

**THE EFFECT OF DIVERSIFICATION STRATEGIES ON THE
PERFORMANCE OF COMMERCIAL BANKS IN KENYA.**

BY

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**A RESEARCH PROJECT REPORT SUBMITTED IN PARTIAL FULFILMENT OF
THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF
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DECLARATION

I declare that this is my original work and has not been presented in any other University or College for Examination or Academic award.

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

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

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DEDICATION

This research project is dedicated to my parents Mr. & Mrs. Mwangi, and to my siblings; Waweru Mwangi, Waithera Mwatha and Mumbi Njuki who inspired me to attain my academic potential and for their encouragement throughout the period of my research writing. For this I say thank you all and God bless.

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ABBREVIATIONS AND ACRONYMS

CBK Central Bank of Kenya

EPS Earning Per Share

IT Information Technology

TCE Transaction Cost Economics

ROI Return on Equity

ABSTRACT

Diversification has been a key strategy employed by organizations in an attempt to improve their attractiveness and performance. In the banking industry, diversification boosts the performance as it helps in initiating actions which leverage in the existing internal as well as external resources which in turn support other venture hence complement the overall performance of the organization. This research therefore sought to find the effect of diversification strategies on the commercial banks performance in Kenya. The study specific objectives were to evaluate the effect of product diversification strategies, to assess the effect of market diversification strategies and finally, to assess the effect of internal growth diversification strategies on the performance of commercial banks in Kenya. The target population was the 42 registered commercial banks in Kenya and a census method was used to obtain the sample size. Both primary and secondary data were used. Primary data was collected through questionnaires from the managerial staff. The data was coded, tabulated and analyzed using Statistical Package for Social Science (SPSS) software and Excel. Descriptive statistics like frequencies, percentages, means and standard deviation were used to analyze the data. Inferential statistics which included linear regression and ANOVA were also carried out. The study established that Mobile and Internet banking is highly employed as a product diversification strategy. Further, addition of new product features to the existing product (pricing) and branding /rebranded most of the existing products and re-launching them into the market are key marketing strategies commercial banks in Kenya can use to enhance their performance. Additionally, using retained earnings for the bank expansions, giving dividends to the stakeholders and paying bank's debts is a significant internal growth diversification strategy. Results further indicated that the independent variables studied explain 53.7% of the effects of diversification strategies on the performance of Commercial Banks of Kenya. The ANOVA report indicated that the regression model was significant. Among the three variables studied, the strongest relationship was exhibited between bank performance and internal growth diversification strategies. The study recommends application of the diversification strategies highlighted in expending the scope of markets and operations of their entities in a bid to ensure sustainable competitive advantage in the banking industry.

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

In the context of turbulent business setting, organizations have to learn to acclimatize themselves to remain very competitive over time (Auster et al., 2011). Consequently, intentional and organized learning has to be there to an ongoing systematic shift between the business setting and the organization's strategies that result in efficiency and effectiveness improvement so as to increase their performance and achieve long term growth (Grant, 2008). He further argues that for organizations to remain successful businesswise, understanding the challenges, opportunities and threats provided by the external setting is needful, for the organization to take advantage of the opportunities and avoid threats by applying appropriate response strategies as well as developing the diversification strategies that will enhance their performance, survival and competitiveness.

Diversification has been a key strategy employed by organizations in an attempt to improve their attractiveness and performance. In the banking industry, diversification boosts the performance as it helps in initiating actions which leverage in the existing internal as well as external resources which in turn support other venture hence complement the overall performance of the organization. According to Thomson et al. (2012), diversification helps organization build the urgency and the need of improving shareholders value by using existing resources. Ansoff (1965) argued that diversification is manifested through product development, market development and market penetration representing product market structure changes.

This study is anchored on the Transaction Cost Economics (TCE) and Resource Based View (RBV) theory. Transaction Cost Economics theory suggests that diversification allows organizations to get bigger market power through vertical integration and by blocking out other competitors. More precisely, Miller (2009), contended that diversified organizations reduces their prices and subsidizing their businesses thus are able to raise barriers for entry and are able to squeeze their competitors out of the market. In the Resource Based View, it is argued by researchers that the allotment of assets in the various available markets with independent cash flows reduces the impact of un-universal risk coming from external eventualities in each of the various markets (Lewellen, 2001).

The banking industry has been cited as one of the industries in which cut throat competition thrives. According to Nyatich (2009), competition has been on the rise in the Kenyan banking industry such that even international banks, in maintaining and enlarging their market shares, have been forced to change their strategies from the larger corporate strategy. Just like other financial institutions, commercial banks have in essence been provoked to better their performance in order to remain significant in the financial market. Diversification as espoused by Miller (2009) in the Transaction Cost Economics theory has been widely used by firms world over to ensure there is vertical integration and competitors are blocked thus relevancy in the market place and as well enhancing their absolute performance.

1.1.1 Diversification Strategies

Constable and McCormick (2009) argued that among the managerial possibilities presumed as the explicit contributor to the economic functioning of organizations is the extent of diversification. According to Dibb (2007), diversification of organizations is by the extension of the operations' scope into multiple markets and a diversification strategy is trailed as explained by Chandler (2010), as when organizations have opportunities embedded in market structures and technology as well as opportunities for growth in the organization's basic business. Boyd et al., (2004) reported that in multiple markets, the assumption is that there are some raised benefits that may be attained by diversification through a more competent utilization of organizational resources. Benito (2003) indicated that diversification increases profitability although only up to the limit of complexity.

According to Ross (1996), organizations have to learn to acclimatize themselves in changing environment. For organizations to have a competitive advantage against their competitors, it is needful for them to engage proactively in strategies that will enable them to respond to the environmental challenges besides the organization's achievements and for their continued existence in the markets. According to Ansoff and McDonnell (1990), strategies should involve variations in the organization's strategic behaviors to ensure there is success in transforming future environment.

There are several business strategies an organization can use depending on their situation. For instance, new organizations in the market compared to more established organizations, usually face different challenges. This therefore means that the business strategies they execute are usually different from those of their key competitors.

According to Rhonda (2010), there are different types of business strategies that a firm can employ in planning which are the growth strategy, product differentiation, entry, exit, marketing and acquisition strategies among others. Commercial banks also apply different strategies depending on their objectives and level of development; these strategies play critical roles in banks' achievement of their mission and objectives. This may include capital formation, new enterprises investments, trade and industry promotion, agriculture sector development among others (Dess, 2005).

1.1.2 Organization Performance

According to Murimiri, (2009), performance is the extent to which an investment is profitable. Basically, performance is the criteria through which an organization determines its capability to survive in the corporate world. McCann (2004) argued that organization performance is related to the efficiency and effectiveness of the firm while Hofer (1983) defined performance as the background concept related with the phenomenon being studied. Maxine, (2012) argued that banks are the intermediaries in the transactions between money demanders and suppliers at a given consideration.

According to March and Sutton (1997), the three sources of variations in firm performance include analytical models that are usually used, information concerning the apparent determinants of variations in performance and finally the theoretical ideas. Financial measures of organizational performance include profit, profit ratios (ROI, EPS, NPR), market share and revenue growth (Pandey, 1999). There are three economic objectives which describes an organization's performance as given by strategic direction (Pearce & Robinson, 2007). These include existence in the market, progress and prosperity.

An organization's growth is connected explicitly to its existence and prosperity. Existence means having a long term strategy to ensure that business remains and the inability to do so implies that the organization is unable to meet the stakeholders' claims, progress in the number of markets served and the variety of products offered and finally in the technologies used in the provision of goods and services. Progress is shown by change, and a proactive change that is critical in a changing business setting.

Profitability is the main objective of business organization. No matter how profit is measured or defined, it indicates an organization's ability to satisfy the claims of all stakeholders (Pearce & Robinson, 2007). Decisions must therefore be based on long term goals as short term goals more often produce misleading profit results which regulate the rising issues of customers, suppliers, creditors, ecologists and regulatory agents.

1.1.3 Banking Industry in Kenya

For many years, there has been accreditation of the Kenya's banking industry because of the size and diverseness. There are several categories of financial institutions and markets in Kenya which include banks, insurance companies, stock and bond markets all of which provides a collection of financial products. Nonetheless, satisfactory access to the majority of the banking services to the vast population by the financial system has not been happening. According to Beck (2009), the biggest amounts of savings come from small depositors yet lending is normally slanted to the large private and public enterprises based mostly in urban areas. In the Kenya's financial system, there has been high interest rates making affordability of financial services to most people difficult and therefore Kenya's financial system has continued to face challenges. There has been a lot of competition in the sector mostly caused by the fragmentation and the many small banks.

In 2007, the Government of Kenya (GOK) published Kenya's Vision 2030. This puts the delivery of financial services as key in the planning of the economic growth projections through the year 2030. The main goals that are highlighted in Vision 2030 for the financial sector relates to stability improvement, efficiency enhancement in credit delivery together with other financial services and finally in improving access to financial services and products to a vast number of Kenyan households. This is achievable through implementation of policies contributing to stable macro and fiscal positions that aims at reducing inflation and stabilizing the financial sector (Vision 2030).

