A STUDY OF STRATEGIC RESPONSES TO COMPETITIVE ENVIRONMENT AND ORGANIZATIONAL PERFORMANCE: A CASE STUDY OF THE CO-OPERATIVE BANK OF KENYA LIMITED

BY
EDWIN MAWIRA KUBAI

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A MANAGEMENT RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENT OF THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION (MBA),
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DECLARATION

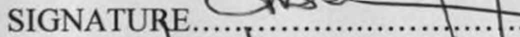
This research project is my original work and has not been presented for examination in any other institution or examination body.

Name: EDWIN MAWIRA KUBAI SIGNATURE..........................

DATE..5/11/2009..........................

REG NO: D61/8763/2006

This research project is presented for examination with my approval as the University supervisor.



Name: DR. Z. B. AWINO SIGNATURE..........................

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LIST OF ABBREVIATIONS

CBK: Central Bank of Kenya
KBA: Kenya Bankers Association
NSE: Nairobi Stock Exchange
KNFC: Kenya National Confederation of Co-operatives
IPO: Initial Public Offer
PBT: Profit Before Tax
SACCO: Savings and Credit Co-operative Society
PSV: Passenger Service Vehicle

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CHAPTER ONE

INTRODUCTION

1.1. Introduction

This chapter introduces the project of study. It starts by giving a background of the study by introducing the concept of an organization's interaction with the environment and other organizations in the same environment competing with it. The concept of Strategy is also defined and its interaction with the environment clearly described. The researcher goes on to introduce the banking industry so as to form a basis of competition and the organization of study which is the Co-operative Bank of Kenya. Lastly, the objectives, importance and the scope of study are described.

1.2. Background of the Study

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

Strategy is described as creating a fit between the external characteristics and internal organizational conditions to solve a strategic problem. Strategic management plays a key role in facilitating the deployment of a firm's resources in an efficient manner to ensure long term performance of the firm in a competitive environment. As Bennet (1999) noted, this makes implementation of competitive strategies critical, especially in the right of the stiff and ever increasing competition and complexity of today's world that can make it extremely difficult to assess and take advantage of opportunities open to a firm.
Banking has traditionally operated in a relatively stable environment for decades. However, today the industry is facing a dramatically aggressive competition in a new liberalized environment. Competition will undoubtedly continue to be a more significant factor.

1.1.1. Strategies and Competition

The primary objective of manager of profit seeking organizations is to maximize the performance of the firm over time. Bowman and Helfat (2001) found that corporate strategy is an essential management tool and is important to a firm performance, and achieving a performance advantage through strategic initiatives is increasingly important in the financial services industry (Farrance, 1993). Porter (1980, 1985) argues that superior performance can be achieved in a competitive industry through the pursuit of a generic strategy, which he defines as the development of an overall cost leadership, differentiation, or focus approach to industry competitor. If a firm does not pursue one of these strategy types, it will be "stuck-in-the-middle" and will experience lower performance when compared to firms that pursue a generic strategy.

The essential managerial dictum of strategy is that competitive advantage accrues to those firms whose distinctive organizational competitive have a superior fit with the business and societal environment within which they operate (Andrews, 1971). As Porter (1984 & 1994) noted, drawing heavily upon industrial organization economies and structure-conduct-performance paradigm, this perspective has been used effectively to explain why certain firms have superior performance in particular market places. Day and Wensely (1988) argue that competitive strategies consist of skills and resources that are available for use by firms in a competitive industry. They define superior skills in terms of staff capability, systems, or marketing savvy not possessed by a competitor. A superior resource is defined in terms of physical resource that is available to help strategy implementation. Examples include operating scale, location, comprehensiveness of a distribution system, brand equity, or manufacturing or processing assets. They conclude that establishing a generic strategy-based positional advantage in the market place will provide a firm with superior performance.

The old competitive strategies of invention and mass production no longer work in an increasingly turbulent business environment. Successful firms are always implementing new competitive strategies of continuous improvement *(kaizen)* and mass customization which is defined as a dynamic flow of goods and services via a stable set of processes. Managers of firms must assess their firm's current competitive position, build a vision for

where they must be in the future, and craft transformation strategy to turn that future vision into reality. Understanding the key forces at work in the competitive environment and identifying the underlying forces in the macro environment that are driving the competitive forces are critical for the success for firms operating in that industry.

1.1.2. Banking industry in Kenya

The Banking industry in Kenya is governed by the Companies Act (Cap 286), the Banking Act, the Central Bank of Kenya Act and the various prudential guidelines issued by the Central Bank of Kenya (CBK). The banking sector was liberalized in 1995 and exchange controls lifted. The CBK, which falls under the Minister for Finance's docket, is responsible for formulating and implementing monetary policy and fostering the liquidity, solvency and proper functioning of the financial system. The CBK publishes information on Kenya's commercial banks and non-banking financial institutions, interest rates and other publications and guidelines.

There are forty-six banks and non-bank financial institutions, fifteen micro finance institutions and forty-eight foreign exchange bureaus. Thirty-five of the banks, most of which are small to medium sized, are locally-owned. The industry is dominated by a few large banks most of which are foreign-owned, though some are partially locally-owned. Seven of the major banks are listed on the Nairobi Stock Exchange. The banks have come together under the Kenya Bankers Association (KBA) which serves as a lobby for the banks' interests and also addresses issues affecting member institutions. The commercial banks and non-banking financial institutions offer corporate and retail banking services but a small number, mainly comprising the larger banks, offer other services including investment banking.

The key issues affecting the banking industry in Kenya are:
(i) Changes in the regulatory framework, where liberalization exists but the market still continues to be restrictive; (ii) Declining interest margins due to customer pressure, leading to mergers and re-organizations; (iii) Increased demand for non-traditional services including the automation of a large number of services and a move towards emphasis on the customer rather than the product; and (iv) Introduction of non-traditional

players, who now offer financial services products. The banking sector is poised for significant product and market development that should result in further consolidation.

Banks are currently facing stiff competition from microfinance institutions and also non bank financial institutions. For instance, safaricom launched M-Pesa and Celtel now, Zain Sokotele and Zap money transfer services recently. These services are aimed at people who do not operate bank accounts. With M-pesa service, clients are able to transfer money through their mobile phones, and soketele devises can be used for making calls and also transfer money. Following this move of Safaricom and Zain, visa has launched an initiative to shift the use of plastic cards to mobile phones. Visa's service will enable users to buy goods by a simple wave of their phone. As can be seen, telecommunications providers are entering into the financial services sector. Banks will have to modify their products and services to satisfy the needs of the customers and to grow their market share.

1.1.3. History of the Co-operative Bank of Kenya.

The Co-operative Bank of Kenya Limited is incorporated in Kenya under the Company's Act (cap 486), and is also licensed to do the business of banking under the Banking Act. The Bank was initially registered under the Co-operative Societies Act (cap 460) at the point of founding in 1965. This status was retained up to and until June 27th 2008 when the Bank's Special General Meeting resolved to incorporate under the Companies Act with a view to complying with the requirements for listing on the NSE.

The Bank went public and was listed on December 22 2008. Shares previously held by the over 3,000 co-operatives societies and unions were ring-fenced under Coop Holdings Co-operative Society Limited which became the strategic investor in the Bank with a 64.43% stake.

The Bank runs two wholly-owned subsidiary companies, namely: Co-op Trust Investment Services Limited, the fund management subsidiary and Co-operative Consultancy Services (K) Limited, the corporate finance, merchant and investment banking subsidiary.

The bank has a controlling stake in Kingdom Securities Ltd, a stock brokerage firm.

Vision: To be the leading and dominant Kenyan bank with a strong countrywide presence, playing a central role in the co-operative movement and providing relevant and

innovative financial services to our customers for the optimum benefit of all our stakeholders.

Mission: To offer value-added financial services to our chosen market segments with special emphasis on the co-operative movement through a highly effective network of service points, excellent customer service and a highly motivated team of qualified personnel.

Shareholding Structure

The Co-operative Bank is 100% privately owned by over 116,000 shareholders (as at point of listing on Dec 22 2008). Out of this, Coop Holdings Co-operative Society Limited owns 64.43%, with the rest held by other investors.

The Bank has an Authorized share capital of Kes 3,700,000,000 made up of 3,700,000,000 shares of Kes 1.00 each, and an Issued and fully paid capital of Kes 3,499,212,000 made up of 3,499,212,000 shares of Kes 1.00 each.

The main **objectives** for establishment of The Co-operative Bank of Kenya were (i) To mobilize financial resources and (ii) Provide banking services to the co-operative movement. The Bank opened for business on 10th January 1968 with a modest capital base of Kes 255,000. The Government supplemented the capital with a Kes 214,000 interest-free loan repayable in 10 years. The Banking Act, however, required banks to have a minimum capital of a 'staggering' Kes 2 million. The Government granted an exemption and offered a grace period within which the required capital was to be raised. The Commissioner for Co-operative Development, with the support of Kenya National Confederation of Co-operatives (KNFC), directed that all co-operative society funds invested with other banks be transferred to the Co-operative Bank. The Commissioner further advised all co-operatives to buy shares in the Bank. This tremendously increased the bank's deposit and capital base, laying a firm foundation for the bank. In 1974, the Co-operative Department, which had operated under several ministries since the colonial period, was upgraded to full ministry status as Ministry of Co-operative Development, to further stimulate the growth of the movement. In its first year of business, the Bank posted a profit of Kes 172,000 from a capital base of Kes 634,000, deposits of Kes 5.3 million and total assets of Kes 5.7 million.

On August 7th 1998, the bank suffered a major setback from a terrorist bombing that completely gutted the Bank's Head office, Co-operative House, necessitating a full re-location of the bank to alternative premises. Despite the bombing, suspected to have been targeted at the neighbouring Embassy of the United States, the Bank managed to realize a remarkable recovery and retained the confidence of customers and other stakeholders.
The Bank reported a significant reduction in performance by posting a Kes 2 billion loss for year 2000. In the same year the bank interconnected all branches countrywide and became only the second bank in Kenya to offer fully centralized banking. The Bank recorded a rapid improvement in performance by reporting a significant 60% reduction on the year 2000 loss position of over Kes 2 billion by reporting a Kes 802 million loss for year 2001. The bank re-occupied Co-operative Bank House in 2002 after renovations occasioned by the 1998 bombing are completed.The Bank realized complete turnaround by recording a Kes 2.3 billion profit before tax for year 2007, as compared to the Kes 2.4 billion loss for year 2000. The Bank also declared a dividend of 8% which translated to Kes 8.00 per share, the highest payout in many years.

In 2008, the bank announced intention to list on the stock exchange in the third quarter of 2008. The listing comes with an Initial Public offer (IPO) intended to raise an estimated Kes 6 billion in new capital, and also enable existing shareholders to discover the value of their stock which is up-to now unlisted. The IPO began on 30th October, 2008 to end on 13th November, 2008. The bank listed on the Nairobi Stock Exchange on December 22. The listing followed a public offer of 701.3 million shares at Kshs 9.50 which achieved an 81% subscription to raise Kshs 5.4 billion in additional capital on top of the existing Kshs 7.4 billion. This was made possible when the bank's special general meeting on 27th June approved conversion of the bank to a limited liability company from a co-operative society that it had been since inception in 1965. All previous shares held by the Co-operatives were ring-fenced under the Co-op holdings Co-operative Society Limited which became the strategic investor in the bank.
The bank announced financial results for 2008 which recorded a 48% increase in profitability to a record approx KES 3.4 billion shillings (PBT).

1.3. Statement of the problem

Organizations are operating in very stiff environments and more so when they are selling products and/or services which are almost similar and when they target the same group of customers. Environmental forces largely influence competition within an industry especially those related to technology, economic forces social and cultural values. Strategic management plays a key role in facilitating the deployment of a firm's resources in an efficient manner to ensure long term performance of a firm in a competitive environment.

Banking has traditionally operated in a relatively stable environment from 1960s to early 90s offered by the government's treasury bills and bonds. However, today the industry is facing a dramatically aggressive competition in a new liberalized environment. Competition will undoubtedly continue to be a more significant factor. Those banks not considering the impacts of the increased competition and protect their competitive position will likely become victims of the industry competition.

