

**RESPONSE STRATEGIES TO CHANGES IN THE
ENVIRONMENT BY FINANCIAL AUDIT FIRMS IN NAIROBI,
KENYA**

BY: WAHOGO BERNADETTE WANJIKU

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DECLARATION

This management project is the result of my independent study and has not been submitted for a degree in any other university

Signed

Date

Wahogo Bernadette W

D61/P/7722/03

This management report has been submitted for examination with my approval as the university supervisor

Signed

Date

Prof. Evans Aosa

Department of Business Administration

School of Business

University of Nairobi

DEDICATION

This project is dedicated to my husband and our two sons for their support, love and understanding without which this project's completion would not have been possible.

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I am indebted to many individuals for their support and contributions towards the successful completion of this project. My first and deep appreciation goes to my supervisor Prof Aosa, for his professional support, guidance, commitment and encouragement. I would also like to acknowledge the management staff of the financial audit firms in Nairobi for their support during the study.

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ABSTRACT

Pearce and Robinson (1997) defined strategic responses as the set of decisions and actions that result 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. This study investigated response strategies to changes in the environment of financial audit firms in Nairobi, Kenya. The objective of the study was to establish the response strategies adopted by the financial audit firms in Nairobi, Kenya to changes in the environment. Cross sectional survey was undertaken focusing on the management of financial audit firms in Nairobi. The study utilized a standard questionnaire to collect primary data from thirty (30) financial audit firms. However, only twenty five (25) of the respondent firms completed the questionnaire. The data was then analyzed and the findings presented using tables giving descriptive statistics including frequencies, mean and percentages. The research findings indicated that the financial audit firms considered corporate, business and operational level responses to environmental changes. Based on the study, it is recommended that the management of financial audit firms should continue considering response strategies to environmental changes at the strategic planning level and implement both the corporate and business level responses at the strategic management level. Operational level responses should be implemented at the middle and line management levels in order to ensure that the entire organization works towards ensuring that its internal resources are efficiently utilized at each management level and within each strategic business unit.

CHAPTER ONE: INTRODUCTION

1.1 Background of the study

Studies have been initiated to understand the different dimensions of the competitiveness of the audit services. In the USA, the Congress mandated in the Sarbanes-Oxley Act of 2002 that the General Accounting Office should study various aspects of the audit services market competitiveness (GAO, 2003). In the UK, the Chancellor of Exchequer and the Secretary of State for Trade and Industry set up a Co-ordinating Group on Audit and Accounting Issues to investigate regulatory arrangements for statutory audit and financial reporting (CGAA, 2003). In addition, the Office of Fair Trading assessed the implications for competition of a cap on auditors' liability (OFT, 2004). Moreover, the European Commission published a recommendation to address auditor independence issues such as the provision of non-audit services to audit clients and the rotation of auditors (EU, 2002).

In Kenya, the regulatory anxiety, competition from the “Big Four” accountancy and audit firms, political reforms, technological advancement and global changes are some of the challenges that have greatly affected the growth of the industry. The dynamism of the audit services environment in the current times is posing a lot of challenges to all financial audit firms. Hence, it is only those financial audit firms that are able to adapt to the changing business environment and adopt new strategies and ways of doing business that can be guaranteed of survival (Ikiara, 1994).

1.1.1 Environment dependency

Today's organizations have to deal with dynamic and uncertain environments. In order to be successful, organizations must understand how changes in their competitive environment are unfolding. They should actively look for opportunities to exploit their strategic abilities, adapt and seek improvements in every area of the business, building on awareness and understanding of current strategies and successes. Organizations must be able to act quickly in response to opportunities and barriers. The environment faced by an organization can be categorized into two, internal and external environment (Pearce and Robinson, 2000).

The internal environment consists of conditions and forces within the organization. It mainly consists of board of directors, employees and culture. The external environment is everything outside an organization that might affect it. It is the non-specific dimensions and forces in its surroundings that might affect its activities. The general environment consists of the economic dimension, technological dimension, socio-cultural dimension and political-legal dimension (Ansoff, 1996). According to Pearce and Robinson (1997) external environment consists of specific organizations or groups that are likely to influence an organization. External environment consists of competitors, customers, suppliers and regulators.

According to Hatherly (1999), the combination of regulatory and fee pressure will cause audit firms to displace their judgment from audit work to finding ways to make audits more efficient (less costly). Furthermore, Francis (1994) suggests that

employees and partner dissatisfaction at the large audit firms is indicative of an environment with very little professional autonomy. The interviewees expressed a deep concern about the low employee morale at their firms, and several partners questioned the attractiveness of pursuing a career in today's public audit environment. These expressions of dissatisfaction may be construed as the effect that compliance type work has in diminishing the professional judgment of the auditor, and thus perhaps lowering the overall quality of audits. However, several other common responses, such as an increase in audit firm collaboration, a reestablishment of the audit function as the primary service within public accounting firms, and a better communication between auditors and audit committees, suggest an increase in overall audit quality. We call on future research to examine the relation that these various elements have on the overall quality of the external audit.

1.1.2 Response strategies to environmental changes

Pearce and Robinson (1997) defined strategic responses as the set of decisions and actions that result 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. According to Aosa (1992) the actions of competitors have a direct impact on a firm's strategy. Therefore, strategy will only make sense if the markets to which it relates are known; and that the nature of the industry in which the company operates needs to be understood. The structure of an industry and trend in that industry will help the current and future attractiveness of that industry.

Ansoff and McDonnell (1990) noted that strategic responses involve changes in the firm's strategic behaviors to assure success in transforming future environment. Pearce and Robinson (1997) defined strategic responses as the set of decisions and actions that result 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 (1998), 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 resources of a firm to the best support of its long term competitive strategy.

Pearce and Robinson (2000), says that there is need to adopt new strategies that match the challenges from the environment. Reengineering, downsizing, self-management and outsourcing are some of the dominant strategies that have been used for restructuring in the 1990's. Ansoff and McDonnell (1990) asserts that the management system used by a firm is a determining component of the firm's responsiveness to environment changes because it determines the way that management perceives the environment, diagnosis their impact on the firm, decides what to do and implements the decisions.

1.1.3 Kenya financial audit services

The level of market concentration and audit prices are dependent on the degree of competitiveness of the audit services. It is important to recognize that there are a

number of “audit markets”. Broadly there is a listed market, an unlisted market, a not-for-profit market and a public sector market. The listed market is dominated by the Big Four accounting firms that are enormous compared to the mid-tier firms. Statistics for 2004 show that within the largest firms globally the Big Four had income of £8-10 billion whereas the next five firms had only £1-1.7 billion (Oxera Consulting Ltd, 2006). In staff terms the comparison is about 100,000 at the Big Four and 20,000 at the next five largest audit firms. This demonstrates the dominance and influence of the Big Four that may well have an effect on audit price.