According to the Banking Supervision Survey Kenya (2010), total assets in the sector have grown tremendously over the past 10 years. From a balance sheet of 328.4 billion in 2007, the sectors total assets stood at Kshs 764.4 billion as at the end of 2006 a growth of 132%. But the story of Kenya's banking sector remains that of a dominant few where 10 players control more than 75% of the market share while the rest 32 share the remaining portion. This scenario is reflected in other measurements across the board, like customer deposits, loans and advances to customers and earnings (CBK, 2012).

1.1.4 Commercial Banks in Kenya

Diversification has been suggested as the most stable way to reducing risks, gaining considerable competitive advantage and leveraging synergy therefore bringing a great impact on firms' performance. This is because they shift from single business strategies to varied diversification strategies (Kiyohiko & Rose, 2008). According to CBK (2012), in East Africa, Kenya has the utmost diversified and established financial sector. There has been a lot of progress in recent years especially in mobile and retail money and other related services in conjunction with regional expansion.

As at 31st December 2011, the CBK, (2011) report indicated that the banking sector encompassed the CBK as the regulatory authority. It also had 44 banking institutions, 4 representative offices of foreign banks, 6 Deposit-Taking Microfinance Institutions, 118 Forex Bureaus and 2 Credit Reference Bureaus. The profitability of commercial banks is dependent highly on the activities that generate revenue (Pearce & Robinson, 2007). Stiff competition and the problem of profitability in the banking sector as indicated by Teimet et al., (2011) has made commercial banks change their tactics on diversification strategies by increasingly diversifying their products in the markets, diversifying ,marketing strategies and internal growth strategies. The establishment of diversification strategies by commercial banks in Kenya and has an impact on the functioning of commercial banks in Kenya.

1.2 Problem Statement

There has been increased competition in the banking sector over the last few years coming from improved transformations among the key players and new participants into the market (Pearce & Robinson, 2007). The sector has witnessed entrance of many banks, micro finance and other non-banks in the provision of financial services to the unbanked and under banked population mainly in the rural areas (Kamau, 2009). Mobile phone companies in various countries have started new mobile phone based money transfer and payment services such as M- pesa, Airtel money and Yu cash, an area which used to be a traditional role of the bank. These services have spread quickly becoming the most effective mobile phone based financial services in most developing countries.

There have been extensive studies conducted in the area of banking sector in the world and Kenya has not been left out. For instance, Fang et al., (2011) in their investigation on German banks found out that diversification tended to be coupled with reductions in bank revenues, even when the risk was controlled. In their report, only few cases like high risky banks and industrial diversification showed a positively statistically significant relationship between diversification and bank revenues. Fang et al., (2011) further on their analysis on the diversification of loan portfolios by German banks, found that most of the banks had increased loan portfolio diversifications significantly. David and Dionne (2005) studied how big banks in Sweden managed their loan portfolios, investigating their loan portfolio diversification strategies. Another study by Warucu (2001) showed that for banks to outdo each other, the key strategies they have been using is focus and product differentiation. Mbwayo (2005) did a study on the anti-money laundering compliance programs strategies adopted by commercial banks in Kenyan industry. In his conclusion, he suggested that strict observance of standards need to be executed to ensure that money legalizing is controlled.

In all the aforementioned studies, the scholars have focused on the influence of products differentiation and market factors on the functioning of commercial banks in Kenya while none has addressed the effect of diversification strategies on bank performance. Further, diversification in the banking sector requires that organizations should have efficient systems put in place to deal with unprecedented occurrences that can deter the set objectives, operations and general functioning of the organizations (Kamau, 2009).

According to CBK (2012), most banks have not been achieving the targeted performance despite their diversification strategies into the market and have continued to register low performance in terms of profits growth. On the same note, there is limited literature on whether these strategies are effective and whether they will be sustainable in the long run. Thus, the effect of diversification strategies in the banking sector is still wanting and thus the research gap. The study thus sought to establish the effects of diversification strategies on the performance of Commercial Banks in Kenya.

1.3 Research Objective

To establish the effects of diversification strategies on the performance of Commercial Banks in Kenya.

1.4 Value of the Study

Commercial Banks managers in Kenya will understand and appreciate the diversification strategies relating to the banking industry. Appropriate decisions will be made by managers in other financial institutions following the studied strategies that have been executed by the Commercial Banks in Kenya thus successfully expanding their operations. Challenges experienced in the adoption and implementations of diversification strategies will also be made aware to the managers thus helping them in the making of appropriate adjustments countering these challenges and in the achievement of optimal performance.

The study will provide insights to regulators and policy makers on the diversification strategies enhancing the sector's growth and functioning, which will help in regulation and policy formulation. Development new policies and reviewing of existing policies will be possible thus achievement of synergy in the banking sector.

The study will also be of paramount help to the banking services users in understanding and appreciating the potential of development in the banking sector. This is crucial because any cost inferences which will need to be catered for by customers in exchange for better service delivery, will be accepted without bargain. Prediction and preparation to conformity by the users about the future of the Commercial Banks will be possible. Finally, to researchers and academicians, this study will provide future reference material on the similar area of diversification strategies. In addition, other topics of future research will be highlighted including relations amongst strategies taken up and industry entrants.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter starts with a theoretical framework presentation for the study. These details the theories that attempt to explain the underlying causal relationship between the study variables. This is followed by a review of past studies done in this area and a critique of the same. Finally, the review presents the research gaps that need to be addressed as per the study objectives.

2.2 Theoretical Review

There are various models that attempt to explain the effect of diversification strategies on organization performance. In this study, Transaction Cost Economics (TCE) and Resource-based view (RBV) attempts to synthesize those factors that influence diversification in organizations

2.2.1 Transaction Cost Economics

Transaction Cost Economics (TCE) theory is useful in organization of new activities in firms which are within their boundaries and also its valuable in sharing of resources across various businesses in their own firm boundaries. This theory's framework submits that obtaining greater market influence is possible by obstructing competitors and vertical assimilation which firms get by diversification. More explicitly, Miller (2009) contended that it is possible to reduce prices in diversified companies thus able to block new entrants or crush competitors out of the market.

Vertical integration as indicated by Penrose (2009), it permits firms in avoidance of market costs, quality control of products and prevention of spilling over its technology from to suppliers and other intermediaries.

According to Williamson (1985), this theory is grounded upon several critical postulations about the behaviour of human beings and characteristics of the environment. These postulations explain why there may be some superior costs faced by organizations for market based transactions and the reason behind some organizations being more efficient at organizing transactions. The firm selects the governance form amongst the various alternatives in the organizational menu which minimizes transactions and productivity costs. Hence, increasing the market influence by firms as depicted by the TCE, it is important to diversify and also firms can organize their extra activities in a more efficient way as compared to the prevailing market or their contenders.

2.2.2 The Resource-Based View (RBV)

The Resource-based view (RBV) has been said to provide the earliest theoretical arguments favouring diversification. Penrose (2009) pointed out that at any point in time a firm has certain productive resources, useful for exploiting productive opportunities to allow the firm to grow successfully. Researchers have identified a variety of resources that create an exceptional advantage for a company by sharing them across businesses. For example, Goold and Campbell (2008) gives the pros of sharing know-how and tangible resources, coordinated strategies, vertical integration, and pooling negotiating power. These resources permit an organization to produce economies of scale and scope by intensifying the efficiency in the use of these resources (Contractor, Kundu & Hsu, 2009). Hence, from the Resource-Based View a firm should try to maximize exploiting.

According to Foss (1998) resource-based theory does not escape the general problem of finding the appropriate unit of analysis. Most contributions within the RBV take the individual resource as the relevant unit of analysis to study competitive advantage. Further, Foss (1998) points out that this choice may only be legitimated if the relevant resources are sufficiently well-defined and free-standing. If, in contrast, there are strong relations of complementarity among resources, it is the way resources are clustered and how they interplay and fit into the system that is important to the understanding of competitive advantage. Foss (1998) recognizes that the capabilities and competences aim at grabbing this clustering and interplay. The conceptual framework takes this problem into account by relating competitive advantage to strategy rather than to individual resources.

2.3 Empirical Review

This section of the project presents a review of the research related to the problem statement and objectives of the study. The part is categorized in accordance to the specific objectives to enhance the achievement of research problem. The literature discussed begins from product, market and finally internal growth diversification strategies and their relationship to the bank performance.

2.3.1 Product Diversification Strategies and Bank Performance

Research findings from Amit and Livnat (2008) in European banks show that product diversification strategies increases risk-return tradeoff. According to Stiroh (2008), diversification strategies raise banks incomes and reduce unpredictability of the profits. Moon (2009) suggested that diversification strategies can lead to improved cost efficiency through lowering of risk if it occurs. Further, he argued that on un-insured debt

and other contingent claims like derivative contracts, diversification lowers the required risk premiums. According to Hughes and Mester, (2008), higher average incomes can be obtained in financial institutions if higher risk investments can be made from the gains obtained from diversification.

