A SURVEY OF THE PRODUCT DIVERSIFICATION STRATEGIES ADOPTED BY FIRMS IN THE BANKING INDUSTRY IN KENYA

BY

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A Management research project submitted in partial fulfillment of the requirements of the Degree of Master of Business Administration.

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DECLARATION

I, the undersigned, declare that this project is my original work and has not been submitted at any college, institution, or university other than the University of Nairobi for academic purposes.

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DEDICATION

To my beloved parents, Jack and Naswa for their inspiration and teaching me the value of education in life.

ACKNOWLEDGEMENTS

My special appreciation and heart felt gratitude to my supervisor Ms. Margaret Ombok for her sacrifice, patience and guidance that made this study a success. May God bless you abundantly.

I acknowledge the support I received from my dear sister Magdalene and brother Dennis; for their unwavering support that made a whole lot of difference.

Finally, I am forever grateful to God Almighty without whom none of this would have been possible.

ABSTRACT

The banking industry in Kenya faces diverse challenges. One of the major challenges is the dynamic competitive environment in which they operate. This has compelled the banks to use various growth strategies like product diversification to achieve a sustainable competitive edge. The objective of this study was to establish the extent to which commercial banks have adopted product diversification strategies, determine the benefits of employing such strategies and the challenges faced thereof.

The study was based on a descriptive design; the population included all the 44 commercial banks operating in Kenya. A census study was carried out due to a small number of banks. Data was collected by use of semi-structured questionnaire, which was administered through drop, and pick and follow up done through email method. The response rate was 82.5%. Data was analyzed using frequency tables, standard deviation and results presented in tables.

The research findings revealed that product diversification is adopted by commercial banks to a large extent. They widely pursued related diversification with relative variation across banks. The main benefits cited for product diversification strategy was increase in profitability, stability of earnings and customer loyalty while the main challenges faced was increased cost of coordination among various new products.

It is recommended that banks undertaking diversification should do so in the context of explicit policy regarding what the objectives of such should be in order to minimize pitfalls and increase shareholder value.

TABLE OF CONTENTS

Declaration...i

Dedication...ii

Acknowledgement...iii

Abstract...iv

Table of Contents...v

List of Tables...viii

CHAPTER ONE...1

INTRODUCTION...1

1.1 Background...1

1.1.1 Product diversification...2

1.1.2 The banking Industry in Kenya...3

1.2 Statement of the problem...6

1.3 Objectives of the study...7

1.4 Importance of the study...8

CHAPTER TWO...9

LITERATURE REVIEW...9

2.1 The Concept of strategy...9

2.2 The Growth strategies...10

2.3 Ansoff's growth strategies...12

2.4 Product diversification Strategy...14

2.5 Dimensions of Product diversification Strategy...16

2.5.1 Related diversification strategies...16

2.5.2 Unrelated diversification strategies...20

2.6 Benefits of product diversification strategies...22

2.7 Challenges of product diversification strategies...24

2.8 Summary of Literature Review...26

CHAPTER THREE..27

RESEARCH METHODOLOGY......................................27

3.1 Research Design..27

3.2 The Population..27

3.3 Data Collection..27

3.4 Operationalizing the Product Diversification Dimensions.........28

3.5 Data Analysis..33

CHAPTER FOUR..34

DATA NALYSIS AND FINDINGS.................................34

4.1 Introduction..34

4.2 Extent to which banks in have adopted product diversification...37

4.2.1 Reasons for product diversification.........................37

4.2.2 Forms of product diversification............................38

4.2.3 Concentric product diversification..........................39

4.2.4 Concentric diversification strategy..........................40

4.2.5 Horizontal diversification....................................41

4.2.6 Conglomerate product diversification.......................42

4.3 Benefits of Products diversification.............................43

4.4 Challenges of Product diversification............................44

CHAPTER FIVE...47

DISCUSSION, CONCLUSION AND RECOMMENDATION.....47

5.1 Introduction..47

5.2 Discussion..47

5.3 Conclusion..49

5.4 Recommendations...51

5.5 Limitations of the study..51

5.6 Suggestions for further research..................................51

REFERENCES..52

APPENDICES..55

APPENDIX 1: Introduction letter..55
APPENDIX 2: Questionnaire..56
APPENDIX 3: List of Commercial Banks in Kenya.....................70
APPENDIX 4: List of foreign owned commercial Banks in Kenya...72