In Kenya, the large proportion of the demand for accountancy and audit services is derived largely from mandatory legal requirements such as financial reporting and taxation. Accounting is one of the largest professional service sectors in Kenya today and accountancy services are taken to include accounting and auditing services, financial advisory services that includes insolvency services, due diligence reviews, business processes outsourcing, tax advice, and management consultancy that includes strategy and operational services, human capital solutions consultancy. The sector in Kenya is heavily dominated by the world’s “Big Four” accountancy and audit firms, which control about 80% of large and public consultancies (Ikiara, 1994).

According to the Institute of Public Accountants of Kenyan (ICPAK), accountancy services in the country should be regulated to a certain degree in order to safeguard consumer interests. The professional association supports corporate or other forms of practice so long as there are limitations to protect consumer interest. It also supports

conditional multi-disciplinary partnerships or practices (Ikiara, 1994). In order for audit firms to compete effectively in such a highly regulated and competitive business environment, there is a need to continuously undertake an environmental scan with an aim of adopting effective response strategies to changes in the environment.

1.2 The Research problem

The dynamism of the audit services environment in the current times is posing a lot of challenges to all financial audit firms. Some of the forces of change that have greatly influenced the audit services industry include intense competition, globalization, increased regulation and political reforms. To remain competitive, the audit firms must constantly adopt new strategies in response to these changes.

Lawrence, et al (1967) stressed that strategic management is applied for the purposes of moulding, directing and relating an organization effectively to its environment. Murray (1988) considered strategic management as the most critical element of the management of organizations because it explains to a large extent, their success and survival. Miles and Snow (1978) indicate that strategic management is a managerial function that helps corporations identify, analyze, and respond to environmental changes that can significantly affect them. Much of the research on strategic management that focuses on business strategies, environment and organizational performance suggests that business strategy can influence organizational performance (Karemu, 1993).

Several studies relating to response strategies to environmental changes have been undertaken by various researchers in Kenya. For instance, Bore (2007) investigated response strategies of supermarkets in Nairobi Central Business District (NCBD) to competition while Muhindi (2007) undertook a study on response strategies to increased competition by spare parts dealers' franchises by Japanese motor vehicles in Kenya. These previous studies did not highlight response strategies to environmental changes by financial audit firms in Kenya, with exception to a study by Nyakang'o (2007) which reviewed competitive strategies adopted by financial audit firms in Nairobi. In the study, several competitive strategies adopted by the financial audit firms in Nairobi were recommended. For example, each firm must have competent and skilled employees, which are often in short supply. An easy solution would be to increase the wages but this will lead to a bidding war when several competitors need people with the same skills. In terms of sales and profit, what managers can do is advertise the product to build brand loyalty, select a less competitive domain, and merge with competition to gain larger market share and also negotiate a co-operative agreement with the competition.

However, Nyakang'o (2007) did not consider the response strategies to changes in the environment by the financial audit firms. Some of the forces of change that have greatly influenced the audit services industry include intense competition, globalization, increased regulation and political reforms (Ikiara, 1994). This research therefore sought to determine the strategies adopted by the audit firms in Nairobi,

Kenya, in response to the changes in the environment. The research question addressed was: What response strategies to changes in the environment are adopted by financial audit firms in Nairobi, Kenya?

1.3 Objective of the study

The objective of this study is to establish response strategies to changes in the environment by financial audit firms in Nairobi, Kenya.

1.4 Value of the study

The findings of this research will be useful to various stake holders in the audit industry.

This study is of value to the management team of financial audit firms in Kenya as a reference point for response strategies to changes in the environment ensuring that the financial audit firms adopt and implement effective response strategies. This will enhance the firms' competitiveness and assist the management in gaining long term competitive advantage.

The findings of this study are of significance to scholars who will use the study's findings for further research in the same area/or related field in universities and other institutions of learning. Strategic responses are subject to the organizational business environment which is dynamic and unique to each industry, therefore, there is a need for continuous research in this field.

In addition, government and professional bodies involved in policy making will also benefit from the study's findings as it provides information on the impact of a dynamic environment in respect to the competitiveness of accounting and audit services in Kenya. This will go a long way in assisting the policy makers in formulating effective policies that not only address key sector and industry areas, but that also matches international best practices and standards.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter reviews the literature for this study. The literature review highlights the concept of strategy, organizations and environment and strategic responses which include corporate level responses, business level responses and operational responses.

2.2 Concept of strategy

There are different definitions of strategy by different authors and scholars. The concept of strategy means its content and substance. Like many other concepts in the field of management, there is no agreed all-embracing definition of strategy. Porter (1980) views strategy as defining the business of an organization. Strategy has been defined by Mintzberg and Quinn (1991) as a plan, ploy, pattern, position and perspective. In his definition, Ansoff (1987) describes strategy as a rule for decision making. He seeks to differentiate policy and strategy. He indicates that while policy is a general decision that is always made in the same way whenever the same circumstances arise, strategy applies similar principles but allows different decisions as the circumstances differ. This definition is all inclusive as it captures and takes into consideration the changing environment.

Corporate strategy is a matter of deciding which business the corporation as a whole should be in and determining the overall scope and mission of the entire organization, (Bowman and Asch, 1996). Argenti (1968) defines the purpose of corporate planning

as “to determine the goals of a company and to generate plans designed to achieve these”. But strategy is not restricted to decision making by the firms’ owners. Strategy within organizations is formulated at two levels, corporate and business (or division). Corporate strategy is concerned with decisions about the type of business to be in, whereas business strategy is concerned with competing within the chosen business, (Chaffee, 1985). Ansoff (1987) notes that two related types of strategy categorize strategic development within the firm. These are portfolio strategy, which is concerned with the type of business to be in and competitive strategy, which deals with development and survival of the firm within its chosen field.

Ansoff and McDonnell (1990) see strategic management as a systematic approach to position and relate the firm to its environment in a way that will assure its continued success and make it secure from environmental surprises. Hamael and Prahalad (1989), perceived an organization as a foundation for sustained competitive advantage when it poses skills or resources that provide superior value to customers and that are difficult to imitate. In a turbulent environment, the more enduring advantage is ability to anticipate evolving customer needs and to generate new values creating capabilities based on that knowledge. And unless there is an advantage over competitors that is not easily duplicated or connected, long term profitability is likely to be elusive.

Pearce and Robinson (2000), says that there is need to adopt new strategies that match the challenges from the environment. Reengineering, downsizing, self-

management and outsourcing are some of the dominant strategies that have been used for restructuring in the 1990's. Ansoff and McDonnell (1990) asserts that the management system used by a firm is a determining component of the firm's responsiveness to environment changes because it determines the way that management perceives the environment, diagnosis their impact on the firm, decides what to do and implements the decisions.