Acharya et al. (2007) initiated key studies about diversification on banks' credit portfolio. Their findings on the Italian banks indicated that industrial and zonal diversification strategies reduced bank revenues while creating risky loans. An investigation was done by Busch and Kick (2009), in the German banking sector on the income diversification strategies. Further, Goetz (2008), studied on risk taking behavior as affected by bank's diversification. Fang et al., (2011), indicated that asset diversification and loan diversification is related positively and negatively respectively with bank functionality.

Cotugno and Stefanelli (2012) in their study on geographical diversification, they found a positive association between the performance of banks and product diversification strategies. Further, Morgan and Stolyk, (2009) as they did a study on the US banks, they found that the lending capacity in the banks was increased by product diversification although there wasn't any increase in the revenues of individual banks or a reduction in the portfolios. The findings of an evaluation on the diversification strategies on the EU and US indicated conflicting results (Stiroh, (2008); Stiroh&Rumble, 2009).

A study carried out Chiorazzo (2008), for the Italian banks indicated that income diversification raised risks adjusted revenues and established some diversification benefits with the enlargement of banks. Stiroh (2008a) in a study for small community banks, to establish the connection between diversification and risk adjusted performance

and found out those diversification strategies paybacks within large activity classes but not between them. Stiroh (2008b) explored the connection between the increased dependence on non-interest revenues and the unpredictability of bank incomes and gains. The findings from the study from aggregate and bank data showed little evidence offered by the shift from large diversification gains in the form of stable revenues.

D'Souza and Lai (2009), found out that banks systematically underperformed over time when measuring the efficiency of Canada's Big Five chartered banks. Dullmann et al., (2010) did an investigation on monitoring abilities of German cooperative and savings banks with their interest on specific industry departments. They contended that sectoral specialization entailed better quality monitoring especially cooperative banks. Deng and Elyasiani (2008) established that product diversification is linked with risk reduction and bank holding company value enhancement, raising the distance between a bank holding company and its networks is linked with firm value decrease and risk growth. Tabaket al., (2010), who did an assessment on the concentration or diversification of credit portfolio in banks operating in the Brazilian banking system and how the choices affected their functionality, found that Brazilian Banks' loan portfolios were more concentrated than those in developed countries. Bebczuk and Galindo (2008), who did an analysis on sectorial diversification in the banks of Argentina indicated that there was a greater benefit from diversification in larger banks than in smaller ones.

2.3.2 Marketing Diversification Strategies and Bank Performance

Marketing diversification is a strategy where organizations take a bigger share of its prevailing markets with its current product range (Wheeller & Hunger, 2008). An organization builds on its current strategic abilities and requires not endeavoring into

unchartered boundaries, essentially maintaining the range. Moreover, greater market share translates into increased control on the buyers and suppliers, economies of scale through more efficient manufacturing ,distribution, purchasing power and overhead sharing and lastly the experience curve benefits (Johnson et al., 2008). According to Johnson et al., (2008), in market diversification strategies, the main concern is on the development and exploitation of expertise thoroughly in delimited competitive grounds. It involves increasing the use of present products in present markets. In the building on an organization's competencies and achievement of a competitive edge, organizations use concentrated progress by ensuring concentration in the product market segment it knows best. Pearce and Robinson, (2007) inferred that this strategy is helps in the growth thus increased production and better coverage the product-market segments.

According to Harzing (2010), gaining of reputation by organization is usually through increased and enlargement of market share which is can be obtained through their leaders influence thus increased its bargaining competence. He further argues that large organizations have a higher negotiating power than small players in the markets with the suppliers. This consequently results to increase functioning of the large organizations as they become more competitive in the market. There are various market share drivers including preference share, which can be improved through product pricing, and changes in promotions. Advertising expenditures increments and share of the available distributions can increase share of voice; this can be increased through more intensive distribution.

Jones (2004) asserts that altering or modifying the variables contained in the marketing mix increases the market share. These are the products whose characteristics can be altered to provide increased value to the customer by product quality improvement. Reduction in prices translates to an increase in sales profits and this is a product of setting the appropriate market prices (Hitt & Ireland, 2005). This only works when the players in the market willingly meet the price cuts put in place.

2.3.3 Internal Growth Diversification Strategies and Bank Performance

According to Samara (2007), internal growth is business expansion rate achieved by increasing production in the organization as opposed to involvements outside the organization like mergers, acquisitions and take-overs. Emefiele, (2008); Emmanuel, (2008), argued that brand name and the trust from customers is key to a bank and thus in achievement of internal growth, there is need of having a strategy founded on customer retention and services offered, employee fulfillment, dynamism in branch management and availability of attractive value plans for each market segment and customer profitability (Atkearney, 2005; Emmanuel, 2008 & Highbeam, 2008).

The usage of (IT), broadly refers to the usage of computers. In the recent past, this has made great contribution towards advancement in service industries; banking industry being one of them. There are two positive impacts that have been found through the studies regarding the relationship between IT and banks functionality like it reduces bank's routine costs. According to Bryjolfsson and Hitt (2006), IT is fundamental to a firm's survival and growth. Studies by Wallace and Carolle (2006) indicate that that there is a great difference in firms that use IT effectively and efficiently. Widely publicized IT programs in firms have been associated with superior business performance.

Customers are critical in any organization without whom there will be no market value since firm has no revenues and no profits. Customers need to be satisfied and their satisfaction is contingent to the degree to which the firm offers/ products is customized to meet heterogeneous customers' needs as versus standardization. Satisfaction, for example makes customers to come back and buy more thus increased sales and profits. Performance measures in this case are Customer satisfaction, Loyalty and Profitability. More satisfied Customers will return with their friends and buy again in the future.

According to Paramasivan and Subramanian (2009), Retained earnings also known as self-finance and plowing back profits are another method of internal sources of finance. Retained earnings represent profits a company has not distributed for years preferring to keep them to fund operating activities. These are profits a company has accumulated for many years and it has not paid out as dividends. Payment of debts can be done using retained earnings or reinvestment into business accomplishments for future growth. Measurement of firm's performance is reflected in stock returns and the predictability by accruals to improve earnings. The purpose of the Performance Reward is to motivate employees towards the successful implementation of strategies, and to increase overall organizational motivation and efficiency (Torrington, 2002). Motivated employees play a key role in an organization's success. Performance reward based system and performance feedback are the major components of control systems positively affecting employee empowerment feelings. There is therefore need to measure performance in organizations so that alternative evaluations can be made for the future action and in rewarding the well performing employees (Thomsons, 2004).

2.4 Summary of Knowledge Gaps

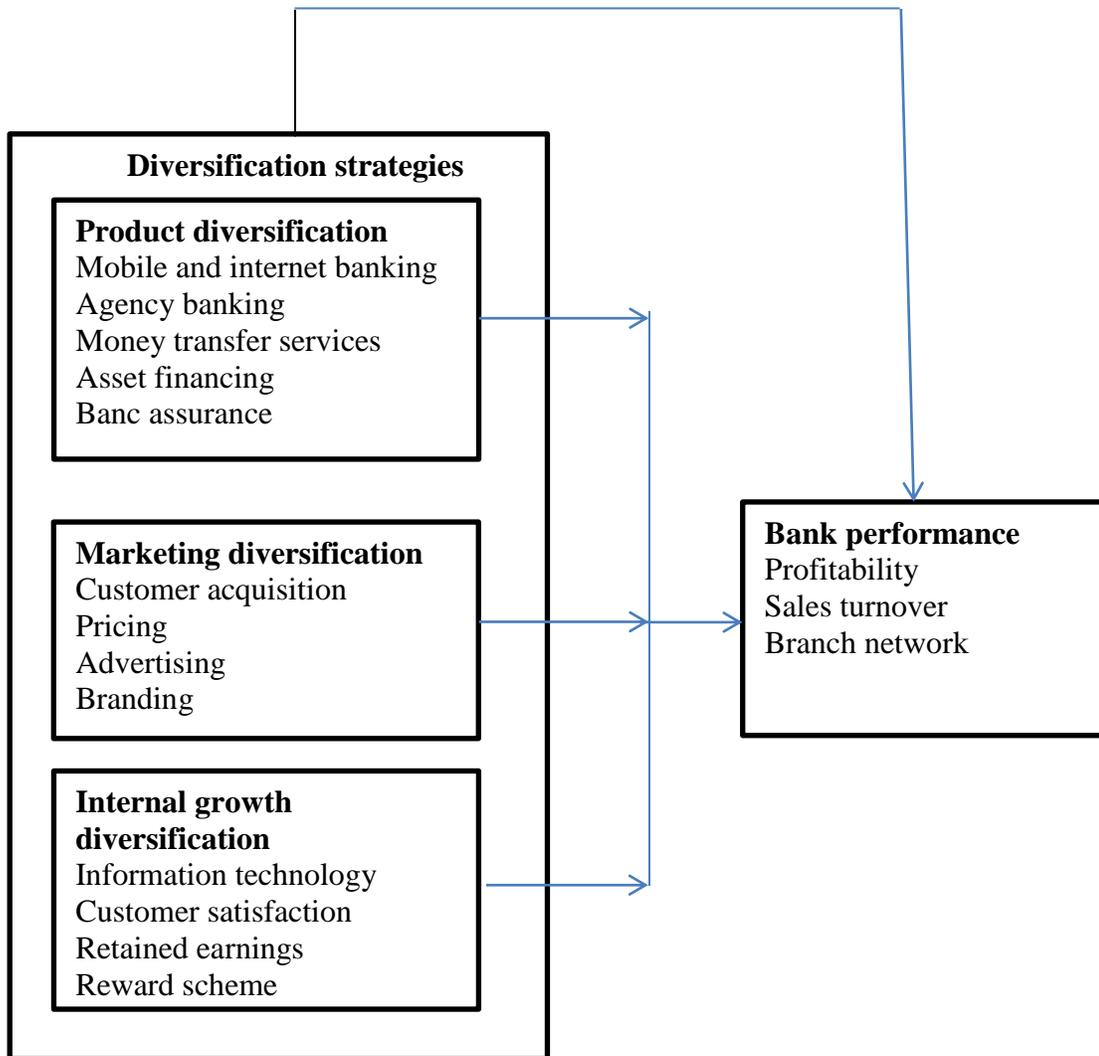
Diversification strategies are very crucial for a bank due to its financial intermediary nature. The benefits obtained from diversifying risks are key in banks as management of risks is part of the financial firm's business. The literature reviewed has indicated that product diversification and bank performance is related positively and negatively with loan diversification negatively respectively (Fang et al., 2011). Further, a study done on Italian banks showed that income diversification increased risk-adjusted revenues and indicated limitations in the diversification gains when the banks expanded (Cotugno & Stefanelli, 2012).