Studies have been carried out and related to the study the researcher is undertaking. Goro (2003) made an evaluation of Strategic responses of commercial banks to the threat of substitute products. The study revealed that to counter the threat of substitutes, commercial banks were diversifying their product portfolio to include these substitute products in their portfolios. Further, it was recommended that commercial banks should monitor emerging competitors both in financial and non financial sectors and quick responses be formulated to counter the threats as they emerge. Koros (2001) carried out an evaluation of financial performance of non- banking financial institutions that converted to commercial banks in Kenya. Gathoga (2001) set out to identify the strategies that commercial banks have applied to respond to changes in the environment. Isaboke (2001) did an investigation of strategic responses by major oil companies in Kenya to the threat of new entrants in the industry. Chepkwony (2001) made an inquiry into strategic responses of petroleum firms in Kenya to challenges of increased competition in the industry. Kandie (2001) was concerned with strategic responses by Telkom Kenya to cope with the competitive environment.

No known study has been carried to study the strategic responses to competitive environment of the Co-operative Bank of Kenya Ltd. The researcher critically studied the

strategic responses that the Co-operative Bank of Kenya Ltd has adopted to cope with the emerging competition in the banking industry and how these responses have helped it to succeed in its operations. Of special interest will be the period preceding its conversion into a commercial bank in 1994 and the dwindling economic fortunes up to the year 2000 when the bank made a historic KES 2 Billion loss. The bank management thereafter came up with various strategies which saw the bank make a complete turn around achieving a profit before Tax of KES 2.3 Billion in the year 2007. This is the same period that witnessed the increased competition in the industry with new entrants and other building societies and micro-finance institutions converting to commercial banks. Despite all this competition, the bank was able to achieve these results.

The following were the research questions:

1. What strategic responses has Co-operative bank established in response to increased competition in the banking industry?
2. What is the effect of these strategic responses to the performance of the bank?

1.4. General Objective

To study the strategic responses of Co-operative Bank of Kenya Ltd to a changing competitive environment.

1.5. Specific Objectives

1. To establish the strategic responses adopted by Co-operative bank in response to increased competition.
2. To establish the effects of the strategic responses to the performance of Co-operative Bank

1.6. Importance of the study

The study will be important to managers of financial institutions in their quest for choice of strategy for managing their organizations to ensure success despite the high competition. Scholars will use the study for reference and further research based on the findings.

1.7. Scope of the Study

The study was conducted at The Co-operative Bank of Kenya Ltd at the head office and information was gathered from major decision makers of the bank who are members of the Board of management and senior managers based at head office.

1.8. Summary

Every organization strives to remain competitive in the industry in which it operates and Co-operative Bank of Kenya is no exception. The chapter deals with the Co-operative Bank of Kenya and the banking industry in which it operates. The objectives of the study are mentioned and lastly the importance and scope of the study. This chapter gives the foundation of the project for the study in detail.

CHAPTER TWO

LITERATURE REVIEW

2.1. Introduction

This chapter gives an elaborate brief on the available literature that relate to the field of study. The researcher gives a description of development of strategy from prominent writers in the field and their contributions to the field of study. This is then collated with other studies done in the past which in one way or another touch the field of study. The study then proceeds to describe the different competitive strategies that a firm may adopt. Michael Porter's five force competitive model is described. Lastly the study's conceptual framework is described and tabulated.

2.2. Development of Strategy

Strategy is about winning (Grant, 1998). While there is no dispute regarding the importance of strategy in business management, there does not appear to be any agreement as to what exactly is strategy or how exactly the 'winning' is achieved. Indeed, there are as many approaches to strategy but none are universally accepted (Stacey, 2003). Likewise Ansof, (1987) says that strategy is an elusive and somewhat abstract concept. Since the introduction of long range planning, and later strategic management, most organizations have been developing corporate strategies in one form or the other. Burnes, (2004) follows the trends in strategy development practices since the times of the classical and Human Relations approach up to the development of the contingency theory around the 1960's to the development of new paradigms in the 1980's and 1990's. Burnes (2004) argues that rather than managers being prisoners of mathematical models and rational approaches to strategy development, they have considerable freedom of action and a wide range of options to choose from. Although he recognizes the fact that managers are not totally free agents as their freedom of action is constrained or shaped by the unique set of organizational, environmental and societal factors, he argues that these constraints are not immutable. He further argues that it is possible for managers to manipulate the situational variables they face with regard to structures. He goes further to argue that managers can exert some influence over strategic constraints and potentially at least they can select the approach to strategy that best suits their preferences.

One of the environmental threats to a business arises from competition. Increased competition threatens the attractiveness of an industry and reducing its profitability. It exerts pressure on firms to be practical and to formulate successful strategies that facilitate proactive response to anticipated and actual changes in the competitive environment. Firms therefore focus on gaining competitive advantage to enable them respond to, and compete effectively in the market, firms respond to competition in different ways. Some may opt to do product improvement divesture and diversification, entry into new markets or even merging or buying out competitors. Porter (1985) postulates that, the essence of strategy formulation is coping with commotion.

The foregoing not withstanding, the subject, of strategy has continued to develop as organizations craft new ways of 'surviving' and 'winning' in a business arena where everything is changing on a real-time basis and the rules of the game are not even known to any of the players. Morgan (1988) equates business management to surfing in a turbulent sea and streets that like surfers, managers and their organizations have to ride on a sea of change that can twist and turn with all the power of the ocean.

Managers of the future will have to ride this turbulence with increasing skills and many more competences will be required (Morgan, 1988). Burnes (2004) argues that the organizational, environmental and societal constraints are not immutable and that managers can select the approach to strategy that best suits their preference is intriguing because it gives an underlying implication that business managers can literally overcome any strategic obstacle placed on their paths.

Environment has been characterized as complex, dynamic multi-faced and having far reaching impact (Chepkwony, 2000). As a result of these characteristics, the environment is composed of various factors, events, conditions and influence, which interact with each other to create an entirely new set of influences leading to constant environmental change in its shape and character. A fundamental change is occurring in the world economy whereby the world economies are witnessing the forces of globalization and liberalization of trade. Ansoff (1987) noted that the environment is constantly changing and so it makes it imperative for organizations to continuously adapt their activities to succeed. In order

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to survive in this very dynamic environment, organizations need strategies to focus on their customers and to deal with the emerging environmental challenges.
The Kenyan business environment has been undergoing drastic changes for sometime now. Some of the changes include the accelerated implementation of economic reforms, the globalization and liberalization of the economy, dis-continuation of price controls, privatization and commercialization of the public sector and increased competition. In this changing environment, organizations have to constantly adapt their activities and internal configurations to reflect the new external realities. Failure to do this may put the future success of the organization in jeopardy (Aosa, 1998).

Aosa (1992) noted that industries are responding to customer's demand by becoming more innovative in their new ways of approaching the changed environment. They adopt strategies such as improved customer service. Rapid technological change has created a business environment where innovation has become a top competitive strategy. According to Ansoff and McDonnell (1990), increased competition has created fundamental shift in economic environment whereas no organization can hope to stay afloat if it fails to come up with proper strategic responses. Terminologies such as retrenchment, mergers, rightsizing and cost reduction have become a routine for survival means. Ansoff and McDonnell (1990) noted that strategic responses involve changes in the firm's strategic behaviour to assure success in transforming future environment.

Pearce and Robinson (2003) defined strategic responses as the set of decisions and actions that results in the formalization and implementation of plans designed to achieve a firm's objectives., therefore it is a reaction to what is happening in the economic environment of organizations. Porter (1996), views operational responses as part of a planning process that coordinates operational goals with those of the larger organization. Hence operational issues are mostly concerned with certain broad policies and policies for utilizing the resource of a firm to the best support of its long term competitive strategy.

Thus strategy refers to the machinery of the resources and activities of an organization to the environment in which it operates (Johnson and Scholes 2001). According to Ansoff

and McDonnell (1990), it is through strategic management that a firm will be able to position and relate itself to the environment to ensure its continued success and also secure itself form surprises brought about by the changing environment. He further argues that this can be done by firstly, positing of the firm through strategy and capability planning in its rightful competitiveness, and secondly, use of real time response through issue management and thirdly, systematic management of resistance during strategic implementation. Therefore strategic management is vital to a firm's success and indeed, for its continued survival.

2.3. Competitive Strategies

Porter (1980) argues that a firm can achieve a higher level of performance over a rival in one of two ways: either it can supply an identical product or service at a lower cost, or it can supply a product or service that is differentiated in such a way that the customer is willing to pay a price premium that exceeds the additional cost of the differentiation. In the former case, the firm possesses a cost advantage. In the latter, the firm possesses a differential advantage. In pursuing cost advantage, the goal of the firm is to become the cost leader in its industry or industry segment. On the other hand, differentiation by a firm from its competitors is achieved when it provides something unique that is valuable to buyers beyond simply offering a low price (Porter, 1980, 1985). A firm that is competing on low cost is distinguishable from a firm that competes through differentiation in terms of market positioning, resources and capabilities, and organizational characteristics. Porter originally viewed cost leadership and differentiation as mutually exclusive strategies. He argued that effectively implementing these generic strategies required total commitment and supporting organizational arrangements that are diluted if there is more than one primary focus.

If a firm attempts to pursue both at the same time, it will result in inferior performance, so-called, "stuck in the middle" (Porter, 1980, 1985). A cost leadership strategy is designed to produce goods or services more cheaply than competitors by stressing efficient scale of operation. When a firm designs, produces, and sells a comparable product more efficiently than its competitors as well as its market scope is industry- wide, it means that the firm is carrying out the cost leadership strategy successfully (Parnell,

2000; Brooks, 1993). Firms often drive their cost lower through investments in efficient-scale facilities, tight cost and overhead control, and cost minimizations in such areas as service, selling and advertising (Porter 1980). They often sell no- frills, standardized products to the most typical customers in the industry. Thus, the primary thing for a firm seeking competitively valuable way by reducing cost is to concentrate on maintaining efficiency through all activities in order to effectively control every expense and find new sources of potential cost reduction (Dess and Davis, 1984). With the differentiation strategy, on the other hand, the unique attributes or perceptions of uniqueness and characteristics of a firm's product other than cost provide value to customers. The firm pursuing differentiation seeks to be unique in its industry along some dimensions that is valued by customers, which means investing in product R&D and marketing (Porter, 1980). It is the ability to sell its differentiated product at a price that exceeds what was spent to create it that allows the firm to out perform its rivals and earn above-average returns.

Unusual features, responsive customer services, rapid product innovations and technological leadership, perceived and status, different tastes, and engineering design and performance are examples of approaches to differentiation (Porter, 1980). Rather than cost reduction, a firm using the differentiation needs to concentrate on investing in and developing such things that are distinguishable and customers will perceive. Overall, the essential success factor of differentiation in terms of strategy implementation is to develop and maintain innovativeness, creativeness, and organizational learning within a firm (Ireland et al., 2001; Dess and Davis, 1984; Porter, 1985).

2.3.1. Low Cost Leadership Strategy

One of Porter's generic strategies is cost leadership (Malburg, 2000). This strategy focuses on gaining competitive advantage by having the lowest cost in the industry (Porter, 1979, 1987, 1996). In order to achieve a low-cost advantage, an organization must have a low-cost leadership strategy, low cost manufacturing, and a workforce committed to the low-cost strategy (Malburg, 2000). The organization must be willing to discontinue any activities to other organizations with a cost advantage (Malburg, 2000).

For an effective cost leadership strategy, a firm must have a large market share (Hyatt, 2001).

There are many areas to achieve cost leadership such as mass production, mass distribution, economies of scale, technology, product design, input cost, capacity utilization of resources, and access to raw materials (Malburg, 2000). Porter (1985) purports only one firm in an industry can be the cost leader (Venu, 2001)) and if this is the only difference between a firm and competitors, the best strategic choice is the low cost leadership role (Malburg, 2000). Lower cost and cost advantages result from process innovations, learning curve benefits, economics of scale, product designs reducing manufacturing time and costs, linking strategic practices and re-engineering activities. A low cost of leadership strategy is effectively implemented when the business designs, produces and markets a comparable product more efficiently than its competitors.

The firm may have access to raw materials or superior proprietary technology which helps to lower costs. Firms do not have to sacrifice revenue to be the cost leader since high revenue is achieved through obtaining a large market share (Porter, 1979, 1987, 1996, Bauer and Colgan, 2001). Lower prices lead to higher demand and, therefore, to a larger market share (Helms et al, 1997). As low cost leaders, an organization can present barriers against new market entrants who would need large amounts of capital to enter the market (Hyatt, 2001). The leader then is somewhat insulated from industry wide price reductions (Porter, 1980; Malburg 2000). The cost leadership strategy does have disadvantages. It creates little customer loyalty and if a firm lowers prices too much, it may lose revenues (Cross, 1999).

