and strategy. According to Yin (1984), a case study allows an investigation to retain the holistic and meaningful characteristics of real life events. It involves a careful and complete observation of social units. Kothari (2004) notes that a case study involves a careful and complete observation of social units. The interview guide enabled the researcher collect qualitative data which was used to get a better understanding of the results of the study.

3.3 Data Collection

The researcher used primary data that was collected from first-hand experience through interviews where the researcher interviewed the respondents and gathered information

using face to face interviews. The data collection instrument used in this study was the interview guide. An interview guide is a set of questions that the interviewer asks when collecting data from the respondents. The questions vary from highly scripted to relatively loose and help to know what to ask about and in what sequence. An in-depth interview allows more interaction between interviewer and interviewee.

The respondents for this research were the top leadership at the NSE consisting of the Chief Executive Officer, Head of Compliance and Legal, Head of Finance and Strategy, Head of Operations & Technology and Head of Market & Product Development. The respondents were selected because their positions in the organisation enabled them to have in depth understanding of the strategy implementation process and challenges faced in the implementation of derivatives strategy. Permission from the organization was sought and consent from individual managers was requested through a formal introduction letter, Appendix I. The researcher personally conducted the interviews.

3.4 Data Analysis

John Tukey (1961) defined data analysis as procedures for analyzing data, techniques for interpreting the results of such procedures, ways of planning the gathering of data to make its analysis easier, more precise or more accurate, and all the machinery and results of statistics which apply to analyzing data. Data analysis involves data preparation where data is checked for accuracy, entered into a computer, examined critically and making inferences (Kombo and Tromp, 2006).

As this was a case study, the data collected from the respondents was in a qualitative form and content analysis method was used in analyzing the data. Content analysis has been defined as a systematic, replicable technique for compressing many words of text into fewer content categories based on explicit rules of coding (Berelson, 1952). Content analysis is the systematic qualitative description of the composition of the objects or materials of the study (Hsieh and Shannon, 2005). It involves observation and detailed description of objects, items or things that comprise the object of study. The themes that were used in the analysis were informed by the variables identified in literature.

CHAPTER FOUR

DATA ANALYSIS AND FINDINGS

4.1 Introduction

Strategy implementation is the most important part of strategic management process as it is what makes an organisation succeed or fail in its objectives. This implies that strategic implementation must be embraced by all members of the organisation, from the Board of Directors, Chief Executive Officer, top management and all other employees in all levels. Organisations face a lot of challenges in the execution of the strategic plans.

This study sought to establish the challenges faced by NSE Limited in the process of implementing the derivatives related strategy. The main challenges identified by the researcher were organisational structure, culture, adequacy and allocation of resources and organisational policies. The method of data collection was personal interviews by the aid of an interview guide which was given the respondents in advance to enable them recollect relevant facts.

The target respondents were the top management at NSE because of their involvement on strategy formulation and implementation. The response rate was very low due to the sensitive nature of the research project. Most of the targeted respondents felt that the derivatives strategy was sensitive and failed to respond to the questions. This chapter presents the analyses and findings of the study.

4.2 Challenges of strategy implementation at NSE Limited

This section provides a discussion of findings from the respondents on the challenges that face NSE Limited in the process of implementing the derivatives strategy and responses by the management to those challenges.

4.2.1 Organisational structure

Chandler (1962) suggested that organizational structure has been influenced by the organization's strategies (structure follows strategy). Corporate structure is created in order to implement a given corporate strategy. Organisational structure is considered important in strategy implementation because strategy must be cascaded to all levels in the organisation. The consistency within which systematic relationships between strategy and organisation have been discovered at the firm level leads to the expectations that the same relationships be held at business unit levels. The role of structure is to coordinate strategy implementation and motivate stakeholders while providing incentives for superior performance.