Literature further indicates that business expansion can be achieved through investments within the organizations versus the mergers and acquisitions which are involved by the organization from without the firm (Samara, 2007). Further, achievement of internal growth by banks, a formal strategy is needed that is grounded on customer retention and services, employee satisfaction and dynamic branch management among many others. (Atkearney, 2005; Emmanuel, 2008 & Highbeam, 2008). The studies reviewed above are mainly done in the developed countries whose institutions diversification strategies effects on financial performance are different from that of banks in Kenya. Therefore, there exist a research gap on the effect of diversification strategies and bank functionality of commercial banks in Kenya.

2.5 Conceptual Framework

The conceptual framework shows the interconnectedness between the research questions stated in the first chapter and the conceptualized theories which have been discussed

earlier in this chapter. The research objectives in this study relate to the effects of diversification strategies and performance of commercial banks in Kenya.



Independent Variables

Dependent Variables

Figure 2.1 Conceptual framework

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This section brings out the research approaches which are: the design used, the study population, method of sampling and lastly the process of data collection and analysis. The study adopted quantitative approach. Questionnaires were used to capture quantitative data from banking representatives.

3.2 Research Design

According to Noum (2007), a design is the plan or sketch that is used to come up with solutions to questions under study. Descriptive survey research design was chosen since it is more specific, correct and describes events in a strategic way according to (Babbie, 2004). Further, Berg and Gall (1996) add that, design produces statistical information about aspects of a study that is specific to the population.

This study employed a cross-sectional descriptive survey design, which involved use of single questionnaire administered to each sampling unit member at a single point in time. According to Andres (2012), surveys are used to gather systematically factual information necessary for decision making. The survey method was elected as it is a versatile method of collecting data.

3.3 Target Population

Population is the entire group under study as specified by objectives of the research; it is the universe from which the sample is to be selected (Ghauri & Gronhaug, 2005). According to Mugenda and Mugenda (2003), the study population should have some evident distinctiveness upon which one can generalize the findings of the study. Thus ensuring that population of interest is uniform.

The research was based on the Kenyan banking sector where the population under research exclusively consisted of all the commercial banks. As per CBK (2016), the banking system comprises of 42 commercial banks, which formed the basis of the target population. (See appendix III).

3.4 Data Collection

The research instrument was a questionnaire for primary data and secondary data was collected from published financial statements of the banks available from the banking supervision department and the Central Bank of Kenya. Kothari (2008) highlights that a questionnaire gives the respondents' adequate time to think through respond to questions accordingly. The questions in the questionnaire were a forced response types and matrix type (Likert-type scales). Kothari and Pals (1993) advocate for forced type of questionnaires like likert-scale which ensures consistency of certain data across respondents as opposed to the open-ended types of questions gives respondents freedom of response hence no consistency on data collected. Likert-type questions serves to assess the extent of persuasiveness of given campaign materials.

Questionnaires were self-administered on the respondents using the ‘drop-and-pick’ later method with the help of 1 graduate research assistant. This approach gave the respondents time to compose feedback that is thoughtful and relevant to the research problem. The research instruments were pre-tested using a sample size of 4 participants as per recommendations by Shaughnessy, Zechmeister and Zechmeister (2006) who observed that a fruitful pilot study employs about 10% of the actual sample size. Participants of piloting are persons in the population with similar characteristics to, but not those that will be used in the main study.

3.5 Data Analysis

Analysis of the data was done using a combination descriptive and inferential statistics. The former included arithmetic mean values, standard deviations, percentages, bar and pie charts (Kothari & Pals, 1993). The mean values enabled the researcher identify diversification strategies most used by banks and those that have the highest impact on bank performance. Standard deviations showed the extent to which the incidence of use and impact on performance departs from the mean value. Multiple linear regressions were used for modeling how independent variables relate to the dependent variables.

The final form of the model enables the researcher to predict values of the dependent variable given values of the independent variables.

This model used was as follows:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \epsilon_0$$

With:

Y = Bank Performance

β_0 = Constant

β_1 = Coefficient of product diversification strategies

β_2 = Coefficient of market diversification strategies

β_3 = Coefficient of internal growth diversification strategies

ϵ_0 = Error term assumed to be a constant

CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents data analysis and discussion of the effects of diversification strategies on the performance of commercial banks in Kenya. Analysis of the data was carried out using descriptive statistics with the aid of statistical package for social sciences (SPSS). The analysis was carried out with the guidance of the research objectives. The results are mainly presented through analysis of descriptive statistics that indicates the relationship between the dependent variable and independent variables in this study. The data was obtained from the senior staff involved in the strategies formulation in various departments of the banks.

4.2 Effects of Diversification Strategies on the Performance of Commercial Banks

Diversification has been suggested as the most stable way to reducing risks, gaining considerable competitive advantage and leveraging synergy therefore bringing a great impact on firms' performance. Several strategies have been used by banks but this study evaluated product diversification strategies, marketing diversification strategies and internal growth diversification strategies as used by commercial banks in Kenya.

4.3. General Information

This sub-chapter presents the main demographic characteristics of the banks/ respondents in the study which included composition of the bank, length of time working in the bank and the dominant services offered by the banks. The profiling was important because it is crucial in organizational decision making processes, strategy formulation and implementation processes. Data was collected by use of questionnaires and analyzed and presented by use of graphs.

4.3.1 Response Rate

The total sample population was 42 respondents. Out the 42 questionnaires sent to the respective respondents 37 of them were filled and collected indicating an excellent response rate of 88% as shown in the Figure 4.1.

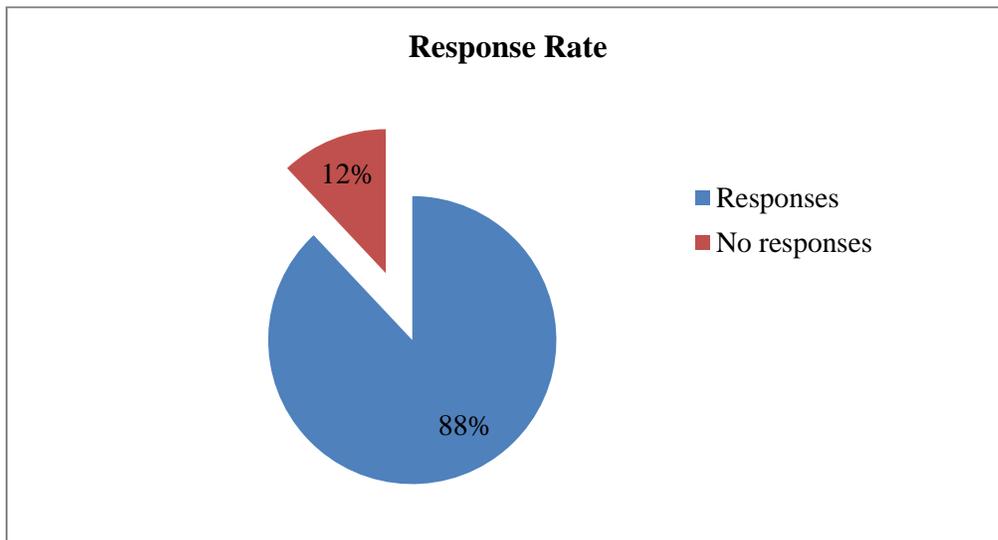


Figure 4.1: Response Rate

Source; Research data (2016)

4.3.2 Composition of the Banks

The respondents were required to indicate the ownership composition of their respective banks. The respondent's bank ownership was required to establish the banks versatility in the decision making processes and banks' ability to out muscle competitors in terms of number of products/services. The ownership composition included foreign owned, locally owned, partly local and partly foreign owned, and government owned. The findings are summarized in Figure 4.2. Findings indicated that 65% of the banks were locally owned, 35% partly foreign and partly locally owned while 5% of the commercial banks studied were foreign owned. This shows that the banks do not have a fair playing ground with the locally owned banks monopolizing the banking industry.