2.3.2 Differentiation Strategy

Differentiation is one of Porter's key business strategies (Reilly, 2002). When using this strategy, a company focuses its efforts on providing a unique product or service (Hyatt, 2001). Since, the product or service is unique; this strategy provides high customer loyalty (Porter, 1985). Pearce and Robinson (2007) contend that strategies dependent on differentiation are designed to appeal to customers with a special sensitivity for a particular product attribute. By stressing the attribute above other product qualities, the

firm attempts to build customer loyalty. As a result, such loyalty translates into a firm's ability to charge a premium price for its products. The product attribute can also be the marketing channels through which it is delivered, its image for excellence, the features it includes and the services network that supports it.

Product differentiation fulfills a customer need and involves tailoring the product or service to the customer. This allows organizations to charge a premium price to capture market share. The differentiation strategy is effectively implemented when the business provides unique or superior value to the customer through product quality, features or after-sale support. Firms following a differentiation strategy can charge a higher price for their products based on the product characteristics, the delivery system, the quality of service, or the distribution channels. The quality may be real or perceived based on fashion, brand name, or image. The differentiation strategy appeals to a sophisticated or knowledgeable consumer interested in a unique or quality product and willing to pay a higher price.

The key step in devising a differentiation strategy is to determine what makes a company different from a competitor's (Cracken, 2002). Factors including market sector quality of work, the size of the firm, the image, graphical reach, involvement in client organizations, product, delivery system, and the marketing approach have been suggested to differentiate a firm (Cracken, 2002; Davidson, 2001). To be effective, the message of differentiation must reach the clients (Cracken, 2002), as the customer's perceptions of the company are important (Berthoff, 2002). Van Raaij and Verhallen (1994) suggested bending the customer's will to match the company's mission through differentiation. When using differentiation, firms must be prepared to add a premium to the cost (Hyatt, 2001). This is not to suggest costs and prices are not considered; only it is not the main focus. However, since customers perceive the product or service as unique, they are loyal to the company and willing to pay the higher price for its products.

2.3.3. Focus Strategy

In the focus strategy, a firm targets a specific segment of the market (Davidson, 2001; Porter, 1979, 1987). The firm can choose to focus on a select customer group, product

range, geographical area, or service line (Anon, 1998). For example; some European firms focus solely on the European market (Stone, 1995). Focus also is based on adopting a narrow competitive scope within an industry. Focus aims at growing market share through operating in a niche market or in markets either not attractive to, or overlooked by, larger competitors.

These niches arise from a number of factors including geography, buyer characteristics, and product specifications or requirements. A successful focus strategy (Porter, 1980) depends upon an industry segment large enough to have good growth potential but not of key importance to other major competitors. Market penetration or market development can be an important focus strategy. Midsize and large firms use focus-based strategies but only in conjunction with differentiation or cost leadership generic strategies. But, focus strategies are most effective when consumers have distinct preferences and when the niche has not been pursued by rival firms (David, 2000).

2.3.4. A Combination of Generic Strategies

These generic strategies are not necessarily compatible with one another. If a firm attempts to achieve an advantage on all fronts, in this attempt, it may achieve no advantage at all. For example, if a firm differentiates itself by supplying very high quality products, it risks undermining that quality if it seeks to become a cost leader. Even if the quality did not suffer, the firm would risk projecting a confusing image. For this reason, Porter (1980) argued that to be successful over the long-term, a firm must select only one of these three generic strategies. Otherwise, with more than one single generic strategy the firm will be "stuck in the middle" and will not achieve a competitive advantage. Porter (1980) argued that firms that are able to succeed at multiple strategies often do so by creating separate business units for each strategy. By separating into different units having different policies and even different cultures, a corporation is less likely to become "Stuck in the middle".

However, there exists a viewpoint that a single generic strategy is not always best because within the same product, customers often seek multi-dimensional satisfactions such as a combination of quality, style, convenience, and price. There have been cases in which high quality producers faithfully followed a single strategy and then suffered

greatly when another firm entered the market with a lower-quality product that better met the overall needs of the customers.

2.4 Value Disciplines

International management consultants Treacy and Wiersema (1995) proposed an alternative approach to generic strategy and called them value disciplines, they believe that strategies must centre on delivering superior customers value through one of three value disciplines: operational excellence, customer intimacy, or product leadership (Pearce and Robinson, 2007). Companies that specialize in one of these disciplines, while simultaneously meeting industry standards in the other two, gain a sustainable lead in their market. This lead is derived from the firm's focus on one discipline aligning all aspects of operations with it. After transforming their organizations to focus on one discipline, companies can concentrate on smaller adjustments to produce incremental value.

2.4.1 Operational Excellence

It is specific strategic approach to the production and delivery of products and services (Pearce and Robinson, 2007). Operation based strategies are defined by Hayes and Upton (1998) as superior operations effectiveness not only serving but buttressing a company's existing competitive position: but when based on capabilities that are embedded on company's people and operating processes, inherently difficult to imitate. For this reason, it can provide the basis for a sustainable competitive advantage, even when the company adopts the same competitive position as one or more of its competitors. A company that follows this strategy attempts to lead its industry in price and convenience by pursuing a focus on lean and efficient operations. Such companies work to minimize costs by reducing overheads, eliminating intermediate production steps, reducing transaction costs, and optimizing business processes across functional and organization boundaries, the focus being delivering products or services to customers at competitive prices with minimal inconvenience. Such company's core competences are operations, including the whole logistical cycle; purchasing manufacturing and distribution. (Pearce and Robinson, 2007).

2.4.2 Product Innovation

Companies whose strategy is based on product innovation guarantee their economic success through systematic introduction of radically new products in the market, usually by making existing ones obsolete. They endeavor to continuously produce state-of-the-art products and services (Pearce and Robinson, 2007). Their core competence is research and development and engineering (R & D & E). Three challenges must be met to attain that goal, creativity being the first one. It's the recognition and embracing ideas usually outside the company. Secondly, innovative companies must commercialize ideas quickly. Thus, their business and management processes need to be engineered for speed. Product leaders relentlessly pursue new solutions to problems. Finally, firms utilizing this discipline prefer to release their implements rather than wait for competitors to enter. Hence, product leaders do not stop for self-congratulation; they focus on continual improvement, they act as their own competition, and believe that if they do not develop a successor, a competitor will. Such firms survive and prospers due to the high profitability they achieve in the period where they enjoy monopolistic market position (Abernathy and Utteback, 1975).

2.4.3 Customer Intimacy

These are companies concerned with servicing specific customers in specific areas: personalizing and customizing products and services to meet unique customer needs. Companies excelling in customer intimacy combine detailed customer knowledge with operational flexibility. They respond quickly to almost any need, from customizing a product to fulfilling special requests to create customer loyalty (Pearce and Robinson, 2007). Customer intimate companies are willing to spend money now to build customer loyalty for the long term, considering each customer's lifetime value to the company, not the profit for any single transaction. Consequently, employees in customer-intimate companies go to great lengths to ensure customer satisfaction with low regard for initial cost (Pearce and Robinson, 2007). The profitability of those companies is the result of a premium price that they are able to charge their customers for the differentiated service they provide.

2.5. Factors influencing choice of strategy

Although managers prefer to formulate decisions through a systematic approach, the concept of bounded rationality suggests that managers might be forced to make these important decisions by giving considerations to only a limited number of issues. Often the focus is on external factors, such as financial risk, market attractiveness and competitive advantage, at the expense of internal factors. Current research into how decisions are influenced by the external environment continues to be an area of interest in the literature (Song et al., 2002). The fit between the organization's strategy and external factors is our crucial importance in the choice and formulation of a plan.

Many researchers have suggested that ignoring internal factors may significantly impact the chances for successful implementation and ultimately, the success of the strategy. Indeed, Hussy, (1999) articulates that specifically, implementation appears an easy task and one that can happily be left to operating management. In strategic management as a whole, implementation is often as thoroughly as it should be. Bomona (1985) drew attention to the fact that when the results of strategy are worse than expected a common reaction is to change the strategy, although many times the failure is due to poor implementation. A good strategy implemented badly can be as damaging to an organization as a bad strategy implemented well. Generally, strategy provides direction to an organization as to how to properly align firm resources to exploit opportunities and minimize threats (Porter, 1985). The term strategic fit describes the degree of alignment among resources of the firm (Internal factors) and the competitive environment (external factors) hence strategic choices (Chorn, 1991).

2.6. Competition and its Challenges

Competition can be defined as action and response (Chen and Miller, 1994; smith et al.1992) – or preemption, attack and retaliation – in competitive engagement against rivals. Competition often aims primarily at jockeying for positions, pre-empting rival action, and gaining valuable resources or access (Chen and Miller, 1994: Ghemawat, 1991; Porter, 1980). The competitive advantage gained through maneuvers is often ownership – based, e.g. a strong market position, or access-based e.g. wining over rivals by securing a dominant distribution channel in a jointly contested foreign market.

Porter (1998) contends that the intensity of competition in an industry is neither a matter of coincidence nor bad luck. Rather, competition in an industry is rooted in its underlying economic structures and goes well beyond the behaviour of current competitors. The state of competition in any industry depends on five basic competitive forces/challenges as shown in the Figure 1 in appendix 3.

2.6.1. The Degree of Rivalry

The intensity of rivalry, which is most obvious of the five forces in an industry, helps determines the extent to which the value created by an industry will be dissipated through head-to-head competition. The most valuable contribution of Porter's five forces; framework in this issue may be its suggestion that rivalry, while important, is only one of several forces that determine industry attractiveness. Rivalry among existing competitors take the familiar from of jockeying for a position-using tactics like price competition, advertising battles, product introductions, and increased customer service or warranties. Rivalry occurs because one or more competitors either feels the pressure or sees the opportunity to improve position (Porter, 1998). Rivalry in some industries is characterized by such phrases as 'warlike', 'bitter,' or 'cutthroat', whereas in other industries it is termed 'polite' or 'gentlemanly'.

2.6.2. The threat of entry

Both potential and existing competitors influence average industry profitability. The key concept in analyzing the threat of new entrants is the entry barriers. They can take diverse forms and are used to prevent an influx of firms into an industry whenever profits, adjusted for the cost of capital, rise above zero. In contrast, entry replicates the incumbents, position. The most common forms of entry barriers, except sharp retaliation from entrenched competitors, the threat of entry is low. (Porter, 1998).

2.6.3. The threat of substitutes

The threat of substitute products to an industry's profitability depends on the relative price-to-performance ratios of the different types of products or services to which customers can turn to satisfy the same basic needs. The threat of substitution is also

affected by switching costs – that is, the costs in areas such as retraining, retooling and redesigning that are incurred when a customer switches to a different type of product or service. The substitution process follows an S-shape curve. It starts slowly as a few trendsetters risk experimenting with the substitute, picks up steam if others customers follow suit, and finally levels off when nearly all the economical substitution possibilities have been exhausted. Substitutes limit the potential returns of an industry by placing a ceiling on the prices firms in the industry can profitability charge (Porter, 1998). The more attractive the price-performance alternative offered by substitutes, the firmer the lid on industry profits.

2.6.4. Buyer Power

Buyers compete with the industry by forcing down prices, bargaining for higher quality or more services, and playing competitors against each other-all at the expense of industry profitability (Porter, 1998). Buyer power is one of the two horizontal forces that influence the appropriation of the value created by an industry. The most important determinants of buyer power are the size and the connection of customers. Other actors are the extent to which the buyers are informed and the concentration or differentiation of the competitors. It is often useful to distinguish potential buyer power from the buyer's willingness or incentive to use that power, willingness that derives mainly from the "risk or failure" associated with a product's use. Porter (1998) asserts that a company's choice of buyer groups to sell to should be viewed as a crucial strategic decision. A company can improve its strategic posture by finding buyers who possess the least power to influence it adversely.

2.6.5 Supplier Power

Supplier power is the mirror image of buyer power. As a result, the analysis of supplier power typically focuses first on the relative size and concentration of suppliers relative to industry participants and second on the second on the degree of differentiation in the inputs supplied. The ability to charge customers different prices in line with differences in the value created for each of those buyers usually indicates that the market is characterized by high supplier power and at the some time by low buyer power (Porter, 1989, 1996). Suppliers can also exert bargaining power over participants in an industry

by threatening to raise prices or reduce the quality of purchased goods and services. Powerful suppliers can thereby squeeze profitability out of an industry unable to recover cost increases in its own prices.

2.7. Organizations and Environment

Pearce and Robinson (2007) define an organization's external environment as all those factors beyond the control of the firm that influence its choice of direction and action, organizational structure and internal processes. Porter (1985) sees this connection as an input-throughout-process, where inputs are received from the environment, processed by the organization, and released back into the environment. What is released back can only be consumed by the environment if it fits the environmental requirements and needs. Thompson (1997) argues that the managers must only be aware of environmental forces and environmental change, but they must also manage the organization's resources to take advantage of opportunities and counter threats.