Organisational structure at NSE limited is hierarchical pyramid. This is not considered a problem by the management because the chain of command is definite and reporting relationships are clearly laid down. The Chief Executive Officer's role is most critical as he is the one who authorizes strategic implementation. However, the researcher found out that the structure has impacted decision making process and in effect slowed down implementation of the derivatives strategy. This is because the approval process is delayed while awaiting top levels of management to authorize implementation. The derivatives strategy has not been given special consideration and is headed by the same

departments handling other financial products development. This has led to delay in implementation of the derivatives strategy as the departments balance performance of existing products against introduction of a new uncertain product.

There was a restructuring done at NSE Limited when the derivative strategy was mooted to enable allocation of employees to the right jobs. This was however not followed through and the old structures were returned. This has led to confusion among employees as coordination of activities is difficult. There have been problems in allocating employees for the right jobs. The organisational structure currently in place had led to many departments with no clear allocation of responsibilities. The derivatives strategy has thus not been given priority leading to the delay in implementation.

4.2.2 Leadership

According to Cater and Pucko (2010), while a well formulated strategy, a strong and effective pool of skills, and human capital are extremely important resources for strategy success, poor leadership is one of the main obstacles in successful strategy implementation. One key challenge in successful strategy implementation is ensuring employees' buy-in and directing their capabilities and business understanding toward the new strategy. Therefore, the need for effective leadership outweighs any other factor. Beer and Eisenstat (2000) addressed this issue from a different perspective; they suggested that in the absence of effective leadership, conflicting priorities will result in poor coordination because employees will suspect that top management prefers to avoid potentially threatening and embarrassing circumstances.

NSE has faced leadership challenges because building of consensus among the management is difficult. Most of the management staff are new to the organisation and the high turnover of top management has created confusion and disharmony among employees resulting in delays in strategy implementation. The derivative strategy was formulated under a different management team and implementation is supposed to be under the new management team. This has created confusion as some of the employees involved in the formulation do not feel connected to the new management.

There was also a lot of restructuring of departments within the NSE leading to confusion among employees. NSE was having a new leadership and this had led to changes made in organisational structure by the prior management to be scrapped and old structures reinstated. This has led to distrust of the management and most employees feel that there is no reward for performance and only patronage to the top management. This had led to reduced morale and lack of motivation.

4.2.3 Organisational Culture

Ahmadi, Salamzadeh, Daraei, and Akbari (2012) studied the impact of organizational culture while implementing strategies and concluded that a meaningful relationship exists between organizational culture and strategy implementation. All types of organizational cultures have significant relationships with the implementation process, but the extent of the culture's influence varies from the most effective (clan culture) to the least effective (hierarchy culture). A flexible structure and adaptable employees who are willing to initiate process and procedure changes are necessary in strategy implementation.

NSE management considers culture important because cultural handicaps can stall well intended strategic objectives. The respondents were asked what aspects of culture they believe to be posing a challenge in the implementation of the derivatives strategy. Responses received were varied and the researcher observed that those in management for over five years did not find anything challenging. Those new in the organisation however indicated that the culture is a challenge. Employees were used to old ways of doing things when the government owned the exchange and despite the fact the ownership changed to public listing, most employees resisted any change they viewed as unfriendly. The hierarchical command structure at NSE Limited has resulted to a culture where employees resist any changes brought by the management. The culture at NSE does not allow for open dialogue between top management and junior employees. There is therefore lack of communication and employees resisting new ideas.

4.2.4 Policies

According to Pearce and Robinson (1991) policies are directives designed to guide the thinking, decisions and actions of the managers including all those involved in the strategy implementation. Policies establish indirect control over actions and provide uniformity in handling of similar activities. McCarthy et al (1996) define policies as broad, general guides to action that outline the framework within which objectives are established and strategies are selected and implemented. Thompson Jr. and Strickland III (1989) state that changes in how internal activities are conducted and administered will be a strategy implementation challenge.