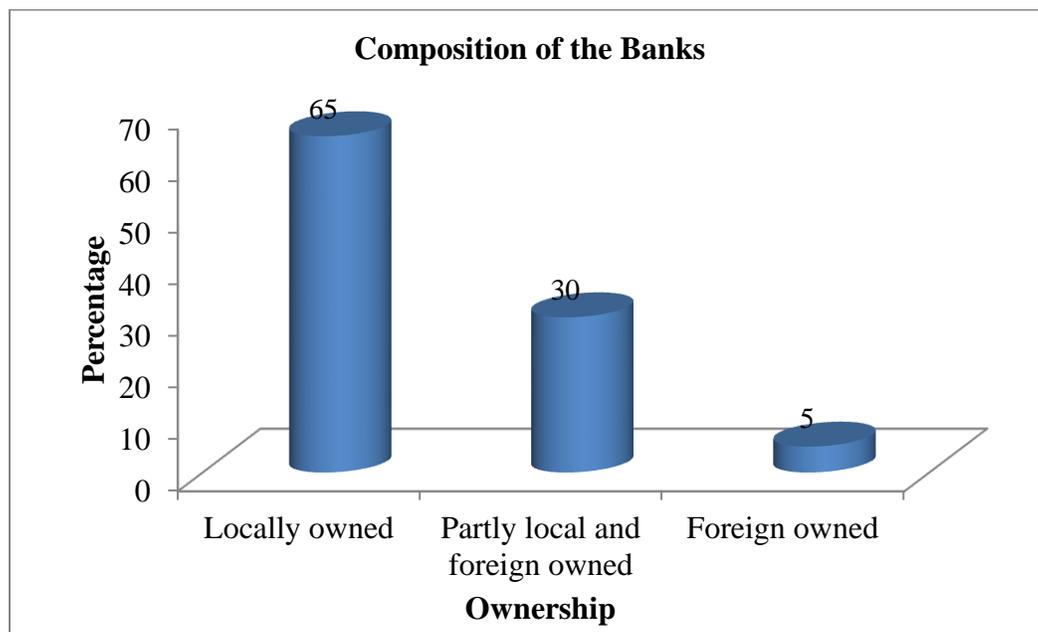


Figure 4.2: Ownership composition of the Banks

Source; Research data (2016)

On the number of branches that the respective banks owned, the bank with the highest number of branches had a locally owned bank with 173 branches and the smallest bank had 7 branches and this was a foreign owned bank. On average most banks had more than 20 branches. This was important in the validation of the overall effectiveness in the diversification strategies.

4.3.3 Length of Time Working

The participants were to state the period they had worked in the different commercial banks. Their responses are summarized in Figure 4.3. Numbers of years were categorized into four that is less than 3 years, between 4 years and 7 years, between 8 years and 10 years and over 11 years. Results indicated that most respondents had worked for 4-7 years (49%). Further, respondents who had worked for over 11 years were 30% while 8-10 years and 0-3 years were 10 and 11 percentage respectively. Findings from this study indicating that 30% of the respondents have a working experience of more than 11 years show that most respondents were aware of the challenges in the banking sector and strategies adopted to cope with challenges thereof. This indicates that the experience gained is very important in ensuring that there is growth in the banking industry.

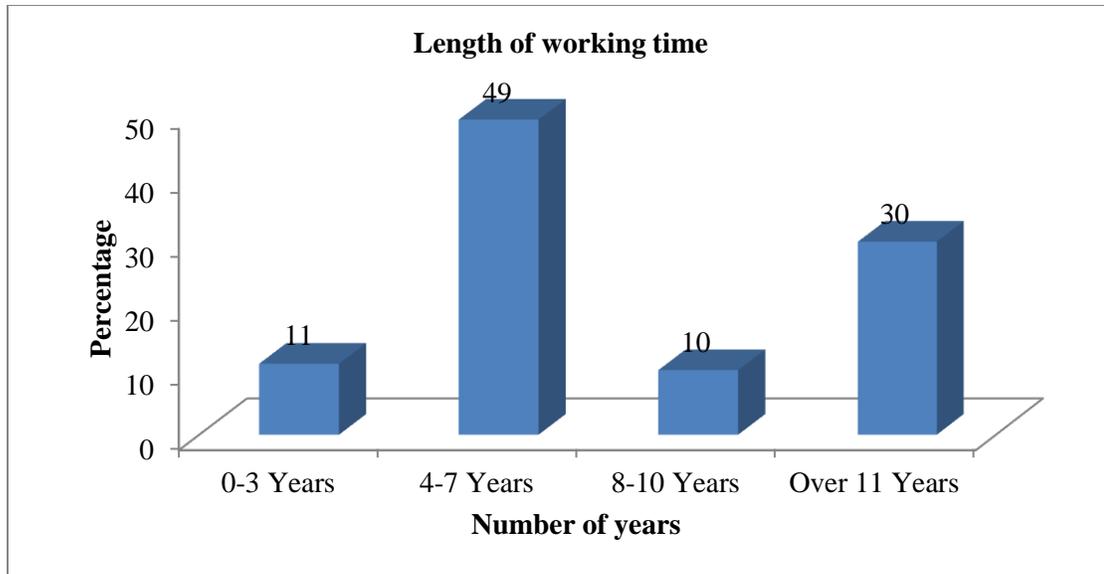


Figure 4.3: Period Worked

Source; Research Data (2016)

4.3.4 Dominant Services Offered by the Banks

The survey asked respondents to indicate the dominant services offered by the banks. The responses are summarized in Figure 4.4. Services offered included core banking services, offering loans, mortgage sales and stock brokerage. Findings indicated that core banking services were the most services offered by the banks with 38%. Offering loans and mortgage sales had 27% and 24%. Stock brokerage was the least services offered by the banks with only 11%. Findings from this study are in line with those of Adamson et al., (2003) who found that core banking services, once put in place, should be vigorous, sealable and ensure business sustainability for longer periods. Financial institutions thus need to pride themselves in innovative ways of making the banking services efficient and effective hence great customer experience.

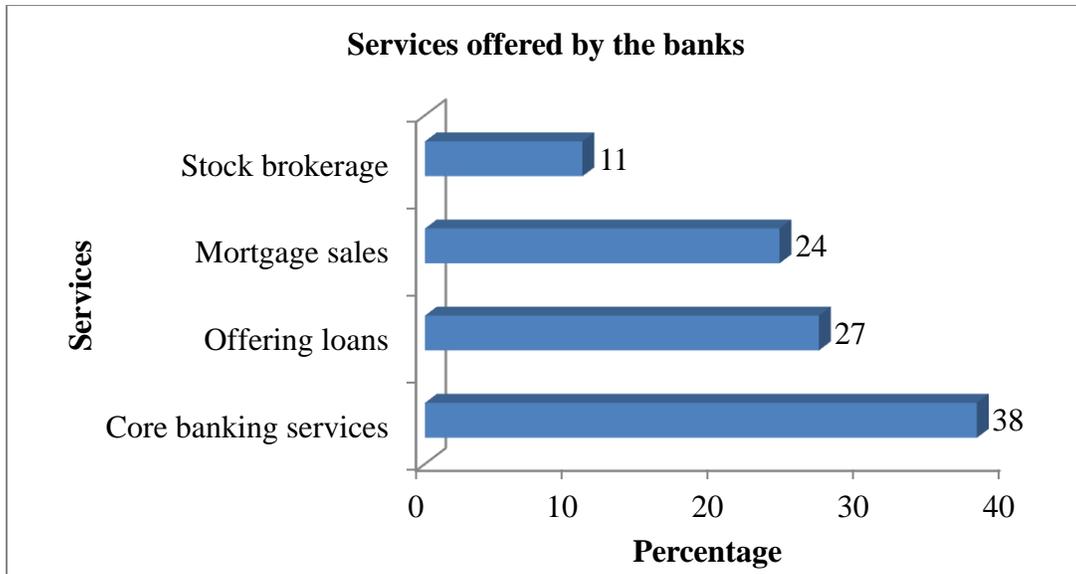


Figure 4.4: Dominant Services Offered by the Bank

Source; Research Data (2016)

4.4 Diversification Strategies

The respondents were to indicate whether diversification strategies enhance bank performance as shown in Figure 4.5. Findings indicated that 95% of the respondents agreed that diversification strategies enhanced bank performance while 5% were not sure.