Pearce and Robinson (2007) reckon that the factors that consist of the external environment can be divided into three inter-related sub-categories: factors in the remote environment, factors in the industry environment and factors in the operating environment. Thompson (1997) sees the external environment as consisting of three aspects: the external stakeholders; the changing political, economic, social and technological forces, and the organizations response to the nature of the stakeholders and the environmental forces. Shipper and White (1988) refer to the external environment as having multiple facets, three of the major ones being, the degree of market competitiveness, the rate of technical innovation and the variability of economic fluctuations that affect the industry.

The volatility of the external environment influences how organizations restructure themselves to cope with change or to anticipate them. Fulmer, Gibbs, and Goldsmith (2000) note that globalization; deregulation, e-commerce and rapid technological change are forcing companies to re-evaluate the way they operate. Pearce and Robinson (2007) argue that the remote environment comprise factors that originate beyond and usually irrespective of any single firm's operating situation: **i)** economic, **ii)** social, **iii)** political

iv) technological **v)** ecological factors. That environment presents with opportunities, threats and constraints but rarely does a single firm exert any meaningful reciprocal influence.

2.7.1. Economic Factors

Pearce and Robinson (2007) state that economic factors concern the nature and direction of the economy in which a firm operates. Since consumption patterns are affected by the relative affluence of various market segments, each firm must consider economic trends in the segments that affect its industry. Some of the economic factors both on the national and international level that managers must consider include general availability of credit, the level of disposable income, and the propensity of people to spend, prime interest rates, inflation rates, and trends in the growth of the gross national product. The economic conditions affect how easy or hard it is for a firm to be successful and profitable at anytime. A firm must therefore include these factors in its strategy formulation.

2.7.2 Social Factors

The social factors that affect a firm involve the beliefs, values, attitudes, opinions and lifestyle of persons in the firm's external environment, as developed from cultural, ecological, demographic, religious, educational and ethnic conditioning. As social attitudes change, so too does the demand for social amenities for example types of clothing, books, leisure activities and so on. Like other forces in the external environment, social factors are dynamic with constant change resulting from the efforts of individuals to satisfy their desires and needs by controlling and adapting to environment factors. For a manager, informed judgment of the impact of changes in social cultural factors is paramount.

2.7.3 Political Factors

Pearce and Robinson (2007) reckon that the direction and stability of political factors are major consideration for managers on formulating company strategy. Political factors define the legal and regulatory parameters within which firms must operate. Political constraints are placed on firms fair – trade decisions, antitrust laws, tax programmes, minimum wage legislation, pollution and pricing policies, and administrative jawboning.

2.7.4 Technological Factors

Previously, the major concern on this environmental condition has been whether technology is high or low. Currently the main issue has changed to the rate of the change. (Pearce and Robinson, 2007); Thompson and Scholes, 1999). Further, Pearce and Robinson (2007) observed that a technological breakthrough can have a sudden and dramatic effect on a firm's environment. It may spawn sophisticated new markets and products or significantly shorten the anticipated life of a manufacturing facility. Hence, for a firm to be or stay successful it must strive to understand both the existing technological advances and probable future technological advances that can affect its products and services, also the ability to forecast future technological advances helps alert strategic managers to both impending challenges and promising opportunities.

2.7.5. Ecological Factors

Pearce and Robinson (2007) define the ecology as the relationships among human beings and other living things and the air, soil, and water that support them. Specific concerns in this area include global warming, loss of habitat and biodiversity as well as air, water and pollution. Firms are increasingly being called upon to pay attention to this by reducing emissions that increase pollution or has an effect on the ozone layer. Pearce and Robinson (1997) observe that businesses are now being held responsible for eliminating the toxic by-products of their manufacturing processes and for cleaning up the environmental damage that they did previously. Pearce and Robinson (2007) finally observe that despite clean up efforts to date, the job of protecting stockholders and executives choose it, increasingly because the public and the government require it. Any business organization with the intention of attaining success through competitive strategies must be full aware of all the external environment factors and their impact on the day to day operations of the business. Goro (2003) made an evaluation of Strategic responses of commercial banks to the threat of substitute products. The study revealed that to counter the threat of substitutes, commercial banks were diversifying their product portfolio to include these substitute products in their portfolios. Further, it was recommended that commercial banks should monitor emerging competitors both in financial and non financial sectors and quick responses be formulated to counter the threats as they emerge. Koros (2001) carried out an evaluation of financial performance of non- banking financial institutions that converted to commercial banks in Kenya.

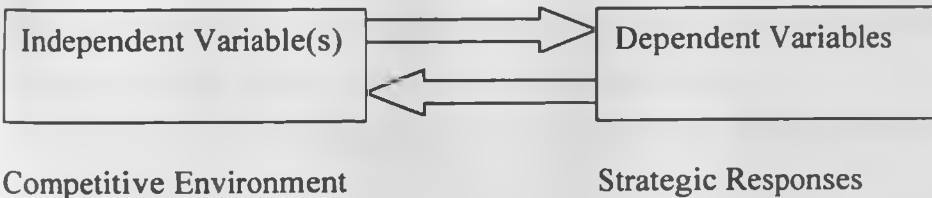
Gathoga (2001) set out to identify the strategies that commercial banks have applied to respond to changes in the environment.

Isaboke (2001) did an investigation of strategic responses by major oil companies in Kenya to the threat of new entrants in the industry. Chepkwony (2001) made an inquiry into strategic responses of petroleum firms in Kenya to challenges of increased competition in the industry. Kandie (2001) was concerned with strategic responses by Telkom Kenya to cope with the competitive environment.

2.8. Performance Indicators of Commercial Banks.

According to the Banking Survey (2008), the following are the performance indicators used to rank the performance of commercial banks; Total Assets, Total Liabilities, Net Assets/ Shareholders' funds, Deposits, Loans and Advances (The Loan Book), Government Securities, Cash and balances with CBK, Total income, Expenses(Interest expenses, Administrative Expenses), Profitability and Non Performing loans and Advances. The market share is determined by the proportion of each of the commercial bank's portion in the market

2.9. The Conceptual Frame Work



Competitive Environment Strategic Responses

Independent Variable(s)	**Competitive Environment** The following institutions constitute competition: • Other Commercial Banks • Micro-finance institutions • SACCOS • Hire Purchase firms • Mortgage Companies • Forex Bureaus

	• Funds transfer organizations • Credit Card issuers • Merry-go-rounds
Dependent Variable(s)	**Strategic Responses** The following are some of the strategic responses to be studied: • Price reductions • Branch network Expansion • Launch of new products • Re-branding • Management re-organization.

The competitive environment is the part of a company's external environment that consists of other firms trying to win customers in the same market. It is the segment of the industry that includes all immediate rivals.

Strategic responses refer to actions by one or more players in the market in reaction to competitors' action with the intention of retaining the market share or winning new a market.

The competitive environment form independent variable and the different competitors are mentioned in the next chapter. The strategic responses by the bank form the dependent variable since they depend on the competition in the industry.

The researcher was investigating the interplay of these two variables within the bank.

2.9.1. Summary

This chapter explains the review of the literature which comprised the secondary data that is available concerning the area of study. This acted as the guiding principles in defining the concepts under which the area of study revolves and helps in identifying the knowledge gap that the researcher studied.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1. Introduction

The chapter focuses on the methodology of research used in the study. This is a description of data collection and analysis method adopted by the researcher to come up the report of the study.

3.2. Research Design

The study was conducted through a case study design. This was deemed appropriate because case study involves an in depth investigation of the phenomenon under study. The researcher used purposeful sampling to select the respondents. This method ensured that data was obtained from resourceful people.

According to Kothari (1990), a case study involves a careful and complete examination of a social unit, institution, family, cultural group or an entire community and embraces depth rather than breadth of a study.

3.3. Data Collection Method

A questionnaire was used to collect data from the respondents. The questionnaire had two sets of questions, those that use the likert type scale and the open ended questions which were used as interview guide. The researcher collected data by personally interviewing senior/ chief managers heading the departments, divisional managers heading divisions, the CEO and other members of the Board of Management. This constituted the population of study.

3.4. Operationalization of study variables

The rate of entry into the market by new entrants portrays the industry attractiveness. The independent variable which is not influenced by other variables was the industry competition while the strategic responses formed the dependent variable.

VARIABLES	Operational Definition
Independent Variable - Competition	This is a combination of existing and potential entrants in the banking sector and all other players who offer services competing with commercial banks for example Micro-

	finance institutions, SACCOS, Hire Purchase firms, Mortgage companies, Forex Bureaus, Merry Go Rounds etc.
Dependent Variable – Strategic Responses	This is the extent of the bank's response to the competition in the banking industry that is Price reductions, Branch expansion, Product launch and re-branding among others.

3.5. Sampling Design

The researcher used purposeful sampling. This is the selection of items on the basis of the judgment or opinion of one or more persons by means of 'expert judgment'.

3.6. Data Analysis

Data is analyzed using content analysis because this study sought to solicit for data that is qualitative in nature given that it is a case study. Analysis of the data collected is by comparing it with the theoretical approaches and documentations cited in the literature review.

3.7. Summary

This chapter describes the research methodology used to carry out the study. The research design used is described and the data collection and analysis method. The results from the analysis of data form the basis of the conclusions and recommendations of the study.

CHAPTER FOUR

DATA ANALYSIS

4.1. Introduction

The chapter gives an analysis of the data obtained by the researcher. An elaborate interpretation of the results is also done and the explanation of the various results and their interpretations.

4.2. Data Analysis and Findings

The opinions or attitudes of respondents were captured on a five point scale and in some cases on a YES or No SCALE .The following scheme was used to interpret the results.

Table 4.1: Interpretation of Results – Opinions or Attitude of Respondents

LABEL	RANGE OF MEANS.
To a very great extent	4.5------------5.0
To a great extent	3.5------------4.49
To a extent	2.50-----------3.49
To a moderate extent	1.50-----------2.49
To a lesser extent	1.00-----------1.49

An alternative five point scale used on questions relating to broad strategic responses applied the following scheme to interpret the results

Table 4.2: Interpretation of Results – Broad Strategic Responses

LABEL	RANGE OF MEANS
Critically Important	4.50-----------5.00
Very important	3.5------------4.49
Moderately important	2.5------------3.49
Less important	1.5------------2.49
Not important	1.0------------1.49

All respondents agreed that the bank is facing stiff competition and the management has embraced on strategies to counter the increased competition.

4.3. General Findings.

Table 4.3: Respondents considered the following factors important.

Factors	Mean	Mean Pricing	Std. deviation	Min	Max
Profitability	4.86	1	0.36	4	5
Customer satisfaction	4.71	2	0.47	4	5
Survival	4.29	3	0.14	1	5
Competitive position	4.14	4	0.77	2	5
Market share leadership	4	5	0.78	2	5
Increasing shareholder value	4	6	1.36	1	5
Staff training	3.93	7	1.14	1	5
Technological advancement	3.54	8	0.66	2	4

The primary purpose of the question was to establish the factors that the banks management rate as important as this has an impact on their strategic direction and therefore their strategic responses in setting goals and objectives of the firm. Profitability, with a rating of 4 to 5 by all respondents is rated the most important factor followed by customer satisfaction. Respondents lacked agreement on the extent of importance of survival, increasing shareholder value and staff training. This is because the three variables have a higher standard deviation. Furthermore the evidence is that some respondents consider share holders values, staff training and survival as less important.

It is difficult reconciling the ranking profitability (high) and shareholder value (low) given that it is profits that translate into value for shareholders.

Table 4.4: Organizations that the Bank considers a major threat.

Org type	Mean	Mean ranking	Std Dev.	Min	Max
Other commercial banks	4.2	1	0.8	4	5
Money transfer org.	3.43	2	0.85	2	5
Investment Companies	3.36	3	1.08	1	5
Hire Purchase Firms	3.31	4	0.75	2	5
Savings and Credit Co-operative Societies	3.29	5	1.33	1	5
Forex Bureaus	3.00	6	1.11	1	5
Mutual Trust Funds	3.00	7	1.04	2	5
Micro Finance Institute	2.86	8	0.95	1	5
Independent Credit Card Issuers	2.87	9	1.09	1	4
Stock Brokers	2.43	10	0.94	1	4
Insurance Companies	2.14	11	0.86	1	4

The existing and potential competition must be identified in order to define and focus the comparative analysis. Identifying sources of threat is not a clear and straight forward task. Competitive strategies can only be effectively established at the level where the bank sells products or services in distinct markets and identifiable competition. Where a business finds it difficult identifying its competitors then it is an indication that the business is not properly defined. Leading the list of competitors to the co-operative bank are other commercial banks.