The usefulness of strategy was equally entrenched further by Aosa (1998) in his argument that strategy is of value to managers when dealing with problems that are potential to their companies. Competitive strategies are therefore a result of strategic management. However, Ansoff (1987) warns that strategy is an elusive and somewhat abstract concept. They further argue that strategic management has got no agreed definition because of its continued development. It is therefore a match between how an organization achieves its objectives within its environment.

Nevertheless, Mintzberg (1973) defined strategy to be a play, plan, pattern, position and perspective. Pearce and Robinson (1997), concludes the foregoing definition of strategy to be a reflection of company's awareness of how to compete, against whom, when, where, and for what. Pearce and Robinson (1997) and Porter (1998) all argued that strategy is about gaining a competitive advantage. Ansoff and McDonnell (1990) concluded that strategy should be taken seriously as a managerial tool not only for the firm but also for a broad spectrum of social organizations.

2.3 Organizations and environment

Organizations are environmental dependent whereby they rely on the environment to get their inputs and consume their outputs. The environment is not static but it is continuously changing. Burnes (2004) defines environment as those forces, external to an organization such as markets, customers and the economy which influence its decision and internal operations. According to Thomson and Strickland (1993), firms have to scan the environment in an effort to spot budding trends and conditions that could affect the industry and adapt to them. Failure to do this will lead to serious strategic problem characterized by the maladjustment of the organization's output and demands of the external environment.

An organization's external environment includes economic forces, social, cultural, demographic and technological features, competitive forces such as the competitors, customers and suppliers. The forces in the environment can be categorized into remote environment, which originates beyond, usually irrespective of any single firms operating situation, industry environment, which comprises entry barriers, supplier's power, buyer power, substitute availability and competitive rivalry and operating environment comprising competitors, creditors, customers, labour and suppliers (Porter, 1985).

Johnson and Scholes (1999) argue that changes in the environment give rise to opportunities for the firm but also exert threats to it. Drucker (1974) affirms this and asserts that neither results nor resources exist in business. He defined business as a

process that converts an outside resource, namely knowledge, into an inside, namely economic value. The firm therefore has to continue changing to keep pace with the changing environment. This is done through strategic management, which is to position and relate the firm to its environment in a way, which will assure its continued success and make it secure from surprises.

The external component should have a strategic fit with the internal environment, which includes the organization's system, policies, resource capability and corporate culture (Pearce and Robinson, 2003). If a resource has little impact on the external opportunities and threats facing the organization, regardless of how rare, inimitable and non sustainable the resources, it will have little value (Hitt et al., 1999). Resistance to change frequently leads to a gap between the behavior of a firm and imperatives of the environment.

Technology has made the world a global economy, thus creating more opportunities and threats that organizations must deal with to remain competitive and in business. Research done within Kenya has shown that firms are as dynamic as the environment. They respond in various ways to changes in the environment, which include marketing, diversification of the products and services offered, restructuring and adoption of new technology. Mwarania (2003) revealed that Kenya Reinsurance had adopted restructuring and staff development as a response to competition in the environment. Thiga (2002) confirmed that airlines responded to change in environment by expanding their networks, shelving of unprofitable routes and cutting

costs. Chepkwony (2001) and Isaboke (2001) concluded that oil firms made major marketing strategy adjustments in order to be more competitive in the liberalized market, while Njau (2000) confirmed that East African Breweries Limited had made adjustment in competitive position in the face of increased competition.

According to Porter (1985), the challenge to organizations is to continuously match the environment, strategy and their internal capabilities in order to survive, remain relevant and succeed. An organization's competitive advantage may reside as much in the environment as in the individual organization. The first step for any organization is to perform a strategic diagnosis, which is to identify the type of strategic aggressiveness and organizational responsiveness a particular firm needs to develop in order to meet the future challenges of its environment. It is a systematic approach to determine the changes that have to be made to a particular organization's strategy and its internal capability in order to assure the firm's success in its future environment. Strategy diagnosis identifies whether a firm needs to change strategic behavior to assure success in future environment (Ansoff and Mc Donnell 1990). If the diagnosis confirms the need, the next step is to select and execute specific cautions, which will bring the firm's strategy and capability in line with the future environment.

2.4 Strategic responses

Burnes (1998) noted that the concern in real time responses is to minimize the sum to total losses and restore profitability to ensure organization's success in a turbulent and

surprising environment. He also observed that unstable and unpredictable conditions in which organizations have to operate today means that the ability to think strategically and manage strategic change successfully is key competitive strength for a sustainable competitive advantage. Real time strategic issue responses are necessary to facilitate the firm's preparedness in handling the impending issue, which may have profound impact on the firm.

Hill and Jones (2001), states that by planning, an organization is able to identify the problems and plan how to solve them by using appropriate strategies. In the strategic decision making process of organizations, there are three levels of strategy under the strategic responses namely corporate level strategy, business level strategy and operational level strategy. According to Das and Kumar (2010) the past several decades have witnessed enormous growth in alliance activity.

Das and Teng (2000) note that strategic alliances apparently have established themselves as cornerstones for the competitive strategy of many firms, enabling those firms to achieve objectives that otherwise would be difficult to realize. According to Management Decision (1967) in the article "The antecedents of response strategies in strategic alliances," economic satisfaction, social satisfaction, alliance-specific investments, and the availability of attractive alternatives differentially and interactively affect response strategies to adverse situations such as uncertainty, interdependence, and vulnerability.

2.4.1 Corporate Level Responses

The company's corporate strategy should help in the process of establishing a distinctive competence and competitive advantage at the business level. There is a very important link between corporate level and business level. According to Johnson and Scholes (2002), corporate level responses is the first level of strategy at the top of the organization, which is concerned with the overall purpose and scope of the organization to meet the expectations of owners or major stakeholders and add value to different parts of the enterprise. This includes issues of geographical coverage, diversity of product / services or business units and how resources are to be allocated between the different parts of the organization.

At a general strategic level these strategies include vertical integration which is where the company is producing its own input (backward or upstream integration) or is disposing its own output (forward or downward integration). Backward integration means moving into intermediate manufacturing and raw material production. Forward integration means moving into distribution at each stage in the chain, value is added to the products. Vertical integration presents companies with a choice about which value-added stages of the raw material to customer chain to compete in. A company achieves full integration when it produces all of a particular input needed for its processes or when it disposes off all its output through its own operation (Hill and Jones, 2001).