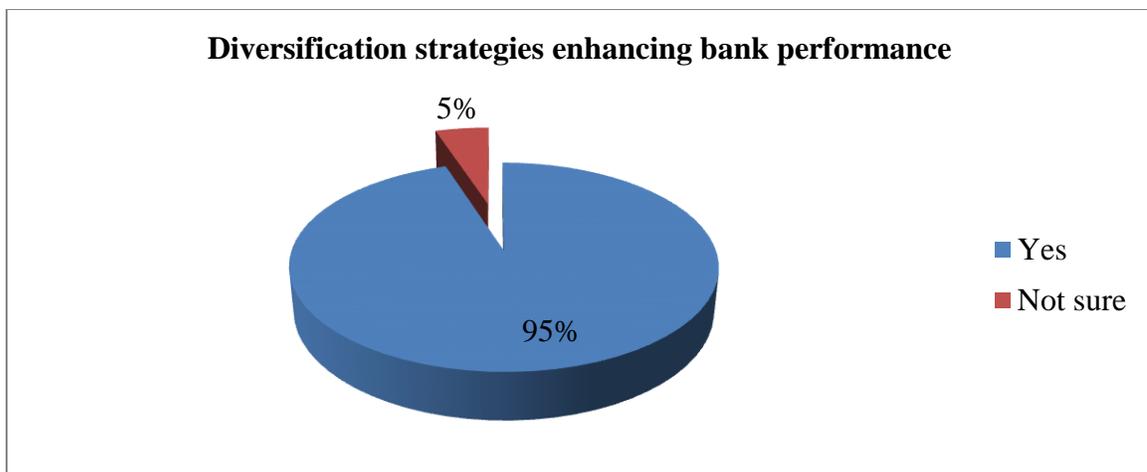


Figure 4.5: Diversification Strategies enhancing Bank Performance

Source; Research Data (2016)

4.4.1 Product Diversification Strategies

The survey asked respondents to indicate the extent of their agreement on the various aspects of product diversification strategies. According to the statistics in Table 4.1, the respondents were to evaluate the extent their banks offer mobile and internet banking, agency banking, money transfer services, asset financing and banc assurance. The findings indicated that mobile and internet banking had the highest scores while money transfer services had the lowest scores.

Okiro and Ndung'u (2013), argues that since the wake of e-banking services offered by financial institutions in Kenya, customers have access faster, effective and efficient services. The internet services pose the financial institutions to a high risk thus stringent measures need to be put in place to mitigate such risk. The financial institutions also need to ensure that they have efficient networks and support systems to ensure that there are no down times on the platforms to avoid inconveniencing customer transactions through system delays. The results of this study are in agreement with the findings above.

Table 4.1: Descriptive Statistics for Product Diversification Strategies

Product diversification strategies	N	Min	Max	Mean	Std. Deviation	Variance	Z-Score
Mobile and internet banking	37	4.00	5.00	4.9459	.22924	.053	-2.0000097
Agency banking	37	2.00	5.00	4.7568	.64141	.411	-2.0000007
Money transfer services	37	1.00	5.00	3.9459	1.59767	2.553	-0.0000003
Asset financing	37	2.00	5.00	4.6486	.75337	.568	-2.0000002
Banc assurance	37	2.00	5.00	4.6757	.74737	.559	4.00000042
Valid N (listwise)	37						

Source; Research Data (2016)

The adoption of product diversification strategies was strongly driven by individual factors. The most influential factor was found to be Mobile and internet banking with a Mean of (4.9459) with the lowest negative z-score of -2.000097, agency banking (4.7568) with negative z-score of -2.000007; money transfer services (3.9459) with negative z-score -0.000003; Asset financing (4.6486) with negative z-score of -2.000002 and bancassurance (4.6757) with the highest positive score of 4.000042.

4.4.2 Marketing Diversification Strategies

The survey asked respondents to indicate the extent of their agreement on the various aspects of marketing diversification strategies as shown in Table 4.2. Strategies for customer acquisition have been put in place in our bank, addition of new product features to the existing product is frequently done in our bank (pricing), our bank has been creating awareness of existing products is upheld (advertising) and our bank has been branding /rebranded most of the existing products and re-launching them into the market were some of the marketing diversification strategies provided.

Table 4.2: Descriptive Statistics for Marketing Diversification Strategies

Marketing diversification strategies	N	Min	Max	Mean	Std. Deviation	Variance	Z- Score
Strategies for customer acquisition	37	2.00	5.00	4.6216	.75834	.575	1.0000008
Addition of new product features to the existing product	37	3.00	5.00	4.8378	.44181	.195	-1.000001
Our bank has been creating awareness of existing products is upheld (advertising)	37	2.00	5.00	3.9459	1.22352	1.497	-2.000002
Branding /rebranded existing products and re-launching them	37	3.00	5.00	4.6486	.67562	.456	1.0000089
Valid N (listwise)	37						

Source; Research Data (2016)

The study further shows the extent of influence of marketing diversification strategies through individual indicators. The most influential factor was found to be addition of new product features to the existing product with mean (4.8378) with a negative z-score of -1.000001. The findings of this study are in line with studies carried out by Johnson et al., (2008), who found out that success of a business strategy is a function of proper policies and procedures in identifying, testing the product and efficiently rolling it out to the market.; banking/rebranded existing products and re-launching them (4.6486) with the positive Z-score of 1.0000089; strategies for customer acquisition (4.616) with a positive Z-score of 1.0000008; Creating awareness of existing products (advertising) scored the lowest mean (3.9459) with lowest negative Z-score of -2.000002.

4.4.3 Internal Growth Diversification Strategies

The survey asked respondents to indicate the extent of their agreement on the various aspects of internal growth diversification strategies. The responses are summarized in Table 4.3. Internal growth diversification strategies given included extensive acquisition and use of IT in our bank for services delivery, involvement of customers or customer representatives before investing to ensure customer satisfaction, our bank has been using retained earnings for the bank expansions, giving dividends to the stakeholders and paying bank's debts and finally there is an established reward scheme in our bank where monetary, non-monetary or contingency rewards are offered to employees. Results indicated that all the strategies given had a mean above four (4). Our bank has been using retained earnings for the bank expansions, giving dividends to the stakeholders and paying bank's debts had the highest score.

On the other hand, involvement of customers or customer representatives before investing to ensure customer satisfaction had the lowest as indicated in the Table 4.3.

Table 4.3: Descriptive Statistics for Internal Growth Diversification Strategies

Internal growth diversification strategies	N	Min	Max	Mean	Std. Deviation	Variance	Z- Score
Acquisition and use of IT in our bank for services delivery	37	3.00	5.00	4.7027	.51988	.270	-0.000003
Involvement of customers or customer representatives for customer satisfaction	37	1.00	5.00	4.2162	1.25023	1.563	-1.000009
Retained earnings for the bank expansions, giving dividends to the stakeholders and paying bank's debts	37	3.00	5.00	4.8108	.46175	.213	-1.000004
Established reward scheme where monetary, non-monetary or contingency rewards are offered to employees	37	3.00	5.00	4.4054	.72493	.526	2.0000043
Valid N (listwise)	37						

Source; Research Data (2016)

The table above shows the extent of influence of Internal Growth Diversification Strategies through individual indicators. The most influential factor was found to be Retained earnings for the bank expansions, giving dividends to the stakeholders and paying bank's debts (4.8108) with a negative z-score of -1.000001; Acquisition and use of IT in our bank for services delivery (4.7027) with negative Z-score of -0.000003; Established reward scheme where monetary, non-monetary or contingency rewards are offered to employees (4.4054) with the highest positive Z-score 2.0000043; Involvement of customers or customer representatives for customer satisfaction (4.2162) with a negative Z-score of -1.000009.

4.5 Bank Performance

Several performance indicators were evaluated to check the extent of their impact on bank performance. Profitability, sales turnover and branch network were among the aspects evaluated as shown in Table 4.4. Results indicated that branch network had the highest score while profitability had the lowest mean score.

Table 4.4: Descriptive Statistics for Bank Performance

Bank performance	N	Min	Max	Mean	Std. Deviation	Variance	Z- Score
Profitability	37	3.00	5.00	4.6216	.68115	.464	-4.000000002
Sales turnover	37	3.00	5.00	4.6486	.67562	.456	1.0000089
Branch network	37	3.00	5.00	4.7027	.66101	.437	-2.0000007
Valid N (listwise)	37						

Source; Research Data (2016)

Table 4.4 above shows bank performance through individual indicators. The most influential factor was found to be Branch network (4.7027) with the negative Z-score of -2.0000007. The utility of the consumer from choosing a particular bank is positively related to the number of its branches in an exogenously delineated market (Ishii, 2004); Sales turnover (4.6486) with a positive Z-score of 1.0000089; the indicator with the lowest effect was profitability (4.6216) with the lowest Z-score of -4.0000002.