4.4. Strategic Responses

This section is largely based on Porters model of generic strategies. It identifies the appropriate courses of action adopted by the banks management to achieve the banks goals and objectives. The results are based on the assumption that to be successful, the bank must either be able to supply the service from the lowest cost base in the industry or able to command a higher price in the market by differentiating its products in the minds of its customers. If it fails on differentiating and cost leadership strategies, they should

adopt the third strategy, which focus on a particular segment of the industry "niche" where it can command a sustainable competitive advantage.

Table 4.5: Broad Strategic Responses.

Strategic Response	Mean	Mean Ranking	Std.Dev.	Min	Max
Cost leadership	3.57	7	0.76	3	5
Differentiation	4.00	4	0.68	3	5
Market Focus	4.57	1	0.51	4	5
Market Penetration	4.21	2	0.70	3	5
Market Development	4.07	3	0.62	3	5
Product Development	4.00	5	0.78	2	5
Diversification	3.71	6	0.83	2	5
Mergers	1.75	9	0.06	1	4
Acquisitions	1.17	10	0.58	1	3
Joint Venture	2.31	8	1.65	1	5

The result shows that the bank considers the market focus as most appropriate and mergers and acquisitions the least appropriate. The study was also interested in finding out the changes related to cost leadership by the bank.

Table 4.6: Changes relating to cost leadership

Factor	Mean	Mean Ranking	Std Dev.	Min.	Max.
Technology	4.29	2	0.83	2	5
Cost cutting	4.21	3	0.58	3	5
Retrenchments	3.93	5	1.21	1	5
Restructuring	4.07	4	6.62	3	5
Automation of process	4.36	1	0.84	2	5

Closely linked competitor strategies are the comparison of relative costs and investments and hence sustainable pricing strategies. The respondents consider all items listed under this section as very important to the bank that follows cost leadership strategy. Technology and cost cutting are ranked next. This suggested the banks recognition of the

need to improve (invest) in processes and support systems to enable it become the cheapest supplier of the banking service. The impact of retrenchment with the highest Standard deviation of 1.21 on cost management is not clear cut. All these point to the importance of understanding several things about competitors such as their cost structures and levels of existing and planned investment.

Organizations will differentiate their products in various ways that they perceive as most effective. In the service industry where products are largely homogenous, organizations are limited in the differentiation scope and have to use more innovative techniques to ensure customers view their products as different.

The study tried to establish what the bank is doing in order to differentiate its products from those of competitors in the eyes of their customers.

The findings were collected using a rate scale and presented in the table below:-

Table 4.6: Changes related to differentiation

Change	Mean	Mean Rating	Std Dev.	Min	Max
New product development	4.14	3	0.77	2	5
Increased Advertising	3.43	7	1.02	1	5
Customer service	4.87	1	0.81	4	5
Provision of Product information	4.00	4	1.04	1	5.
Positioning	4.21	2	0.80	2	5
Branding	3.86	6	1.29	1	5
More strategic locations	4.00	4	0.68	3	5
Training	3.29	8	1.20	1	5

Under a strategy of differentiation, the primary focus is on differentiating the product of the business unit by creating that which is perceived by customer as unique. Approaches to product differentiation include Brand loyalty, Product design and technology. Most of the items under this section are listed as very important and above. Superior customer

service is the most critical factor to take into account while considering product or service differentiation strategy. The conclusion is that competitive advantage in the market is derived from providing better customer service for equivalent cost.

Table 4.7: Changes Related To Marketing and Other Initiatives

Change relating to Market and other indicators	Mean	Mean ranking	Std Dev.	Min	Max
Price Discounts	2.79	7	1.25	1	5
Identification of customer	4.36	1	0.50	4	5
Needs					
Reduction of complaints	4.36	2	0.50	4	5
Matching substitute Prices	3.64	5	0.50	3	4
Developing new markets	4.14	3	0.77	2	5
Relationship marketing	4.07	4	0.07	1	4
More Outlets	2.71	8	1.07	1	4
Strategic alliances	3.29	6	1.20	1	5

All respondents agree that identification of customer needs and reduction of complaints were the major initiatives that would steer the bank in the desired direction. Matching pricing was also important owing to the homogenous nature of products in this sector. A price discount has a mixed reaction and this is reflected on the high standard deviation.

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CHAPTER FIVE

SUMMARY, DISCUSSIONS AND CONCLUSIONS

5.1. Introduction

This chapter summarizes the study and gives its overall view. It also discuses the relevance of the study to decision makers of the organization, gives recommendations of issues the researcher fells should be done in light of the study findings to enable the organization succeed in its operations.

5.2. Discussions

With the management and gravity of the problems, which ranged from non-performing loans, lack of product innovativeness, poor technology, stiff competition and low employee morale, Co-operative Bank of Kenya faced eminent collapse. This would have had a bad effect on the economy since co-operative movement is a key segment of Kenyan economy mobilizing over 30% of annual Gross Domestic Savings. The management realized this and moved fast to stem the decline situation from deteriorating further. Through various strategies they successfully managed to halt the decline and realized a complete turnaround in 2007 when they recorded a profit of 2.3 billion compared to a loss of the same amount in 2000.This was commendable recovery.

The study aimed at analyzing the strategic responses that the Bank has adopted in response to the increasing level of competition in the banking industry and how these strategies have helped the bank to achieve the positive results that have been witnessed. The respondents have provided valuable information which together with the secondary data obtained from the bank's intranet and website together with the banking survey report and different published reports.

The bank's management are aware who their major competitors as seen in table 4.4 in the previous chapter. Other organizations in the financial services sector follow closely but their impact is not that big. After identifying the competitors, the management as seen in table three has identified broad strategic responses to counter the competitors' actions. The leading one being market focus. This is evidenced by their mission statement whose focus is on adding value added financial services and offer excellent customer service. Another one is cost leadership where the bank has adopted automation of most of its

processes to save on operation costs, retrenchment exercise which has reduced staff to save on staff costs. The bank has equally differentiated its products and services e.g. Introduction of Jumbo Junior account for children, Young Ennovaters Account for young adults, Salary account and personal loans for the employed, Lariba account for the Muslims. The bank has adopted the market penetration strategy by continually opening more branches and seeking strategic alliances with Saccos to ensure the services reach as many customers as possible.

The respondents, who are the major decision makers in the management of Co-operative bank, consider profitability as very important as seen in table 4.3 in the previous chapter. This is followed closely by customer service. The stability in the banking industry is seen in terms of profitability and banks are doing all they can to increase their profit levels. The bank's Managing Director who was appointed in early 2000 took the task of cleaning the balance sheet and reduces non performing loans and hence reduction of provisions for non-performing loans which eat into profits. This has had a great impact on high profitability levels that the bank has achieved over time.

The bank's management have keenly studied the competitive environment and designed strategies to counter the competition. The first major one was the adoption of full range commercial banking activities in 1994, followed by the adoption of branchless banking where the bank was one of the pioneers in this model and then the introduction of specialist products. The bank later pioneered other products and services like the Mobile phone banking and the internet banking which are utilizing the information technology and have produced good results and earned a lot of revenue for the bank.

Another major strategic move that has greatly helped the bank to grow is the expansionist strategy where the bank has opened several branches and is continuing to do and thereby bringing banking services closer to the people. During the mid and late nineties when there was crisis in the banking industry which led to collapse of several commercial banks, the big multi-national banks closed some branches in some rural areas which they considered not economically rewarding. The bank did not close any branch though it trimmed its expansion strategy to reduce the risk and this indeed earned itself goodwill from the members of the public. Early this year, the bank bought a controlling stake in stock brokerage firm and renamed it Kingdom Securities Ltd. According to the Bank's Managing Director, this was meant to complete the financial supermarket model

the bank has adopted where the bank will offer all financial services which includes fund management, custodial services and normal retail banking.

The latest major strategy was the initial pubic offer done in 2008 which injected additional capital thereby increasing its overall banking operations. This also achieved the second listing objective which was to enable the share holders to realize the real value of their shares. More funds were availed for lending and support the long term strategies that the banks management has which include continuous expansion and launch of mortgage financing.

5.3. Limitations of the study

Being a case study, research findings cannot be generalized for other firms in other industries. This is because management is sensitive to environmental and organizational factors. The study was carried out within limited time and resources. This constrained the scope as well as the depth of the research.

The study was time limiting as it had to be conducted within a short period despite it being broad. The top management did not have sufficient time to explain all the issues in detail hence some strategies were derived from the bank's internal publications.

5.4. Recommendations

Some of the recommendations that the researcher would wish to give to the bank's management include the following:

The bank should be cautious about the expansion strategy in view of the looming global economic crises which is affecting most sectors of the economy. The financial services industry is not prone to the economic meltdown and should therefore be cautious as there are likely to be high default rates in loans they lend to their customers.

The bank should equally designate some sectors depending on their risk. When the risky sectors are identified, then the lending to the sector should be on strict criteria to minimize the bank's exposure. For example, the building and construction industry has been identified as risky so lending to this sector should be strictly monitored. The same case applies to the Passenger Service Vehicle (PSV).

Investing in information technology is very expensive for a bank. On the other hand, the rate of revolution in information technology is very rapid. The bank should be very

cautious when changing its Information Technology system to reap maximum benefits from the system before it becomes obsolete.

The researcher would wish to make the following recommendations for further research:

SACCOs have continued to grow and become competitors to the banks. Co-operative Bank is like a 'central bank' to these SACCOs as it provides them with financing solutions including lending them in wholesale to lend to their members. In fact, before the liberalization in the banking industry in 1994, it was mandatory for all SACCOs to bank with The Co-operative Bank. The government has increased the minimum capital for commercial banks from Kshs. 250 million to one Billion to be implemented in phases. This is meant to reduce the number of small banks which don't add much value to the economy and encourage these small banks to merge as it was done in Nigeria. A study needs to be carried out to determine the feasibility of this move and the contribution of these small family owned banks classified as Tier 3 banks.

The study has found that the strategic responses that the bank has been making over time to counter the competition have yielded positive results and the bank has continued to grow and expand as a result of this. The growth can be seen from the financial statements analyzed and the future growth prospects are positive if the trend is maintained.

5.5. Conclusion

The goal of this research was to study the strategic responses at Co-operative Bank to the competitive environment. From the research findings and in consonance with existing theory, top management need to be able to continuously study the competitive banking environment to determine the appropriate strategies to counter this competition. No single strategy is able to confront the competition but it has to be fought from various fronts. Co-operative Bank managed to strategize on competition, return to profitability and growth. This explains why the researcher chose Co-operative Bank. The Bank has continually grown and had a successful listing last year which enabled it to increase its capital base. It has also expanded with a current branch network of 52 and recently acquired a financial brokerage firm in attempts to become a one 'stop shop' for financial service. This therefore indicates that it is possible to return a failing company to profitability if rescue efforts are instituted early enough and the appropriate strategies are chosen and implemented properly.

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Appendix 1: Questionnaire

The information derived from the questionnaire will be treated with confidentiality and will not be used for any other purpose other than academic.

Section A

1. Name of the respondent (Optional) ....
2. Position of the respondent in the Co-operative Bank ....
3. How long have you been with the Organization?
   a) 0 – 5 Years ( )
   b) 5 – 10 Years ( )
   c) 10 – 15 Years ( )
   d) 15 – 20 Years ( )
   e) Over 20 Years ( )
4. To which tier does the Co-operative Bank of Kenya belong?