Taper integration occurs when a company buys from an independent supply in addition to a company's own supplier, or when it disposes off all its output through independent outlets in addition to company owned outlet. A company pursuing vertical integration is normally motivated by the desire to strengthen the competitive position of its original, or core business (Hill and Jones, 2001).

Acquisition and mergers are also effective corporate level responses. It is feasible to use acquisition as a means of achieving several possible business objectives. Those considered are growth, market entry, diversification, improved efficiency and profitability. According to Hamel and Prahalad (1991) acquisition is a particularly attractive means of growth because of the rapidity with which this can be achieved through the external route of acquiring an existing business as opposed to the internal route of building up capacity by purchasing the necessary assets such as premises, plants, among others. Provided appropriate 'victim' businesses are available, acquisitions are secure for the expansion of the necessary working equipment, access to scarce raw materials and distribution networks.

2.4.2 Business Level Responses

According to Hill and Jones (1999), focus strategy concentrates on serving particular market niche, which can be defined geographically, type of customer or by segment of the product line. A focus strategy provides an opportunity for an entrepreneur to find and then exploit the gap in the market by developing a unique product that a customer cannot do without. The company has enormous opportunity to develop its

own niche and compete against low-cost and differentiated enterprises which tend to be larger. It differs from corporate strategy in that whereas corporate strategy involves decisions about the entire organization, strategic decision under the business units are basically concerned with how customers' or clients' needs can best be met. According to Johnson and Scholes (2002) "Business unit strategy is about how to compete successfully in particular markets".

Cost-leadership strategy is a company's goal in pursuing a cost leadership strategy to outperform competitors by doing everything it can to produce goods or services at a cost lower than theirs. The cost leader chooses a low level of product differentiation. The cost leader aims for a level of differentiation not markedly inferior to that of differentiator, but maintains a level obtainable at low cost (Hill and Jones, 1999).

Differentiation strategy on the other hand aims to achieve a competitive advantage by creating a product (goods and services) that is perceived by customers to be unique in some important way. The differentiated company's ability to satisfy a customer's need in a way that the competitors cannot means that it can charge a premium price (Johnson and Scholes, 2002).

Focus strategy is based on selecting a market niche where buyers have distinctive preferences. The niche is defined by geographical uniqueness, specialized requirements in using the product or by special attributes that appeal to members. A focus strategy based on low cost depends on there being a buyer segment whose

needs are less costly to satisfy than the rest of the market. On the other hand, a focus strategy based on differentiation depends on there being a buyer segment that demands unique product attributes (Potter, 1980).

2.4.3 Operational Responses

The third level of strategy at the operating end of the organization, concern with how component part of the organization delivers effectively the corporate and business level strategies in terms of resources, processes and people. Thus operational strategy looks at how corporate and business level strategies can be translated into concrete operational functions and processes in areas like marketing, research and development, manufacturing, personnel and finances. Strategic management is therefore wide and complementary. Other types of management are like operations management and financial management, which are basically in the operational level of the organization. They focus on the short-term and aim at achieving efficiency in the use of resources and maximizing the returns for the stakeholders in the organization (Hill and Jones, 1999).

According to Johnson and Scholes (2002), operational strategies are concerned with how parts of an organization deliver effectively the corporate and business level strategies in terms of resources, process and people. Companies adopt strategies directed at improving, the effectiveness of basic operations within the company, such as production, marketing, materials management, research and development, and human resources. Even though strategies may be focused on a given function, they

embrace two or more functions and require close co-operation among functions to attain companywide efficiency, quality innovation, and customer responsiveness goals. Such strategies include but are not limited to marketing efficiency, research and development efficiency, human resource efficiency, self managing teams, paying for performance, information system and internet efficiency as well as infrastructure efficiency.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter outlines the overall methodology that was used in the study. This includes the research design, population of the study, sample size, sample frame, data collection methods, research procedures and data analysis and presentation.

3.2 Research design

Research design is defined as “an arrangement of conditions for collection and analysis of data in a way that combines their relationship with the purpose of the research to the economy of procedures” (Chandran, 2004, p.68). It concerns the several considerations a researcher should think about and adhere to when carrying out a research project (Robson, 2002). The choice of a research design is determined by the research purpose, categories of data needed, data sources and cost factors among others (Chandran, 2004).

Cross sectional survey was used in this study. The survey involved collection of quantitative data from members of the population by use of questionnaires. Quantitative research design includes discrete numbers or quantified data (Cooper and Schilder, 2003). This research design results with numerical information or statistics which can be realized by structuring the research questionnaire with pre-determined closed and scaled questions. This design was appropriate because of the

comparative analyses that were expected to be done and the cross sectional nature of the data collected. Moreover, the design allowed the researcher to collect data and information using a standard questionnaire from the selected financial audit firms in Nairobi, Kenya.

3.3 Population of interest

Mugenda (2003, p.20) defines population as “an entire group of individuals, events or objects having a common observable characteristic.” The target population of this study consisted of all financial audit firms that are located in Nairobi and are listed as members of ICPAK as at 31st December 2009. According to ICPAK, there were 700 registered auditing firms, hence, the population size $N = 700$.

3.4 Sampling

Chandran (2004) has specified two main sampling techniques. These are probability and non-probability sampling techniques. In probability sampling, the principle of equal representation for all members of the entire population is a norm without bias. The main methods used here are random and simple random sampling where every member of the population has an equal chance of being selected (Chandran, 2004).

For this study, the sampling frame was the list of financial audit and accountancy firms maintained by the Institute of Certified Public Accountants of Kenya (ICPAK), and a systematic sampling procedure was adopted. According to Mugenda and Mugenda (2003), for such a study a sample size of $n=30$ is sufficient. Consequently,

the financial audit firms were randomly selected between 1 to K, where; $\{K = N/n\}$, that is, $700/30 = 23$.

3.5 Data collection

The data collected was quantitative in nature and was collected using a structured questionnaire containing closed questions. A questionnaire, as the data collection instrument of choice is, easy to formulate and administer and also provides a relatively simple and straightforward approach to the study of attitudes, values, beliefs and motives (Robson, 2002). Questionnaires may also be adapted to collect generalized information from almost any human population and results to high amounts of data standardization. It also allows collection of large amounts of data at relatively low costs within a short period alongside a big allowance of anonymity which encourages frankness from the respondents especially in sensitive issues like governance and/or management.

The questionnaires accompanied by an official cover letter from the university, were dropped and picked later from any one (1) of the partners within the selected financial audit firms. Follow-up calls were made to ensure that the questionnaire was dully filled within a reasonable period of time.