4.6 Inferential Statistics

Inferential statistics creates inferences about a population from information taken from a small sample of that population. Inferential statistics is important in social sciences research where it allows generalization of results to a larger population. Inferential statistics are important in social sciences research as we typically study a sample yet we wish to reach conclusions about the larger populations from which the sample drawn.

4.6.1 Regression Analysis

The researcher did a linear regression modeling so as to indicate the relationship between variables. The Statistical Package for Social Sciences (SPSS) was used to code, enter and compute the measurements of the linear regression. The goodness of fit of a regression model is measured by the coefficient of determination R^2 is a statistical measure of how well the regression line approximates the real data points. The coefficient of determination lies between 0-1; 0 indicates an absolute lack of fit while 1 represents perfect fit. Coefficient of determination explains the relationship between the depended variable and the independent variables.

Table 4.5: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
	.759 ^a	.575	.537	.44890

Predictors:(Constant),product, marketing, internal growth diversification strategies

The model summary in Table 4.5 indicates an adjusted R Square of 0.537 meaning that the factors independent variables examined were able to depict 53.7% of the relationship between diversification strategies and performance of commercial banks in Kenya. Thus unexplained variables constitute the remaining 46.3%.R-squared cannot determine whether the coefficient estimates and predictions are biased and therefore adjusted R-square was used. Further, adjusted R-square is used to compare models with different numbers of predictors and also it is used to determine how well the model predicts new observations and whether the model is too complicated.

Table 4.6 indicates the ANOVA findings thus the level of significance of the model was at 95% confidence level. In general, if the F statistic in a test is smaller than the F value, the null hypothesis (model) is usually rejected meaning it is not significant. In this study, the F statistic is bigger (14.910) than the F critical (1.355) and therefore the model was significant.

Table 4.6: ANOVA

Model	Sum of		Mean Square	F	F critical	Sig.
	Squares	df				
Regression	9.014	3	3.005	14.910	1.3 55	.000
Residual	6.650	33	.202			
Total	15.664	36				

a. Predictors:(Constant),Product, Marketing, Internal growth diversification strategies

b. Dependent Variable: Bank performance

Source; Research Data (2016)

Table 4:7 is the table of coefficients for the regression model applied in the study. The table of coefficients provides the model coefficients for the parametric models. In addition to the estimates of the coefficients, the table includes a measure of the variability or error of each estimate and a test statistic (p value).

Table 4.7: Table of Coefficients

Model	Unstandardized		Standardized		Sig.
	Coefficients		Coefficients		
	B	Std. Error	Beta	t	
(Constant)	-.887	.916		-.968	.340
Product	.225	.142	.193	1.586	.122
Marketing	.193	.171	.141	1.123	.269
Internal growth	.778	.144	.639	5.385	.000

a. Dependent Variable: Bank performance

Source; Research Data (2016)

The linear regression model used in this study was;

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \epsilon_0$$

Where:

Y = Bank Performance

β_0 = Constant

β_1 = Coefficient of product diversification strategies

β_2 = Coefficient of market diversification strategies

β_3 = Coefficient of internal growth diversification strategies

ϵ_0 = Error term assumed to be a constant

The equation translates to:

$$\mathbf{Bank Performance} = -0.887 + 0.193X_1 + 0.141X_2 + 0.639X_3$$

Where; **Bank performance** = Constant + Product diversification strategies + Marketing diversification strategies + Internal Growth diversification strategies

Constant = -0.887, shows that if product, marketing and internal growth diversification strategies = 0, then increase in the bank performance would be 0.887.

0.193X₁: shows that one unit change in product diversification strategies results in 0.193 units increase in bank performance. 0.141X₂: shows that one unit change in marketing diversification strategies results 0.141units increase in bank performance. 0.639X₃: shows that one unit change in internal growth diversification strategies results 0.639units increase in bank performance.

At 5% level of significance and 95% level of confidence, product diversification strategies had a .122level of significance; marketing diversification strategies showed a .269level of significance, internal growth diversification strategies showed a .000level of significance and hence internal growth diversification strategies is the most significant factor.

4.6.2 Hypothesis Testing

Hypothesis testing is an essential procedure that is usually conducted in statistics. A hypothesis test evaluates two mutually exclusive statements about a population to determine which statement is best supported by the sample data under study. One sample t-test was used to test hypotheses and the results are shown in Table 4.8.

Table 4.8: One-Sample Test

	Test Value = 2.5				95% Confidence Interval of the Difference	
	T	df	Sig. (2-tailed)	Mean Difference	Lower	Upper
Product	22.563	36	.000	2.09459	1.9063	2.2829
Marketing	25.403	36	.000	2.01351	1.8528	2.1743
Internal growth	24.487	36	.000	2.18243	2.0017	2.3632

Source; Research Data (2016)

Hypothesis One

H₀1; Product diversification strategies have no significant effect on the performance of commercial banks in Kenya.

Findings from the study indicated that the *p*-value is .000 which is statistically significant at 5% level of significance. This implies that the null hypothesis is rejected therefore product diversification strategies have significant effect on the performance of commercial banks in Kenya.

Hypothesis Two

H₀2; Marketing diversification strategies have no significant effect on the performance of commercial banks in Kenya

Findings from the study indicated that the *p*-value is .000 which is statistically significant at 5% level of significance. This implies that the null hypothesis is rejected therefore marketing diversification strategies have significant effect on the performance of commercial banks in Kenya.

Hypothesis Three

H₀3; Internal growth diversification strategies have no significant effect on the performance of commercial banks in Kenya.

Findings from the study indicated that the *p*-value is .000 which is statistically significant at 5% level of significance. This implies that the null hypothesis is rejected therefore internal growth diversification strategies have significant effect on the performance of commercial banks in Kenya.

4.7 Discussion of Research Findings

Having collected and done the analysis of the data, an attempt to internalize the information obtained from respondents of 37 commercial banks who participated in the study has been made with the aim of identifying the various diversification strategies adopted by commercial banks and an evaluation of the relationship of these strategies on bank performance. Most of the respondents indicated that core banking services were the dominating services offered by the banks. The findings were in agreement with Adamson et al., (2003) who found out that core banking services, once put in place, should be vigorous, sealable and ensure business sustainability for longer periods. There is therefore need for financial institutions to pride themselves in innovative ways of making the banking services efficient and effective hence great customer experience.

Findings from the study also showed that mobile and internet banking among agency banking, money transfer services, asset financing and banc assurance as product diversification strategies used by banks was the main product that most banks have diversified into. This incorporation of related financial services is part of Kenyan banking industry's solidification strategy that ensures customers have a one stop shop for all their financial services. According to Lepetit et al., (2007), in their research in the financial industry concluded that this eventually leads to commercial banks achieving a balanced way to both risks reduction and leveraged synergies. There are several marketing diversification strategies adopted by commercial banks to enhance their performance.

In this study, customer acquisition strategies, improving the existing products, advertising and branding/ rebranding strategies were evaluated. Kumar (2009) contended that pricing matters to banks because it impacts on customer satisfaction and profitability. This means that pricing is key to customers as it determines whether the customers will acquire the products offered in the market or not which is in line with the findings of this study.

Earnings retained by banks are key sources of financing growth that enhances business performance. Findings from this study are in agreement with Gilchrist and Himmelberg, (1995) who contended that the level of internal funds gives information about the growth prospects of any firm/ organization. Growing firms will pay lower dividends, plan to reinvest more of their earnings, and will provide a greater percentage of their total returns as capital gains. On the other hand, firms with a few major investment opportunities would limit paying out a larger percentage of their earnings. Consequently, higher dividends are paid in stable, low-growth industries. On the other hand, high-growth companies with lots of investment opportunities are likely to pay low dividends because they have profitable uses for the capital. So, growth is likely to place a greater demand on internally generated funds.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This section outlines the synopsis of major results, the wrap up obtained from the results pointed out and the suggestions made. The findings are aimed at answering the research question which was to ascertain the effect of diversification strategies on commercial banks in Kenya.

5.2 Summary of Findings

5.2.1 Product Diversification Strategies

The study revealed that commercial banks have adopted several product diversification strategies to enhance their performance. Mobile and internet banking, agency banking, money transfer services, asset financing and banc assurance are some of the strategies that are being employed. Mobile and Internet banking is highly employed among the strategies evaluated.

Additionally, findings indicated that money transfer services are the least employed product diversification strategy by the commercial banks. Findings from the study on the z scores indicated that mobile and internet banking were significantly less than the mean. Findings from the study also indicated that product diversification strategies had a p -value of .000 which is statistically significant at 5% level of significance.