Tier 1 [ ]

Tier 2 [ ]

Tier 3 [ ]

7. Please indicate the extent to which the following factors are important to your organization (kindly tick the relevant box for each)

	5 To a very great extent	4 to a great extent	3 to a moderate extent	2 to a lesser extent	1 to no extent
Profitability	[ ]	[ ]	[ ]	[ ]	[ ]
Market share Leadership	[ ]	[ ]	[ ]	[ ]	[ ]
Technological advancement	[ ]	[ ]	[ ]	[ ]	[ ]
Customer satisfaction	[ ]	[ ]	[ ]	[ ]	[ ]
Staff training	[ ]	[ ]	[ ]	[ ]	[ ]
Competitive position	[ ]	[ ]	[ ]	[ ]	[ ]
Survival	[ ]	[ ]	[ ]	[ ]	[ ]
Increasing share Holder	[ ]	[ ]	[ ]	[ ]	[ ]

8. Please indicate the level of competition your company is facing

(i) Very high [ ]

(ii) Fairly high [ ]

(iii)Low [ ]

9. To what extent do you consider the following organizations a threat to your organization?

	5 To a very great extent	4 to a great extent	3 to a moderate extent	2 to a lesser extent	1 to no extent
Fellow commercial banks	[ ]	[ ]	[ ]	[ ]	[ ]
Micro finance institutions	[ ]	[ ]	[ ]	[ ]	[ ]
Forex Bureaus	[ ]	[ ]	[ ]	[ ]	[ ]
Saccos	[ ]	[ ]	[ ]	[ ]	[ ]
Mutual Trust Funds	[ ]	[ ]	[ ]	[ ]	[ ]
Independent Credit Card Issuers e.g. Oil companies	[ ]	[ ]	[ ]	[ ]	[ ]
Investment Companies	[ ]	[ ]	[ ]	[ ]	[ ]
Stock Brokers	[ ]	[ ]	[ ]	[ ]	[ ]
Money Transfer organizations	[ ]	[ ]	[ ]	[ ]	[ ]
Hire purchase Firms	[ ]	[ ]	[ ]	[ ]	[ ]

10. Following changes in the market, to what extent has your organization been affected in the following parameters.

	5 To a very great extent	4 to a great extent	3 to a moderate extent	2 to a lesser extent	1 to no extent
Loss of market share	[ ]	[ ]	[ ]	[ ]	[ ]
Decline in profits	[ ]	[ ]	[ ]	[ ]	[ ]
Loss of Customer	[ ]	[ ]	[ ]	[ ]	[ ]

11. How important has each of the following strategic responses been to your firm in response to the changes in the market? (Rank them in the order of importance: 5 being the most important and 1 being the least important.

	5 Critically Important	4 Very Important	3 Moderately important	2 less important	1 Not Important
i. Cost leadership	[ ]	[ ]	[ ]	[ ]	[ ]
ii. Differentiation	[ ]	[ ]	[ ]	[ ]	[ ]
ii. Market Focus	[ ]	[ ]	[ ]	[ ]	[ ]
iv. Market penetration	[ ]	[ ]	[ ]	[ ]	[ ]
v. Market development	[ ]	[ ]	[ ]	[ ]	[ ]
Vi. Product development	[ ]	[ ]	[ ]	[ ]	[ ]
Vii .Diversification	[ ]	[ ]	[ ]	[ ]	[ ]

Please explain diversification type..

viii. Merger	[ ]	[ ]	[ ]	[ ]	[ ]

Please explain the merger type...

ix. Acquisition	[ ]	[ ]	[ ]	[ ]	[ ]
v. Joint Venture	[ ]	[ ]	[ ]	[ ]	[ ]

Please explain the joint venture type...

12. How important are changes in each of the following areas, which your organization has initiated in response to increase in substitute products (please tick one each as appropriate

Cost leadership	5 Critically Important	4 Very Important	3 Moderately important	2 less important	1. Not Important
i. Technology	[ ]	[ ]	[ ]	[ ]	[ ]
ii. Cost cutting	[ ]	[ ]	[ ]	[ ]	[ ]
iii. Retrenchments	[ ]	[ ]	[ ]	[ ]	[ ]
Iv. Restructuring	[ ]	[ ]	[ ]	[ ]	[ ]
V. Automation Process	[ ]	[ ]	[ ]	[ ]	[ ]

Differentiation.	5 Critically Important	4 Very Important	3 Moderately important	2 less important	1 Not important
Vi .New Product Development	[ ]	[ ]	[ ]	[ ]	[ ]
Vii. Increased Advertising	[ ]	[ ]	[ ]	[ ]	[ ]
Viii. Customer service	[ ]	[ ]	[ ]	[ ]	[ ]
ix. Provision of product information	[ ]	[ ]	[ ]	[ ]	[ ]
x. Positioning	[ ]	[ ]	[ ]	[ ]	[ ]
xi. Branding	[ ]	[ ]	[ ]	[ ]	[ ]
Xii. More strategic locations	[ ]	[ ]	[ ]	[ ]	[ ]
Xiii .Training	[ ]	[ ]	[ ]	[ ]	[ ]
Focus					
xiv. Segmentation	[ ]	[ ]	[ ]	[ ]	[ ]
xv. Market Focusing	[ ]	[ ]	[ ]	[ ]	[ ]
Marketing and other initiatives.					
xvi. Price discounts	[ ]	[ ]	[ ]	[ ]	[ ]
xvii. Identification customer needs	[ ]	[ ]	[ ]	[ ]	[ ]
xviii. Reduction of complaints	[ ]	[ ]	[ ]	[ ]	[ ]
xix. Matching substitute Prices	[ ]	[ ]	[ ]	[ ]	[ ]
xx. Developing new markets	[ ]	[ ]	[ ]	[ ]	[ ]
xxi. Relationship marketing	[ ]	[ ]	[ ]	[ ]	[ ]
xxii. More outlets	[ ]	[ ]	[ ]	[ ]	[ ]
xxiii. Strategic Alliances	[ ]	[ ]	[ ]	[ ]	[ ]

13. In terms of market share, where did Co-operative Bank of Kenya fare in the last eight years performance in the following parameters:

a. Profitability

b. Total Assets

c. Customer Deposits

d. Loans and Advances

e. Interest Income

f. Non-interest Income

g. Customer Numbers

h. Service Outlets (Branches)

14. A Firm can pursue any of the following strategies:

a. Produce and sell at the least cost (Cost Leader)
b. Develop a product or service that offers unique attributes that are valued by customers and perceived to be better than that offered by competition(Differentiation)
c. Both the two above.

Which of the above does the Co-operative Bank pursue?..

Explain..

....

15. Does the Co-operative Bank pursue any of the above strategy from:

a. An industry wide approach,
b. From a specific market segment point of view,
c. Others (please specify)...

16. If Co-operative Bank uses industry wide approach, how does it initiate the following?

a. Penetration Strategies,
b. Market Development Strategies,
c. Geographical expansion Strategies,
d. Product Development Strategies.

17. By use of market segment approach, which among these does Co-operative Bank use to differentiate its products and services:

i. Price
ii. Image
iii. Support
iv. Quality
v. Design

18. These strategies driven by external forces;

Agree ☐ Partly Agree ☐ Disagree ☐

19. When were these strategies initiated?...

20. How are the strategies chosen operationalised by the company?...

21. These competitive strategies cushioned the company against external threats by competitors;

Agree ☐ Partly Agree ☐ Disagree ☐

22. The strategies have brought benefits in terms of return on investment and shareholder value:

Agree ☐

Partly Agree ☐

Disagree ☐

Appendix 2: Letter of Introduction

Edwin M. Kubai
P. O. Box 13732
Nairobi-00100
19th November, 2008

The Managing Director,
Co-operative Bank of Kenya Ltd
P. O. Box 48231,
Nairobi-00100

Through
The Director
Human Resource Development
Co-operative Bank of Kenya Ltd

Dear Sir,

RE: REQUEST FOR DATA AND COMPANY INFORMATION

I am a MBA student at the University of Nairobi. I am carrying out a Management Research Project as a requirement in partial fulfillment of award of Master of Business Administration with the specialization of Strategic Management. My chosen area of study is, **"A study of Strategic responses to competitive environment: A case study of The Co-operative Bank of Kenya Ltd"**

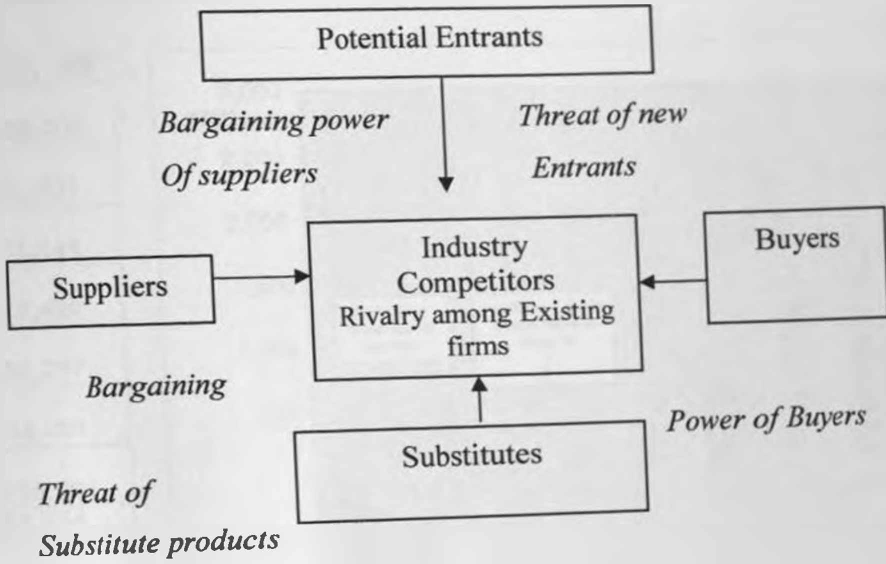
In order to ensure that my study is complete, I am required to seek information from The Co-operative Bank and use the information to write the academic research project. I am therefore requesting for permission to use the company's information to be collected through the questionnaire attached. The information gathered will be treated as confidential and will be used for academic purposes only.

A copy of the completed project will be availed to your company.

Regards,

Edwin M Kubai

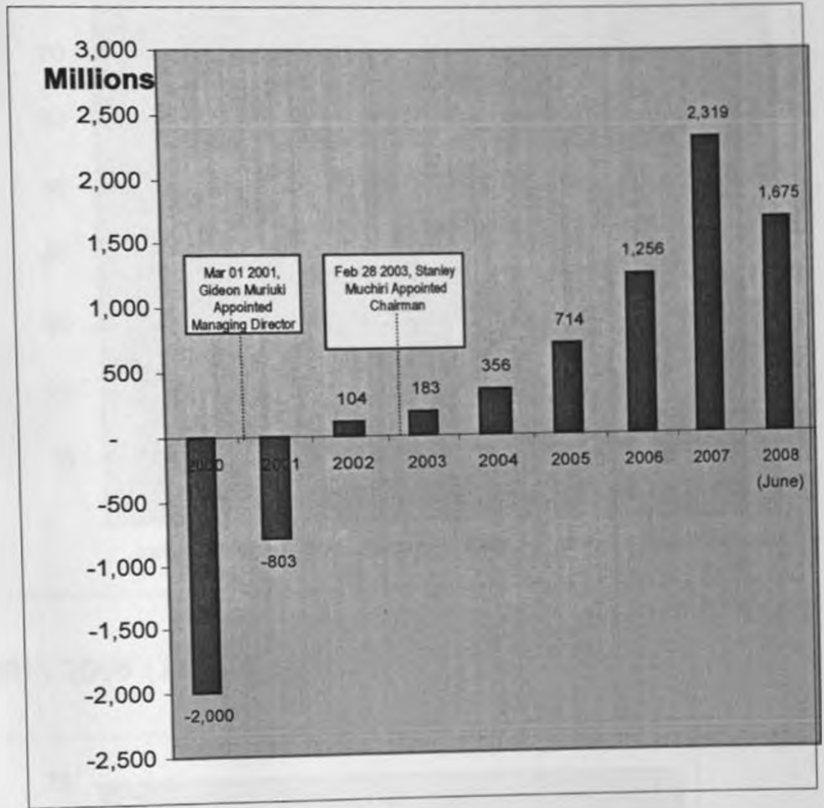
Appendix 3: Michael Porter's five force competitive model.