3.6 Data analysis

Mugenda and Mugenda (2003) describe data analysis as the process of data coding, data entry and the common methods used in data analysis. The data collected was

edited, coded and analyzed using descriptive analysis. The results were then presented using pie-charts, graphs and tables and descriptive statistics such as mean, percentage, frequency, standard deviation and variance were used to describe the study's research findings. Percentages revealed the proportions of different attributes that were being studied for relative comparison to address the objective of the study.

CHAPTER FOUR: DATA ANALYSIS AND FINDINGS

4.1 Introduction

This chapter presents analysis and findings of the study on Audit firms in Nairobi, Kenya. The objective of this study was to establish response strategies adapted to changes in the environment by financial audit firms in Nairobi, Kenya. The data was analysed using descriptive statistics by use of percentages as shown in the following sections. Out of the 30 firms selected, 5 did not respond, either they declined to participate in the study or did not fill in the questionnaire thus they are not included in the analysis and findings. The response rate was therefore 83%. A response rate of 50% is adequate for analysis and reporting, whereas a rate of 60% is good and a rate of 70% and over is very good (Mugenda and Mugenda, 2003).

4.2 Response strategies adopted by financial audit firms in Nairobi, Kenya

This section highlights the findings on the response strategies to environmental changes adopted by financial audit firms in Nairobi, Kenya. The questionnaire mentioned the various responses strategies the financial audit firms can adopt at the corporate, business and operational levels in response to the changes in the environment. The respondents were asked to rate the validity of these response strategies to the business environment of their firms into whether they were very valid, valid, indifferent, invalid and very invalid.

Table 4.1 illustrates the validity of corporate level responses as response strategies to environmental changes by financial audit firms. To measure the validity of the corporate level responses, the researcher coded the respondents considerations where “Very valid” was given the value five (5.0), “Valid” was given the value four (4.0), “Indifferent” was given the value three (3.0), “Invalid” was given the value two (2.0) and “Very invalid” was given the value one (1.0). According to the table, the respondents considered vertical integration, acquisitions and mergers as very valid corporate level response strategies to environmental changes by financial audit firms in Nairobi as their means were five (5.0). The respondents also considered taper integrations as very valid corporate level response strategy as the mean drew closer to five (5.0) at 4.96.

Table 4.1: Validity of corporate level responses

Please rate the validity of the following corporate level responses as response strategies to the business environment of your firm	Mean
Vertical integration	5.00
Taper integration	4.96
Acquisition and Mergers	5.00

Source: Research data

Table 4.2 illustrates the validity of business level responses as response strategies to environmental changes by financial audit firms. To measure the validity of the business level responses, the researcher coded the respondents considerations where “Very valid” was given the value five (5.0), “Valid” was given the value four (4.0),

“Indifferent” was given the value three (3.0), “Invalid” was given the value two (2.0) and “Very invalid” was given the value one (1.0). According to the table, the respondents considered differentiation strategy and focus strategy as very valid business level responses to environmental changes by financial audit firms in Nairobi as their means were five (5.0). The respondents also considered cost leadership strategy as very valid business level response strategy as the mean drew closer to five (5.0) at 4.72.

Table 4.2: Validity of business level responses

Please rate the validity of the following business level responses as response strategies to the business environment of your firm	Mean
Differentiation strategy	5.00
Cost Leadership strategy	4.72
Focus strategy	5.00

Source: Research data

Table 4.3 illustrates the validity of operational level responses as response strategies to environmental changes by financial audit firms. To measure the validity of the operational level responses, the researcher coded the respondents considerations where “Very valid” was given the value five (5.0), “Valid” was given the value four (4.0), “Indifferent” was given the value three (3.0), “Invalid” was given the value two (2.0) and “Very invalid” was given the value one (1.0). According to the table, the respondents considered marketing efficiency and human resource efficiency as very valid operational level responses to environmental changes by financial audit firms in

Nairobi as their means were five (5.0). The respondents also considered research and development efficiency, information systems and internet efficiency and infrastructure efficiency as very valid operational level responses as their means drew closer to five (5.0) at 4.88, 4.92 and 4.92 respectively. Self managing teams and paying for performance were considered to be valid operational level responses as their means drew closer to four (4.0) at 4.42 and 4.12 respectively.

Table 4.3: Validity of operational level responses

Please rate the validity of the following operational responses as response strategies to the business environment of your firm	Mean
Marketing efficiency	5.00
Research and Development efficiency	4.88
Human resource efficiency	5.00
Self managing teams	4.42
Paying for performance	4.12
Information system and Internet efficiency	4.92
Infrastructure efficiency	4.92

Source: Research data

The researcher was also interested in determining whether financial audit firms in Nairobi have acquired a competitive advantage over other financial audit firms as a result of adopting strategic responses to environmental changes. Findings also indicated that 100% of the respondents concurred that the financial audit firm gained

competitive advantage over other financial audit firms due to the adoption of response strategies to environmental changes.

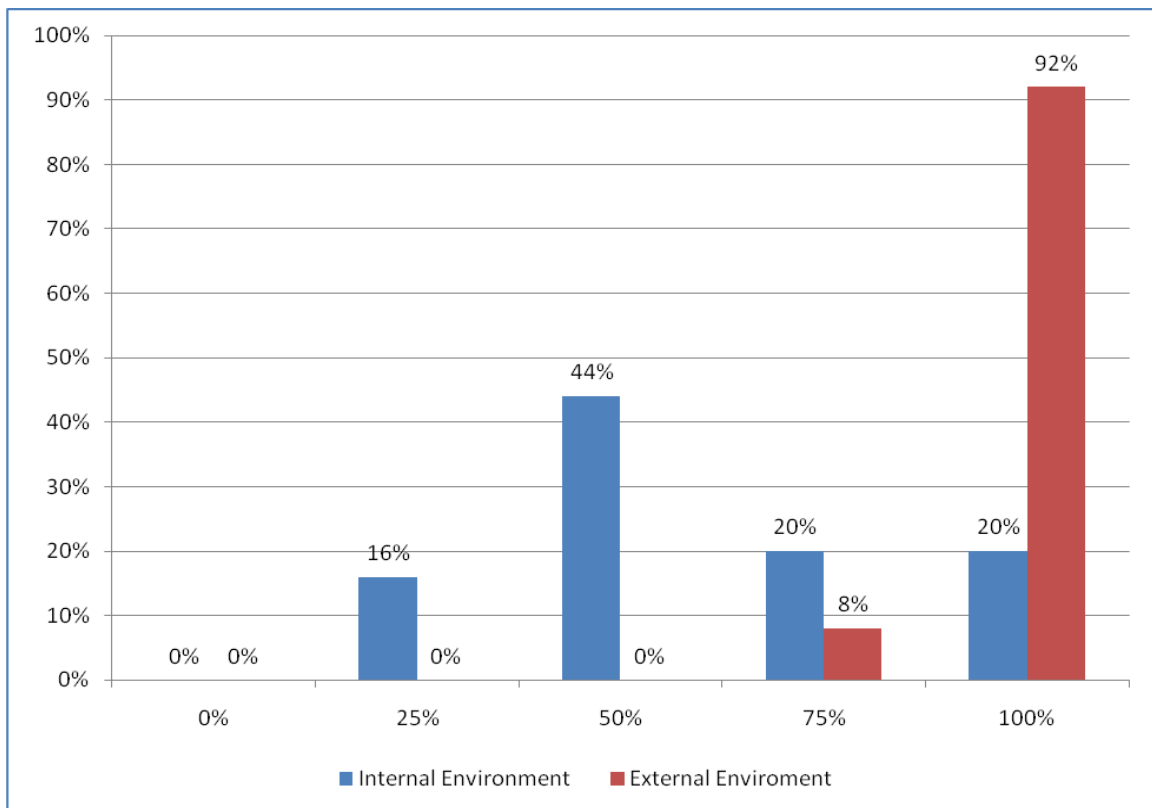
4.3 Factors influencing the identification and implementation of response strategies by financial audit firms in Nairobi, Kenya