5.2.2 Marketing Diversification Strategies

There are several marketing diversification strategies that commercial banks employ. Among the strategies evaluated in this study included strategies for customer acquisition being put in place and addition of new product features to the existing product (pricing). Also creating awareness of existing products (advertising) and branding /rebranded most of the existing products and re-launching them into the market are some of the marketing diversification strategies.

The study revealed that addition of new product features to the existing product (pricing) and branding /rebranded most of the existing products and re-launching them into the market are major marketing approaches employed by the population to improve performance. The further that creating awareness of existing products through advertising as the least employed marketing diversification strategy. Results further from the z score indicated advertising was significantly less and below the mean among the marketing diversification strategies evaluated.

5.2.3 Internal Growth Diversification Strategies

Internal growth diversification strategies used by commercial banks in Kenya include but not limited to extensive acquisition and use of IT for services delivery and involvement of customers or customer representatives before investing to ensure customer satisfaction. Also, using retained earnings for the bank expansions, giving dividends to the stakeholders and paying bank's debts and having established reward scheme where monetary, non-monetary or contingency rewards being offered to employees. Results from this study revealed that using retained earnings for the bank expansions, giving dividends to the stakeholders and paying bank's debts is a significant internal growth

diversification strategy that commercial banks can adopt to enhance their performance. On the other hand, involvement of customers or customer representatives before investing to ensure customer satisfaction is the least internal growth diversification strategy that can be adopted. Findings from the study indicated that internal growth diversification had *p*-value is .000 which is statistically significant at 5% level of significance. In reference to the z scores, having an established reward scheme where monetary, non-monetary or contingency rewards are offered to employees was significantly less and below the mean.

5.3 Conclusion

The study concludes that commercial banks in Kenya have adopted several diversification strategies to enhance their performance. Further, the results of the study confirmed the existence of a significant positive relationship between diversification strategies and bank performance. Additionally, diversification strategies have an effect on the performance of commercial banks in Kenya.

The study concludes that banks are employing diversification strategies in attaining and sustaining competitive advantage in the local and regional market. The study further concludes that for banks to reach the target market more conveniently and swiftly, they have to embrace diversification strategies as one of their focus in the overall strategy. According to TCE and RBV theories, it is important to diversify and organize firms' activities in a more efficient way as compared to the prevailing market or their contenders. In this study, it was found that diversification strategies evaluated were significant at 95% thus the results were in agreement with the postulations of this theory.

5.4 Recommendations

Several suggestions were made in the light of the findings and conclusions to assist the management of commercial banks in Kenya to improve on their performance relative to the use of diversification strategies. Commercial bank managers and other high level stakeholders could apply the range of diversification strategies highlighted in expanding the scope of markets and operations of their entities in a bid to ensure sustainable competitive advantage. The empirical results further have implications for the regulator (Central Bank of Kenya) who will find this study useful in advising and reviewing applications by banks for diversification.

The results will contribute towards making necessary endorsements that will enhance a resilient banking industry. Further, the empirical results will contribute to the steadily growing knowledge on the effects of diversification strategies on bank performance. The empirical results validate the current theories and paradigms. This will advance strategic management discipline, which is still in the pre-paradigmatic stages.

5.5 Areas for Further Research

The study was carried out in a banking industry thus similar examination should be done on other industries to ascertain the relationship between diversification approaches and performance. Studies should be done to establish the factors driving the quality, efficiency and effectiveness of diversification strategies in commercial banks in Kenya. Studies should be carried out to establish if the trend being observed is sustainable in the long run.

Research can also be carried out to establish the long term sustainability of diversification strategies as a means of improving performance of commercial banks in Kenya. The factors studied explained about 53.7% of the relationship thus still 46.5% is yet to be studied. A researcher can conduct the study using non-financial measures of performance indicators which are increasingly becoming important in decision making and performance evaluation be considered in future studies.

5.6 Limitations of the Study

The major limitation of this study was accessibility of the relevant information for the study. This was due to the sensitivity nature of the information required thus the majority of the respondents were very reluctant to cooperate with the researcher in giving out what they perceived as the bank's secrets of success. Secondly, a majority of the respondents were holding management positions and therefore were relatively busy and not readily available.

The findings of this study are only applicable to commercial banks in Kenya. It therefore means that they cannot be directly applicable to other regions with different geographical diversifications and sectors. The use of regression analysis assumes that there is an assumption of linearity with the various models. Also, these observations are independent of each other, homogeneity of variances exist which may not be the case.

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APPENDICES

Appendix I: Letter of Introduction

Anne Nyachomba Mwangi

University of Nairobi,

School of Business,

P O BOX30197 – 00100,

Kenya.

Re: Management Research

I am a master's student undertaking a student undertaking Masters in Business Management from the University of Nairobi I am currently developing a management research project whose theme is an enquiry on the *Effect of diversification strategies on Performance of Commercial Banks in Kenya*. To this end, I kindly request you to provide the requested information by filling out the attached questionnaire. The information required is purely for academic research purposes only and in no way will your name or that of your institution be implicated in the research findings.

Your co-operation and quick response shall be highly appreciated.

Yours respectfully,

AnneNyachombaMwangi

Appendix II: Questionnaire

Section A: Bank Bio-Data

1. Please indicate the name of your bank

2. Below, indicate the ownership composition of your bank.

- i. Foreign Owned
- ii. Locally Owned
- iii. Partly local and partly foreign owned
- iv. Government Owned

3. How many branches does your bank have?

4. How long have you worked in the bank?

0-3Years 4-7 years 8-10 years Over 11 years

5. What are the dominating services offered by your Bank? (Please tick appropriate)

- a) Core banking services
- b) Offering loans
- c) Mortgage sales
- d) Stock brokerage

Section B: Diversification strategies

6. Do you think diversification strategies enhance bank performance?

YES NO Not Sure

7. To what extent does your bank offer the following product diversification services/products?

Where, **1= Strongly disagree 2= Disagree 3= Neither disagree nor agree**

4= Agree 5= Strongly agree

Product diversification strategies	1	2	3	4	5
Mobile and internet banking					
Agency banking					
Money transfer services					
Asset financing					
Banc assurance					

8. To what extent do you agree with the following statements in relation to how the bank has used market diversification strategies to improve bank performance

Where, **1= Strongly disagree 2= Disagree 3= Neither disagree nor agree 4=**

Agree 5= Strongly agree

Marketing diversification strategies	1	2	3	4	5
Strategies for customer acquisition have been put in place in our bank					
Addition of new product features to the existing product is frequently done in our bank (pricing)					
Our bank has been creating awareness of existing products is upheld (advertising)					

Our bank has been branding /rebranded most of the existing products and re-launching them into the market					
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9. To what extent do you agree with the following statements in relation to how the bank has used internal growth diversification strategies to improve bank performance

Where, **1= Strongly disagree 2= Disagree 3=Neither disagree nor agree 4= Agree 5= Strongly agree**

Internal growth diversification strategies	1	2	3	4	5
There has been extensive acquisition and use of IT in our bank for services delivery					
There has been involvement of customers or customer representatives before investing to ensure customer satisfaction					
Our bank has been using retained earnings for the bank expansions, giving dividends to the stakeholders and paying bank's debts					
There is an established reward scheme in our bank where monetary, non-monetary or contingency rewards are offered to employees					

10. BANK PERFORMANCE

To what extent has the bank experienced improved performance in the following areas:

Where, 1= None 2= Fairly 3= Moderate 4= High 5= Very High

Bank performance	1	2	3	4	5
Profitability					
Sales turnover					
Branch network					

THANK YOU

Appendix III: Commercial Banks

- 1.ABC Bank (Kenya)
- 2.Bank of Africa
- 3.Bank of Baroda
- 4.Bank of India[3]
- 5.Barclays Bank of Kenya
- 6.CfC Stanbic Holdings
7. Chase Bank Kenya (In Receivership)
8. Citibank
9. Commercial Bank of Africa
10. Consolidated Bank of Kenya
11. Cooperative Bank of Kenya
12. Credit Bank
13. Development Bank of Kenya
14. Diamond Trust Bank
- 15.Ecobank Kenya
16. Equity Bank

17. Family Bank
18. Fidelity Commercial Bank Limited
19. First Community Bank
20. Giro Commercial Bank
21. Guaranty Trust Bank Kenya
22. Guardian Bank
23. Gulf African Bank
24. Habib Bank
25. Habib Bank AG Zurich
26. Housing Finance Company of Kenya
27. I&M Bank
28. Imperial Bank Kenya (In receivership)
29. Jamii Bora Bank
30. Kenya Commercial Bank
31. Middle East Bank Kenya
32. National Bank of Kenya
33. NIC Bank

34.Oriental Commercial Bank

35.Paramount Universal Bank

36.Prime Bank (Kenya)

37.Sidian Bank

38.Spire Bank

39.Standard Chartered Kenya

40.Trans National Bank Kenya

41.United Bank for Africa

42.Victoria Commercial Bank

Source: CBK 2013