Appendix 4: Key Performance indicators for Co-operative Bank

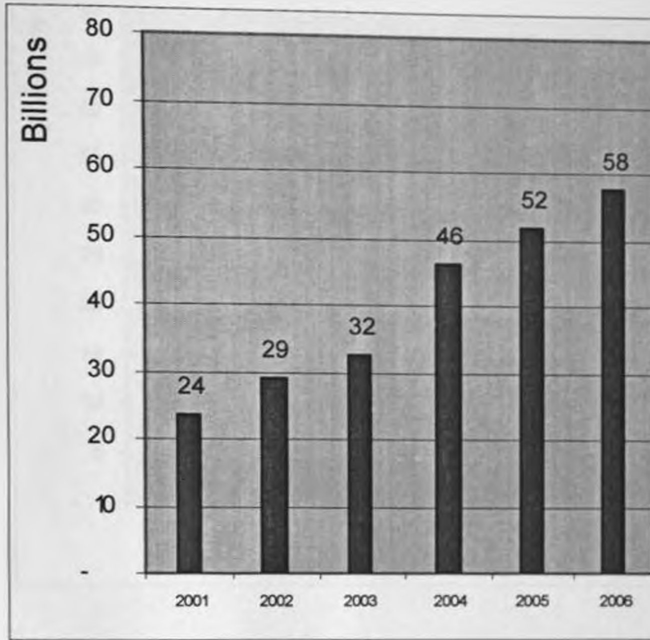
1. Profitability, 2001 - Jun 2008

YEAR	PROFIT, '000
2000	**-2,300,000**
2001	**-802,901**
2002	**103,545**
2003	**183,420**
2004	**356,297**
2005	**714,001**
2006	**1,256,001**
2007	**2,318,524**
Half Year 2008	**1,675,294**
Full year 2008 (projection)	**3,200,000**



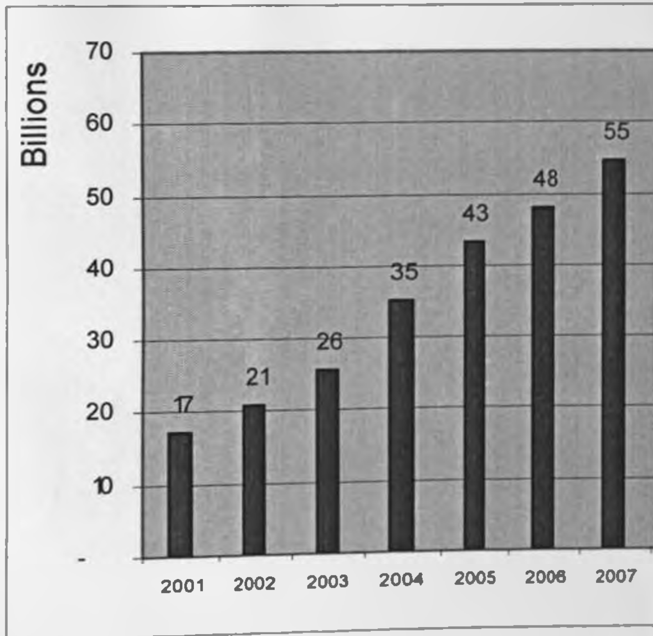
2. Total Assets, 2001 - 2008 (end June)

YEAR	TOTAL ASSETS, '000
2001	23,600,266
2002	28,957,110
2003	32,396,202
2004	46,433,933
2005	51,829,678
2006	57,693,207
2007	65,708,905
2008, Jun 30	72,073,635



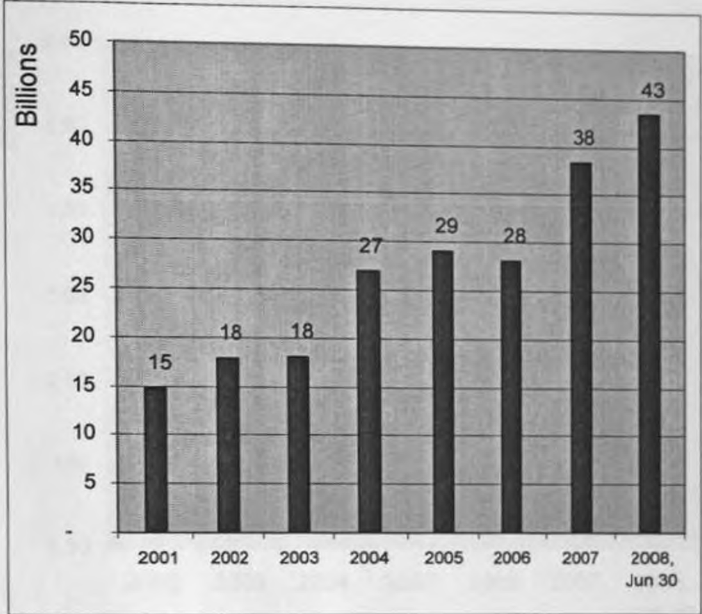
3. Customer Deposits, 2001 - 2008 (Jun 30)

YEAR	DEPOSISTS, '000
2001	17,220,000
2002	20,863,953
2003	25,715,364
2004	35,151,287
2005	43,354,127
2006	48,182,587
2007	54,775,390
2008, Jun 30	59,066,266



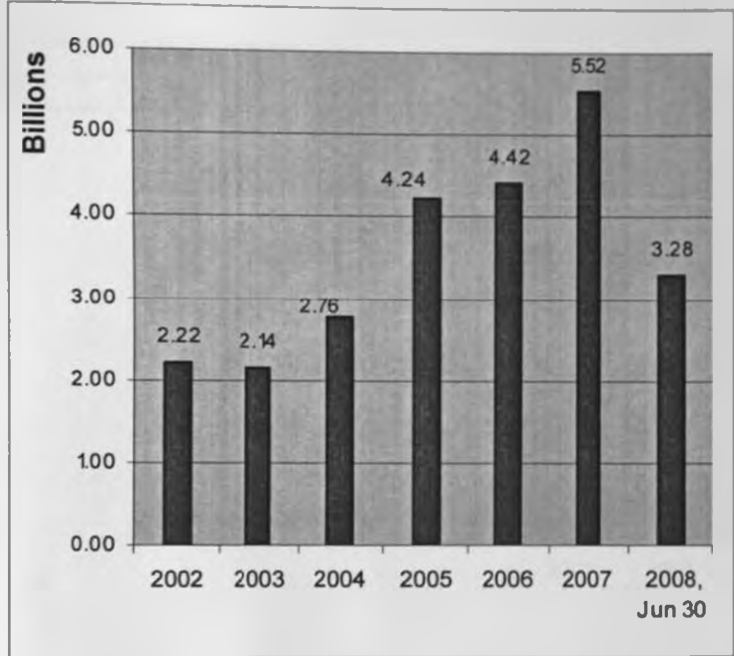
4. Loans & Advances to Customers, 2001 - 2008 (Jun 30)

YEAR	LOANS, '000
2001	14,801,097
2002	17,896,572
2003	18,094,478
2004	27,008,715
2005	29,088,569
2006	28,036,652
2007	38,429,473
2008, Mar 31	43,404,264



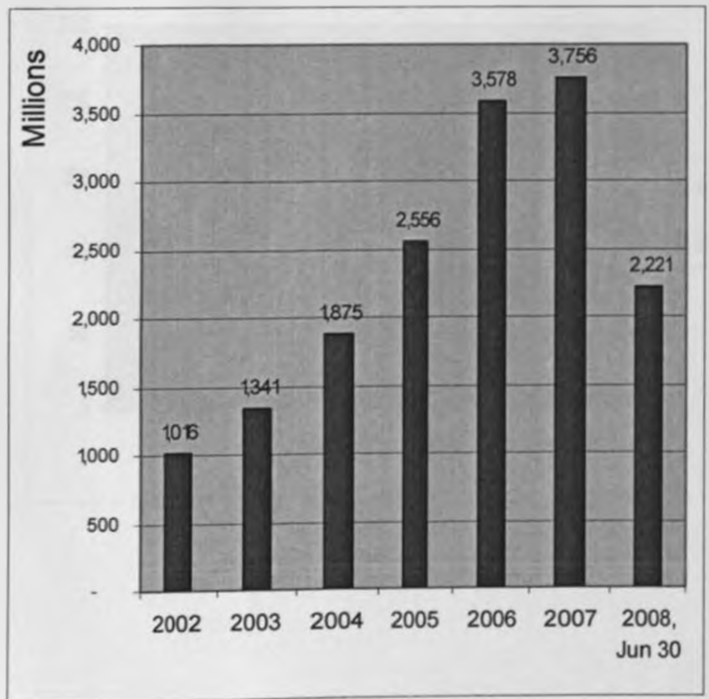
5. Total Interest Income, 2001- 2008 (Jun 30)

YEAR	INTEREST INCOME, '000
2001	2,271
2002	2,217
2003	2,136
2004	2,756
2005	4,241
2006	4,418
2007	5,520
2008, Jun 30	3,283



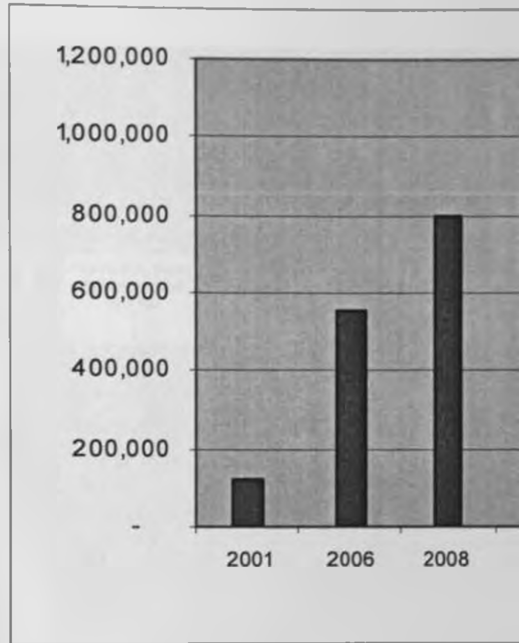
5. Total Non-Interest Income, 2002 - 2008 (Jun 30)

YEAR	COMMISSIONS, '000
2002	1,015,737
2003	1,340,640
2004	1,875,113
2005	2,556,214
2006	3,578,079
2007	3,756,462
2008, Jun 30	2,220,980



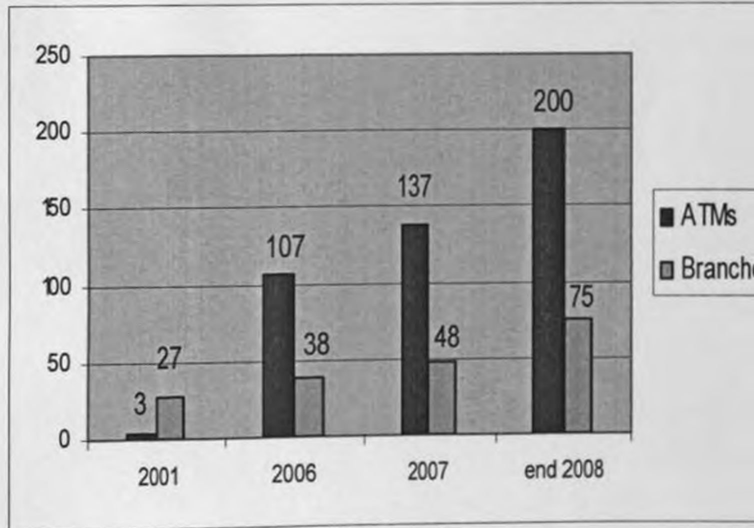
6. Growth in Customer Numbers

2001	2006	2008	2009
125,000	552,000	800,000	1,000,000



7. Growth in Service Outlets, 2001 - 2007

	ATMs	Branches
2001	3	27
2006	107	38
2007	137	48
End 2008	200	75



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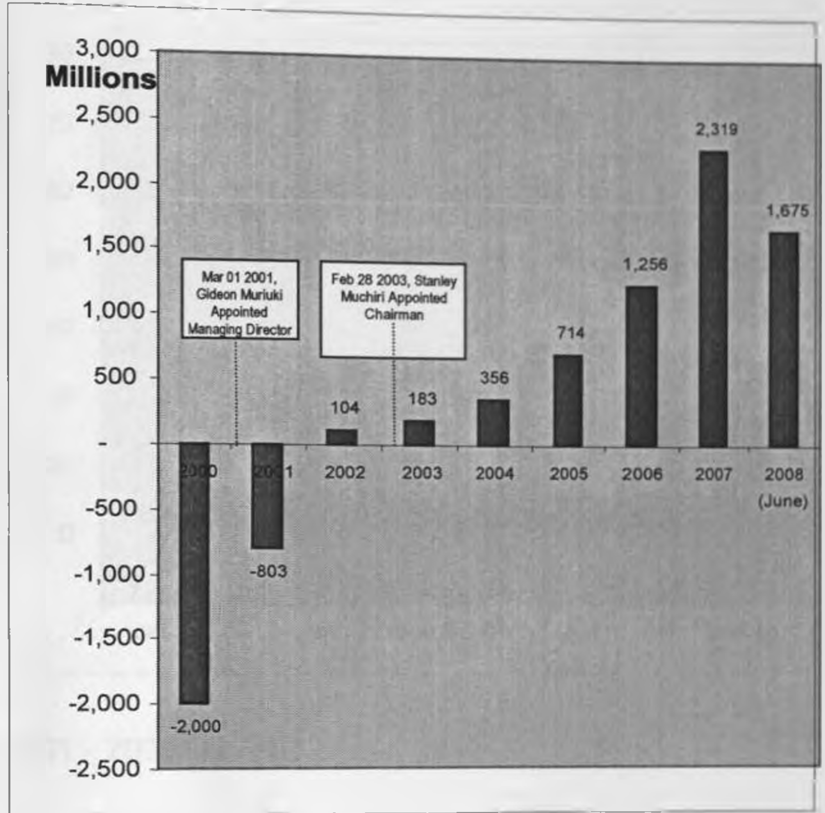