This section highlights findings on the factors influencing the identification and implementation of response strategies to environmental changes by financial audit firms in Nairobi, Kenya. The researcher was interested in establishing the level at which the management of financial audit firms consider and implement response strategies to environmental changes. Findings indicated that 100% of the financial audit firms in Nairobi incorporated response strategies to environmental changes into their strategic plans. This finding indicates that financial audit firms in Nairobi did consider response strategies to environmental changes at the strategic planning stage, hence it can be inferred that such strategies are implemented at the strategic management level.

The study also investigated the influence of both the internal and external environments in the implementation of response strategies to environmental changes by the financial audit firms in Nairobi. Figure 4.1 illustrates the percentages of influence posed by the internal and external business environments on the implementation of response strategies to environmental changes by financial audit firms in Nairobi. According to the figure, 16% of the respondents were of the opinion that the internal business environment influenced such implementation at a 25 percent

level. 44% of the respondents were of the opinion that the internal business environment influenced such implementation at a 50 percent level. 20% and 8% of the respondents were of the opinion that the internal and external business environments influenced such implementation at a 75 percent level respectively. 20% and 92% of the respondents were of the opinion that the internal and external business environments influenced such implementation at a 100 percent level respectively.

Figure 4.1: Incorporation of response strategies into the strategic plans of financial audit firms

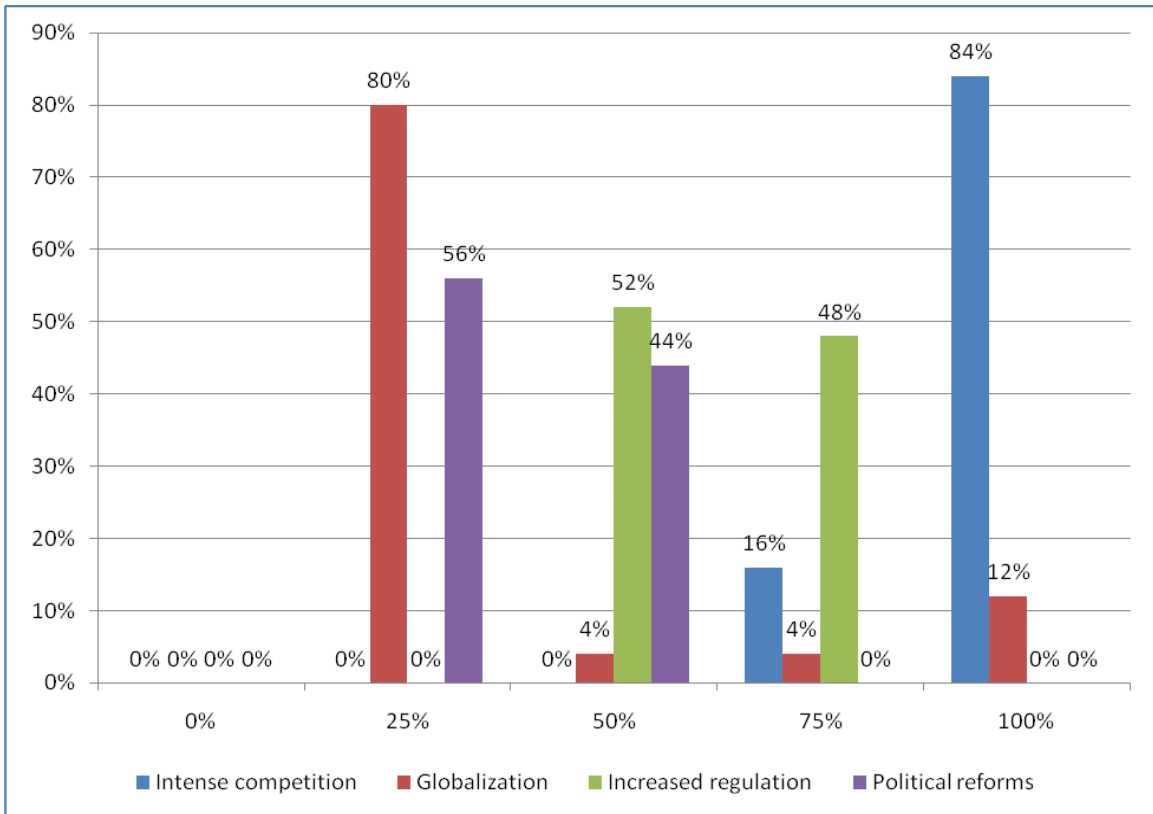


Source: Research data

Due to the significance of the business environment in the implementation of response strategies to environmental changes, the study also investigated the influence of various aspects of both the internal and external environments in the

implementation of response strategies to environmental changes by the financial audit firms in Nairobi. Figure 4.2 illustrates the percentages of influence posed by external business environmental aspects/factors on the implementation of response strategies to environmental changes by financial audit firms in Nairobi. According to the figure, 80% and 56% of the respondents were of the opinion that globalization and political reforms influenced the implementation of response strategies at a 25 percent level respectively. 4%, 52% and 44% of the respondents were of the opinion that globalization, increased regulation and political reforms influenced such implementation at a 50 percent level respectively. 16%, 4% and 48% of the respondents were of the opinion that intense competition, globalization and increased regulation influenced such implementation at a 75 percent level respectively. 84% and 12% of the respondents were of the opinion that intense competition and globalization influenced such implementation at a 100 percent level respectively.