The study found that NSE is operating in a fast changing environment and it does not have clear policies guiding the implementation of the derivatives strategy. Most of the policies at the NSE are outdated and act as a challenge in the implementation of strategy. The researcher found out that NSE needs to upgrade policies to be in line with the organisation mission and to enable strategy execution. Policies on human resources need to be upgraded to uplift staff morale and motivate them to take ownership of the implementation. The policies should have a reward structure to boost employee morale.

4.2.5 Adequacy and allocation of Resources

While looking at how resource allocations within organisations are made, Bower (1970) found that the nature of capital investment projects initiated by business unit management was strongly influenced by the structural context established by top level management. Resources include financial resources, human resources, systems and tangible resources. There is a positive relationship between resource allocation policies and successful strategic implementation plan.

The respondents strongly emphasised that resource allocation, both financial and human resources greatly influenced strategy implementation. According to the respondents of this study, inadequacy of resources was a major obstacle to the implementation of derivatives strategy. NSE Limited will act as the clearing house for the derivatives products and it is required to have a Guarantee Fund to settle potential claims. The Guarantee Fund will act as protection against players who default on their obligations. Financial resources will be acquired from profit reserves accumulated over the years. The derivatives strategy requires a lot of financial capital.

Human resource was also a challenge identified in the study. Derivatives market is globally led by professionals with the required CFA qualification. The researcher found that NSE does not currently have employees with the required CFA qualification and this poses a huge challenge in fronting the derivatives product in the region. Acquiring professionals with the required qualifications was found to be difficult given that there are fewer than 100 people with the CFA qualifications in Kenya by the time this study was taken.

4.3 Measures taken by NSE Limited to overcome the challenges

Recommendations from the respondents on the challenges faced by NSE in the process of implementation of the derivatives strategy indicate that the leaders must take aggressive action to institutionalize strategy within the firm. The CEO indicated that managers involved in strategy formulation and implementation plan showed commitment and interest in strategy implementation which led to greater support for the strategic plan and execution.

On the challenge of policies, the responses from the management was that a business plan, NSE strategy 2014-2019 was being launched and this would address the structural resources and policies. The NSE Strategic plan would address the outdated policies and ensure implementation of policies adaptive to the fast changing markets and human resource needs.

The respondents indicated that a Derivatives Market Director would be hired to handle the derivatives market. This would ensure enough attention is given to the derivatives strategy implementation. The Derivatives Market Director will be accountable to the

Board of Directors and responsible for the successful execution of the derivatives strategy. By the time of study, the researcher found that recruitment for the position of Derivatives Market Director was ongoing.

On resource allocation and utilization, the management responded that that NSE has setup and allocated capital for the guarantee Fund. The management admitted that it is yet to address the human resource challenges especially acquiring employees with the Chartered Financial Analyst (CFA) qualifications but efforts had been put in place to educate existing employees on the derivative products. A Head of Human Capital would be appointed to handle the Human Resource challenge.

On challenges posed by culture, the management indicated that NSE Limited is undergoing a cultural transformation process to create a new culture that supports the derivatives strategy. Employees were undergoing training where they are equipped with skills to implement the strategy and operate in new changing environments. Also to cope with the cultural challenge, management would ensure effective communication to ensure employees understood their responsibilities. There was also employee involvement in the strategic management process to enable them own the derivatives strategy project and be more receptive to new ideas.

CHAPTER FIVE:

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter provides a summary of the discussions of findings, conclusions and recommendations. The objectives of the study were to determine the challenges faced by NSE in the implementation of the derivatives related strategy and how NSE has addressed those challenges.

5.2 Summary of findings

Implementation of the strategy has come with many challenges especially since this is a new market in the country. These challenges emanate from factors that influence strategy implementation namely; organisational structure, leadership, organisational culture, policies and resources.

The organisational structure at NSE does not allow easy implementation of strategy because the junior employees do not feel connected to the top management. The structure is hierarchical pyramid and the junior employees often do not have the avenues to approach the top management. This has led to many problems detected at the lower levels not to be reported to the management. There are also many departments in the organisation which have led to confusion as tasks are duplicated and there is also breakdown of communication.