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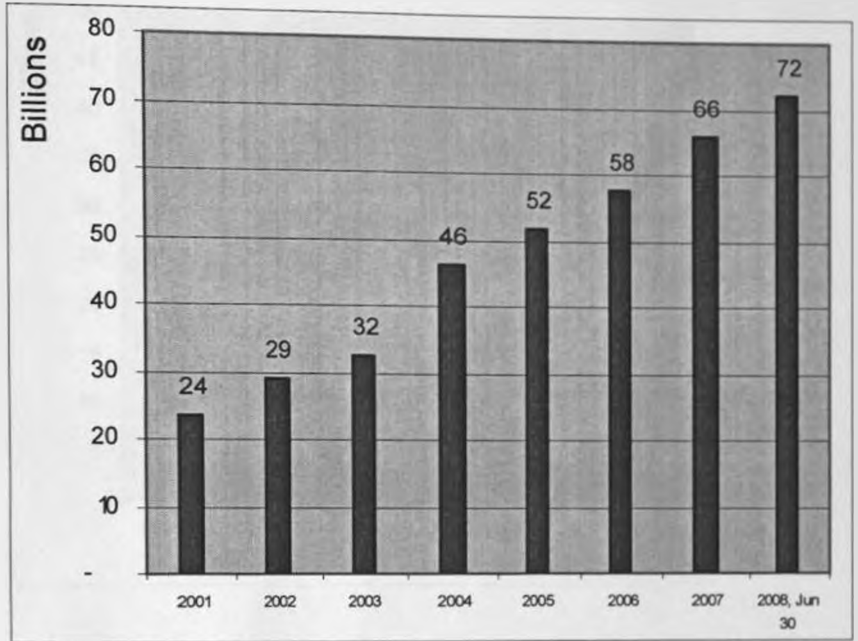

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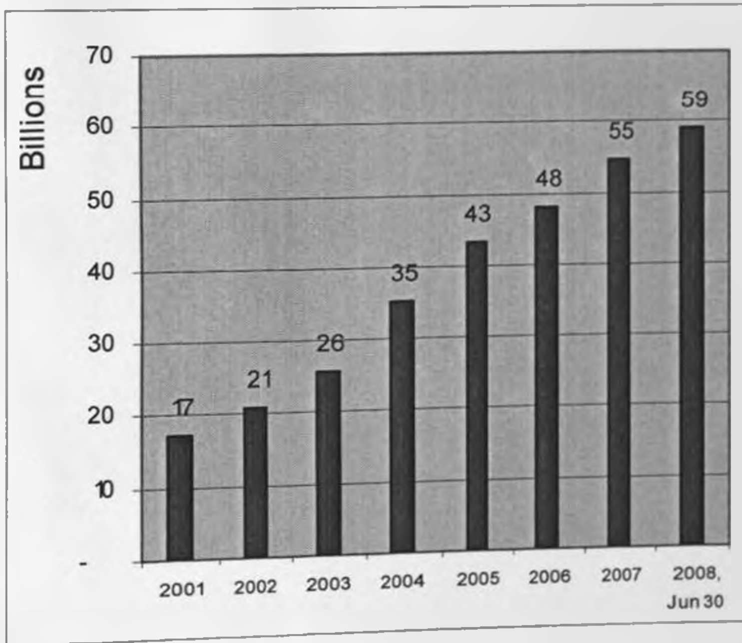

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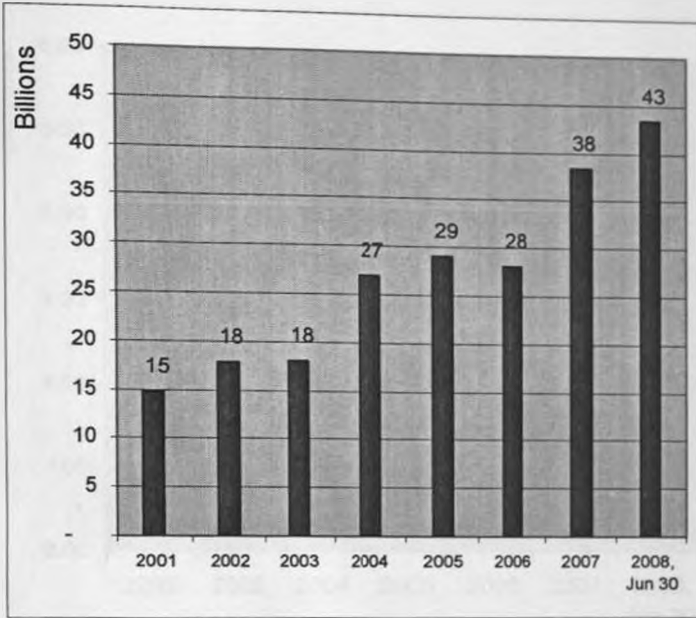

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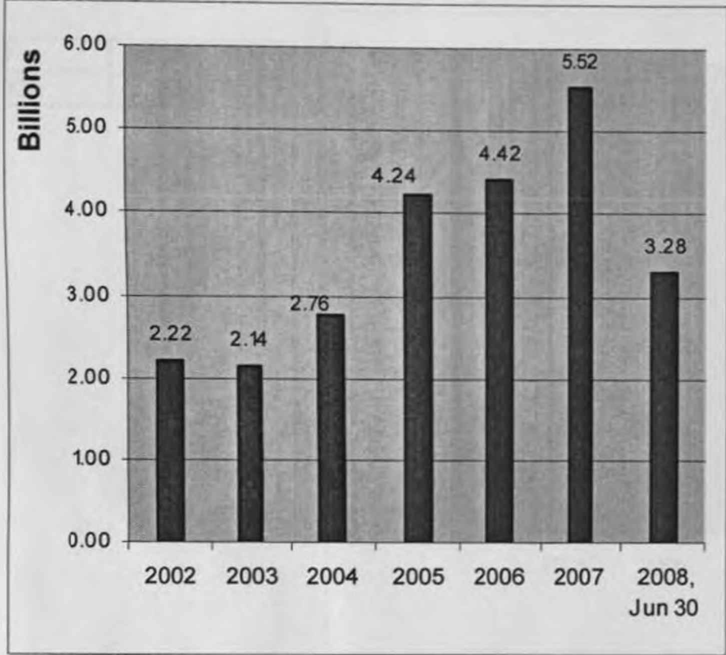

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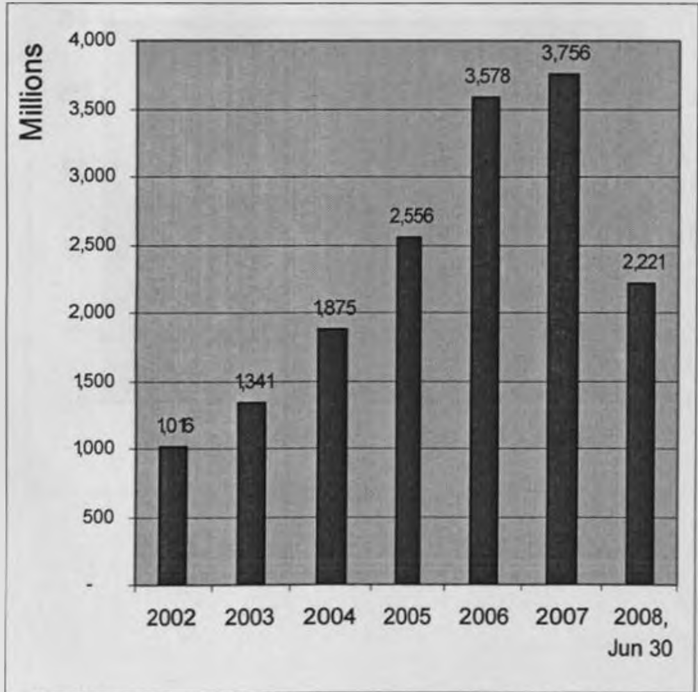

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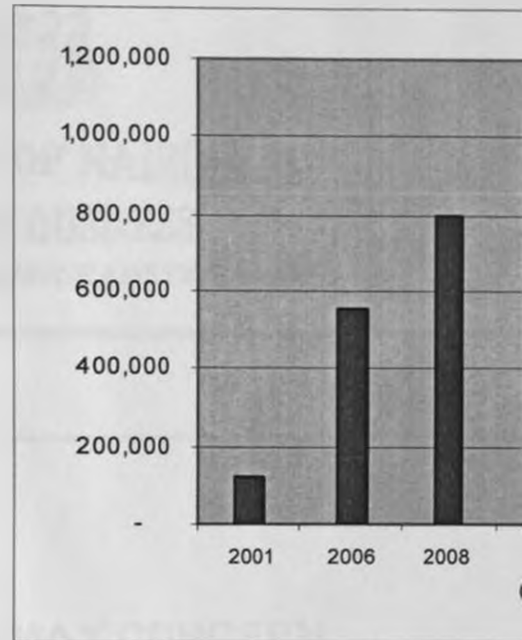

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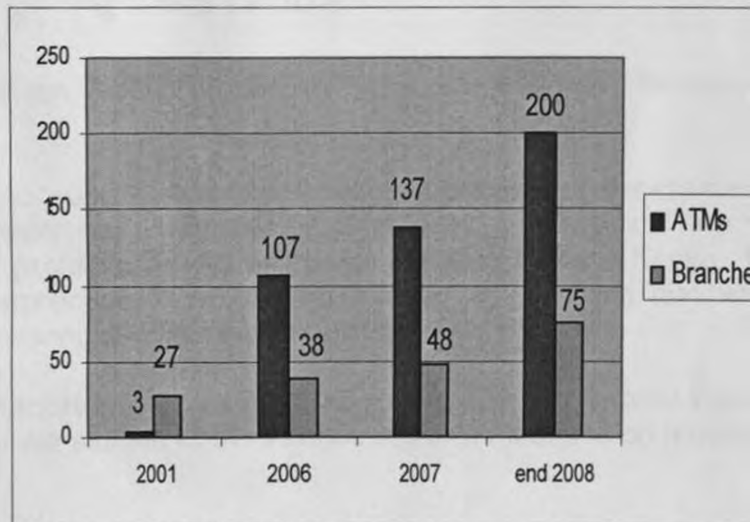

UNIVERSITY OF NAIROBI
SCHOOL OF BUSINESS
MBA PROGRAM – LOWER KABETE CAMPUS

Telephone 020-2059162
Telegrams "Varsity", Nairobi
Telex: 22095 Varsity

P.O. Box 30197
Nairobi, Kenya

DATE 20/04/2009

TO WHOM IT MAY CONCERN

The bearer of this letter EDWIN M. KUBAI

Registration No: D61/8763/2006

is a Master of Business Administration (MBA) student of the University of Nairobi.

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

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

Thank you.

DR. W.N. IRAKI
CO-ORDINATOR, MBA PROGRAM

UNIVERSITY OF NAIROBI
SCHOOL OF BUSINESS
MBA OFFICE
P. O. Box 30197
NAIROBI

CO-OPERATIVE BANK OF KENYA

The Co-operative Bank of Kenya Limited
Co-operative Bank House
Haile Selassie Avenue
P. O. Box 48231 - 00100 GPO, Nairobi
Tel: (020) 3276100
Fax: (020) 2227747 / 2219831
Website: www.co-opbank.co.ke

6th July, 2009

Edwin Kubai,

Thro'

Head,
Corporate & Trade Finance

RE: AUTHORITY TO COLLECT DATA FOR MBA PROJECT

Your email of 18th June, 2009 refers.

Authority has been granted for you to gather the required data for your MBA Project.

As agreed however, you will be required to liaise closely with the Chief Manager, Finance & Planning on all information regarding the Bank's strategy issues.

Please therefore proceed as guided by the Chief Manager, Finance & Planning.

MRS W. WELTON
DIRECTOR,
HUMAN RESOURCES DIVISION

Directors: S. C. Muchiri (Chairman); J. Riungu (Vice Chairman); Gideon Muriuki (Managing Director & CEO); J. Sitienei; Major (Rtd) G. Wakasyaka; M. Malonza; W. Ongoro; R. Kimanthi; J. Murugu; F. Odhiambo