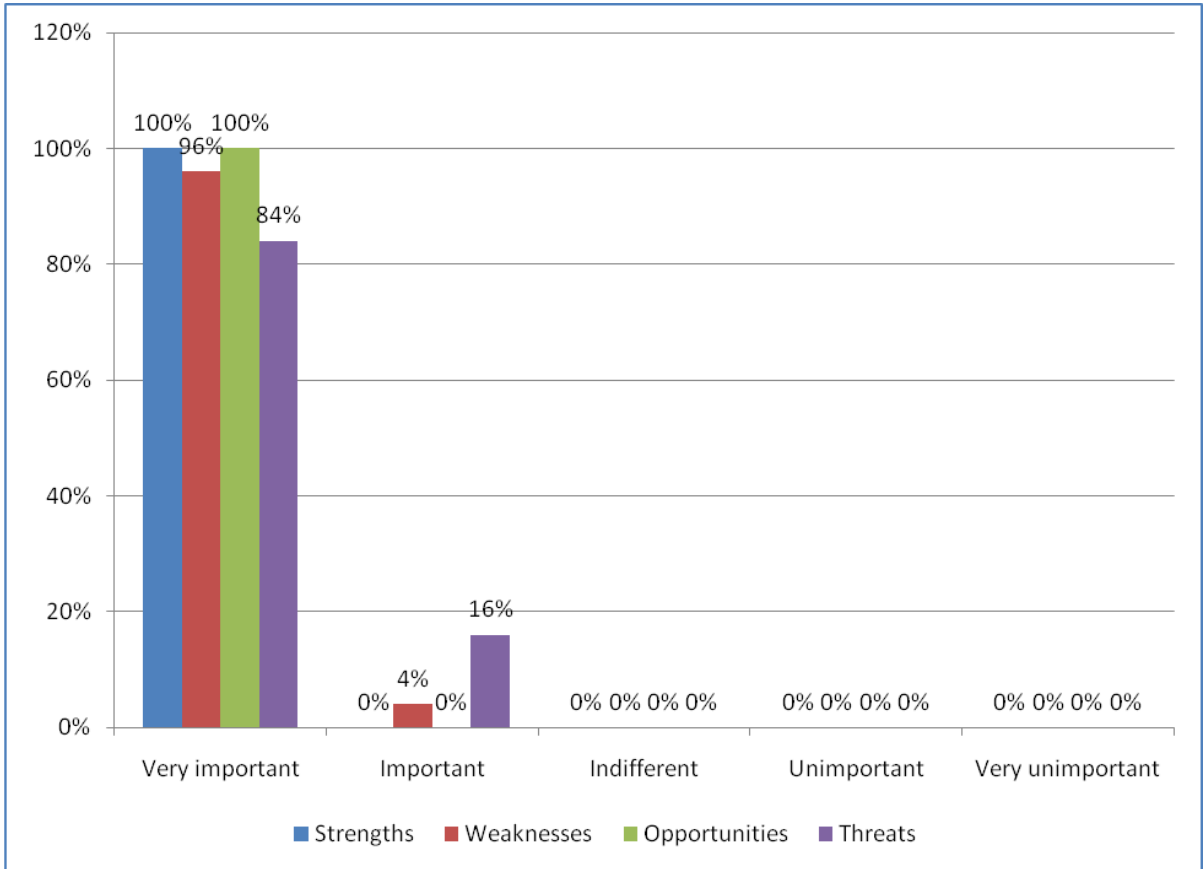
Figure 4.2: Influence of external business environmental aspects/factors



Source: Research data

Figure 4.3 illustrates the percentages of the importance of organizational factors in identifying response strategies to environmental changes by financial audit firms in Nairobi. According to the figure, 100%, 96%, 100% and 84% of the respondents were of the opinion that strengths, weaknesses, opportunities and threats are very important in identifying response strategies to environmental changes respectively. 4% and 16% of the respondents were of the opinion that weaknesses and threats are important in identifying response strategies to environmental changes respectively.

Figure 4.3: Importance of organizational factors in identifying response strategies



Source: Research data

4.4 Discussion

Based on the research findings and in line with the study’s research objective, which aimed at establishing response strategies to changes in the environment by financial audit firms in Nairobi, Kenya, it was evident that vertical integration, acquisitions and mergers, and taper integrations were considered as very valid corporate level response strategies to environmental changes by financial audit firms in Nairobi. Differentiation strategy and focus strategy were considered very valid business level

responses, while marketing efficiency and human resource efficiency were considered very valid operational level responses to environmental changes by financial audit firms in Nairobi, Kenya.

Consequently, it is inferred that management of financial audit firms considered response strategies to environmental changes at the strategic planning stage and implements the said strategies at the strategic management level. Although response strategies are mostly targeted to external environmental changes, especially the corporate and business level responses, the internal business environment also influences the implementation of response strategies and should therefore be considered in the adoption and implementation of response strategies to environmental changes by financial audit firms. The external component should have a strategic fit with the internal environment, which includes the organization's system, policies, resource capability and corporate culture (Pearce and Robinson, 2003).

According to Porter (1985), the challenge to organizations is to continuously match the environment, strategy and their internal capabilities in order to survive, remain relevant and succeed. An organization's competitive advantage may reside as much in the environment as in the individual organization. The first step for any organization is to perform a strategic diagnosis, which is to identify the type of strategic aggressiveness and organizational responsiveness a particular firm needs to develop in order to meet the future challenges of its environment. It is a systematic approach

to determine the changes that have to be made to a particular organization's strategy and its internal capability in order to assure the firm's success in its future environment.

Ansoff and Mc Donnell (1990) note that strategy diagnosis identifies whether a firm needs to change strategic behavior to assure success in future environment. If the diagnosis confirms the need, the next step is to select and execute specific cautions, which will bring the firm's strategy and capability in line with the future environment. The study's findings further supported Mwarania (2003) who revealed that Kenya Reinsurance had adopted restructuring and staff development as a response to competition in the environment. Moreover, Thiga (2002) confirmed that airlines responded to change in environment by expanding their networks, shelving of unprofitable routes and cutting costs, while Chepkwony (2001) and Isaboke (2001) concluded that oil firms made major marketing strategy adjustments in order to be more competitive in the liberalized market.

CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter outlines the summary of findings, conclusions, implications of the study, suggestions for further research and limitations of the study.

5.2 Summary of findings

The research findings indicated that all of the financial audit firms in Nairobi, Kenya incorporated response strategies to environmental changes into their strategic plans. The findings also indicated that the financial audit firms considered corporate, business and operational level responses to environmental changes. Corporate and business level response strategies were all considered to be very valid as response strategies to environmental changes by the financial audit firms. However, marketing efficiency, human resource efficiency, research and development efficiency, information systems and internet efficiency and infrastructure efficiency were considered as very valid operational level responses to environmental changes, while self managing teams and paying for performance were considered to be valid operational level responses.