The leadership has contributed to the implementation challenge because of the short term tenure of top management. New leadership is appointed every three years and this had led to short term thinking since every new management brings new ideas and do not necessarily feel the need to implement plans of the preceding leadership.

The culture of NSE does not allow for open dialogue between top management and junior employees who are expected to implement the strategy. While top management may formulate good plans, implementation is delayed because of disconnect between those expected to execute and those formulating the strategies.

Resources at NSE are not optimally allocated and strategies requiring a lot of financial capital are not always allocated enough resources. NSE relies on commissions from trading of financial securities for its financial capital. The financial market is unstable due its unpredictable nature and this means that NSE cannot forecast with certainty its cash flows Allocation of funds to the derivatives strategy is thus limited.

There is also failure of allocating people to right roles leading to apathy and dismal job performance. NSE also lacks employees with the technical capacity to drive the derivatives strategy. The derivatives strategy requires a dedicated team of technically competent people which is lacking at NSE.

In response to the above challenges, the study identifies the following methods employed by NSE to address the challenges faced in the implementation of derivative strategy. On the challenge of organisational structure, NSE is looking at restructuring to reduce the number of departments to allow for easier communication flow and reduce the level of bureaucracy. A derivatives department will be created with a dedicated team to handle

the implementation of the derivatives strategy. NSE also would begin training of employees and human resource reorganization to address the challenge of culture and human resource. NSE was aiming at marketing the financial market to increase trading which would in turn increase financial resources available.

5.3 Conclusion of the study

NSE Limited is governed by the Board of Directors and the Executive committee. The Board of Directors sets the policy and determines the direction of the organisation. The derivatives strategy was formulated by the board to enable the organisation compete with other exchanges in the world. The Board has caused delays due to failure to appoint the governance and advisory committees and set rules for capitalisation of the Guarantee Fund. This has led to lack of approval by the CMA for the launch of the derivative strategy. It has also led to delays as the executive committee cannot proceed in the implementation without finances and the advisory committee to guide implementation.

The Executive Committee, consisting of the top management at NSE, was tasked with the implementation of the strategy. The information gathered indicated that the executive committee has contributed to the delay in the implementation due to failure to finalise rules and directives and the failure to address the structural challenges relating to human resources.

5.4 Limitation of the study

The limitations of the study refer to those characteristics of design or methodology that impacted or influenced the application or interpretation of the results of the study.

The biggest challenge was time constraint which contributed to the difficulty in accessing information. Data collection was through face to face interviews requiring both respondent and interviewer to be present. Unavailability of the respondents for interview at the agreed upon time, owing to their busy schedules in attending to official issues that may not have been anticipated, which at times were conducted outside the NSE offices. This led to rescheduling of the interview time to fit into the respondents' diary and this led to the researcher not getting adequate time to capture all the information that may have been required for this study.

Another challenge was willingness of the respondents. Many of the respondents were not willing to participate in the study fearing breach of confidentiality. Despite persuasion and assurance to the respondents of absolute confidentiality, some respondents withheld important information which in the long run impacted on the outcome of the study.

5.4 Recommendation of the study

The study makes specific recommendations guided by the objectives of the study. The derivatives strategy provides immense opportunities for growth of the financial market in Kenya and in the region. NSE as the organisation mandated to drive the development of the derivatives market is faced with challenges in the implementation and has also taken measures to overcome the challenges.

NSE should put in place an organisational structure that supports the derivative strategy being implemented. The organisational culture should also be aligned to the strategy to reduce resistance to change by the employees. The study recommends that organizations should create higher levels of involvement of members in the organization through

effective communication and training. NSE management should also encourage open dialogue among all employees in order to collect views affecting the implementation.

As a strategy is being formulated, resources required should be well identified, quantified and set aside to enable execution and reduce delays. NSE should establish resource process policies so as to efficiently regulate resource allocation to ensure strategy implementation is a success.