Research findings further indicated that the influence of both the internal and external environments in the implementation of response strategies to environmental changes

by the financial audit firms in Nairobi was ranging from a 25 percent level to a 100 percent level with external factors being the most influential. The audit firms strengths, weaknesses, opportunities and threats are very important in identifying response strategies to environmental changes.

5.3 Conclusion

The researcher drew conclusions based on the research findings (in Chapter Four) and in line with the study's research objective, which aimed at establishing response strategies to changes in the environment by financial audit firms in Nairobi, Kenya. Management of financial audit firms considers response strategies to environmental changes at the strategic planning stage and implements the said strategies at the strategic management level.

Although response strategies are mostly targeted to external environmental changes, especially the corporate and business level responses, the internal business environment also influences the implementation of response strategies and should therefore be considered in the adoption and implementation of response strategies to environmental changes by financial audit firms. Intense competition, globalization and increased regulation are the most influential external business environmental factors in the implementation of response strategies to environmental changes by financial audit firms. It can therefore be concluded that since the external business environment influences the implementation of response strategies to environmental changes to a great extent, both the corporate and business level responses are very

effective as response strategies as they mainly focus on external environmental factors and/or business aspects. Moreover, operational level responses are effective in dealing with the internal business environment factors and/or aspects and generally improve the efficiency with which the financial audit firm utilizes its internal resources in the implementation of response strategies to environmental changes. It is also important to note that research findings indicated that all the financial audit firms gained competitive advantage over other financial audit firms due to the adoption of response strategies to environmental changes. It can therefore be concluded that the management of financial audit firms undertake a SWOT analysis of their respective firms with an aim of adopting and implementing response strategies to environmental changes.

5.4 Implications of the study

Based on the conclusions of this study, the researcher recommends the following with regard to the adoption and implementation of response strategies to environmental changes by financial audit firms. First and foremost, that the management of financial audit firms should in their policies the need to continuously consider response strategies to environmental changes at the strategic planning level and implement both the corporate and business level responses at the strategic management level. Operational level responses should be implemented at the middle and line management levels in order to ensure that the entire organization works towards ensuring that its internal resources are efficiently utilized at each management level and within each strategic business unit.

Management of financial audit firms should also continuously scan the external business environment and adjust the organization's response strategies accordingly. In this light, a firm that considers growth as key to responding to environmental changes should consider vertical integration, acquisitions and mergers as its corporate level response strategies and pursue differentiation strategy and/or focus strategy as its business level responses. This will ensure that such a firm is continuously increasing its business size by acquiring existing and/or new business opportunities, while at the same time maintaining market relevance through product differentiation and market focus.

For instance, a firm that develops adequate management of linkages within the organization's value chain and linkages into the supply and distribution chains and competition within the organization's industry as well as focuses on specific differentiated product lines that can ensure profitability as well as enter into strategic alliances aimed at reducing the degree of rivalry between existing competitors and/or acquiring such competitors will stand a high chance of successfully responding to environmental changes. Management should also ensure that the firm is efficient in utilizing its internal resources by capitalizing on its strengths and opportunities while mitigating any effects from the organizations weaknesses and threats. This will ensure that the financial audit firm continuously gains and maintains competitive advantage over the competition as well as increase the firm's success in responding to environmental changes.

5.5 Limitations of the study

The major limitations of this study related to time constraints, limited financial resources and geographic distance between the financial audit firms in Kenya. Time and geographical constraints were overcome by selecting a relatively small sample size that did not compromise the validity and reliability of the research findings, while the limited financial resources available were spent on research activities that could not be undertaken solely by the researcher. In addition, the researcher did not overlook the major limitation of cross-sectional research studies which is that their design makes it difficult to explain phenomena that occur over time, hence the study's findings are only applicable to the study's time frame.

5.6 Suggestions for further research

The researcher recommends that further research should be undertaken to investigate the factors affecting the implementation of response strategies to environmental changes by firms within the Kenyan accounting and audit service industry as well as managers' perception of response strategies to environmental changes and their impact on organizational performance. Findings of such a study would enrich the conclusions and recommendations made in this study by providing more insight into the business environment and strategic responses of firms within the Kenyan service industry.

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APPENDIX I: QUESTIONNAIRE

Instructions: This questionnaire contains questions relating to response strategies to changes in the environment by financial audit firms in Nairobi, Kenya. Kindly fill in by ticking (√) the appropriate response.

1. Does your firm's overall strategic plan incorporate the use of response strategies as a way of gaining competitive advantage in the industry and/or improving organizational performance?

Yes

No

2. Please assign an appropriate percentage to the extent with which the internal and external environments influence/affect the implementation of your firm's overall strategic plan.

0% 25% 50% 75% 100%

Internal environment

External environment

3. Please assign an appropriate percentage to the extent with which the following business environmental factors influence/affect the implementation of your firm's overall strategic plan.

Environmental Factor	0%	25%	50%	75%	100%
Intense competition					
Globalization					
Increased regulation					
Political reforms					

4. Please rate the importance of the following organizational factors in identifying response strategies by your firm: (Rating Scale: 1- *Very important*; 2 – *Important*; 3 – *Indifferent*; 4 – *Unimportant*; 5 – *Very unimportant*)

Factor	1	2	3	4	5
Strengths					
Weaknesses					
Opportunities					
Threats					

5. Please rate the validity of the following corporate level responses as response strategies to the business environment of your firm: (Rating Scale: 1- *Very valid*; 2 – *Valid*; 3 – *Indifferent*; 4 – *Invalid*; 5 – *Very invalid*)

Factor	1	2	3	4	5
Vertical integration					
Taper integration					
Acquisition and Mergers					

6. Please rate the validity of the following business level responses as response strategies to the business environment of your firm: (Rating Scale: 1- *Very valid*; 2 – *Valid*; 3 – *Indifferent*; 4 – *Invalid*; 5 – *Very invalid*)

Factor	1	2	3	4	5
Differentiation strategy					
Cost Leadership strategy					
Focus strategy					

7. Please rate the validity of the following operational responses as response strategies to the business environment of your firm: (Rating Scale: 1- *Very valid*; 2 – *Valid*; 3 – *Indifferent*; 4 – *Invalid*; 5 – *Very invalid*)

Factor	1	2	3	4	5
Marketing efficiency					
Research and Development efficiency					
Human resource efficiency					
Self managing teams					
Paying for performance					
Information system and Internet efficiency					
Infrastructure efficiency					

8. In your opinion, has your firm acquired a competitive advantage over other financial audit firms as a result of adopting strategic responses to the environment?

Yes []

No []

Thank you.