5.5 Area for further studies

Generally, there is no research that is an end in itself. All research works are building blocks for future research. What this research has achieved in this area of study is minimal thus requiring further research. From the knowledge gained from the study, the researcher recommends the following which should act as a direction for further research.

This study was limited to the management of NSE Limited who were charged with implementing the derivatives related strategy. It is recommended that further research be done on the influence of the Board of directors of NSE on the implementation of the derivative strategy in the Kenyan market.

This study further recommends that future research be undertaken on the effect of high turnover of top management at the NSE on the implementation of strategy. The three year tenure for the Chief Executive Officer impacts on implementation of strategy especially where the strategy plan takes more than three years to formulate and implement.

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APPENDICES

Appendix I: Letter of Introduction

Lucy Muchiri

Department of Business Administration

University of Nairobi

P.O. Box 30197, Nairobi

September 2015

Dear Sir/Madam,

RE: Collection of survey data

I am a post graduate student at the University of Nairobi, at the School of Business. As part of my course work assessment, am required to submit a management research project. In this regard, am undertaking a research on “Challenges of implementing derivatives related strategy at the NSE in Kenya”.

This is to kindly request you to assist me by responding to the attached questionnaire. The information you provide will be used exclusively for academic purposes. I assure you that the information you give will be treated with strict confidence and at no time will your name appear in my report. A copy of the final paper will be availed to you upon request.

Yours sincerely

Lucy Muchiri

Appendix II: INTERVIEW GUIDE

Section A

- i. Position/Title of respondent.....
- ii. Department.....
- iii. Length of service in the organisation.....

Section B: Strategic Management Process

1. Does NSE Limited have a derivatives strategic plan?
2. Is the strategic plan formal or informal (written or unwritten)?
3. Has NSE Limited implemented its derivative strategic plan?
4. Does NSE monitor and evaluate its derivative strategic plan? If so how often?
5. Does NSE review its strategic plan?
6. What influences the review of the derivative strategic plan?
7. How often does NSE review its strategic plan?

Section B: Strategy Implementation

8. State briefly whether implementation of the derivative strategy at NSE has been successful and why you say so?
9. Did any changes take place in the organization during strategy implementation?
10. What kind of changes were these? State whether they were structural, cultural, leadership or otherwise.

Section C: Challenges of Strategy Implementation:

1. Organisational structure

1.1. What is the organizational structure at NSE?

1.2. Does NSE consider structure an important factor to strategy implementation?
Why do you say so?

1.3. Is the organizational structure a problem at NSE?

1.4. If so, why?

1.5. What aspects of the organizational structure are challenging, if any?

2. Leadership

2.1. Does NSE consider leadership an important factor in strategy implementation?

If so why?

2.2. What aspects of leadership are challenging, if any?

3. Culture

3.1. Does NSE consider culture an important factor to strategy implementation?

If so, why?

3.2. Is culture a challenge in the implementation of derivative strategy at NSE?

If so, why?

3.3. What aspects of the culture at NSE cause challenges in the implementation of derivatives strategy, if any?

4. Policies

- 4.1. State whether NSE considers policies important to strategy implementation. Why do you say so?
- 4.2. Do the existing policies support strategy implementation? What aspects of the policies are challenging?

5. Resource Allocation

- 5.1. Is resource allocation an important factor to strategy implementation at the NSE? If so, why?
- 5.2. Who determines resource allocation at NSE?
- 5.3. What aspects of the resource allocation are challenging, if any?

6. Management and Employee Involvement

- 6.1. Who formulates strategy at NSE? Is it the board or the managing director or the senior management or the middle management or is it participatory?
- 6.2. Does the approach adopted by the NSE pose a problem to strategy implementation? If so, why is the approach adopted by NSE problematic to strategy implementation.

7. Communication of Responsibility and Accountability

- 7.1. Does NSE consider communication of responsibility and accountability an important factor to strategy implementation? If so, why?
- 7.2. Is the communication of responsibility and accountability a challenge at NSE?
- 7.3. What aspects of the communication of responsibility and accountability are challenging, if any?