LIST OF TABLES

Table..Page

Table 1: Operationalizing the product diversification dimensions.....28

Table 2: Analysis of ownership of banks..................................35

Table 3: Branch NetworkDistribution......................................35

Table 4: Number of years in operation....................................36

Table 5: Pre-tax profits...36

Table 6: Why banks pursue product diversification........................37

Table 7: Categories of product diversification...........................38

Table 8: Variables of concentric diversification.........................39

Table 9: Products under concentric diversification.......................40

Table 10: Products under horizontal diversification......................41

Table 11: Products under conglomerate diversification....................42

Table 12: Benefits of product diversification.............................43

Table 13: Product diversification challenges.............................45

CHAPTER ONE

INTRODUCTION

1.1 Background

Today's business world is characterized by dynamic and rapidly changing environment. (Haggins, 1989). Changing customer values, increased global competition, liberalization and a host of other economic, political and social dynamics cannot be overlooked (Samms, 2000). It is generally accepted in the business environment to talk about constancy of change and that the old, certainties of planned growth, predictable sales and stable markets no longer exist (Morris and Brian, 1996). The secret to a company that will last in such a turbulent environment is its ability to manage both continuity and change. Such companies are capable of responding with nimbleness to these environmental drivers. Pearson and Robinson (1997), state that in order for organizations to achieve their goals and objectives, it is necessary for them to adjust to the environment. For instance, liberalization and globalization of the world economies has reduced trade protection. This has effectively increased the movement of capital and other factors of production. Therefore, organizations that have been mainly focusing on local markets have extended their range in terms of markets and products to a national, multinational, and even global reach.

The dynamism of the environment implies that organizations have to constantly redesign their strategies in order to remain competitive. Failure to effectively adapt the organization to its environment leads to a strategic mismatch between what the organization offers and what the markets demand. Executives have to make strategic choices that are concerned with decisions about an organization's future and the way in which it needs to respond to these environmental pressures and

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influences. Designers of planning systems have agreed on the critical role of grand strategies in achieving a lasting competitive advantage. Grand strategies, often called master or business strategic choices provide basic direction for strategic options. They are the basic coordinated and sustained efforts directed toward achieving long-term business objectives, a comprehensive general approach that guides a firm's major actions. These include specific options concerning both the direction (e.g. products and market diversification) and the method (e.g. internal merger/ acquisition and alliances)

1.1.1 Product Diversification

Diversification is typically defined as a strategy, which takes the organization away from its current markets or product or competencies (Johnson and Scholes, 2002). Product diversification concerns the scope of industries and markets in which the firm competes and how managers buy, create and sell different products to match skills and strengths with opportunities presented to the firm. It refers to the deployment of resources across lines of products. Rumelt (1974) classified diversification as either related or unrelated. Product relatedness diversification is the extent to which a firm's different lines of products are linked while unrelated ness refers to a lack of direct links between products.

Product diversification might occur because of various reasons. First, due to change in business environment both threatening the future of current strategies and throwing up new opportunities – some of which may be related. Secondly, Porter (1985) suggests that a firm can gain competitive advantages if it has skills or resources that it can transfer into new lines of business or markets. Lastly, the expectations of powerful stakeholders may also drive diversification.

In order to maximize the economic benefits of product diversification, firms are increasingly relying on various strategies for making more efficient explorations of advantages of diversification. Even small organizations may find themselves in circumstances where diversification may be a real option – or even a necessity. Product diversification interacts with the market diversity, an interaction that is important to gaining a competitive advantage and reducing cash flow variance of an organization (Hitt et al., 1997).

1.1.2 The Banking Industry in Kenya

The banking industry in Kenya comprises of 44 commercial banks, three non- financial institutions, two building societies, two mortgage finance companies and forty foreign exchange bureaus (CBK Report, 2006). The major players in the industry are Standard Chartered Bank (SCB), Barclays Bank of Kenya (BBK), Kenya Commercial Bank (KCB), National bank of Kenya (NBK), Citibank, Credit Finance Corporation (CFC), Commercial Bank of Africa (CBA) and National Industrial Credit Bank (NIC), (Khan, in Afri Invest, June 2000 Issue. No.4). The large banks control up to 70% of the market (Aosa, 1999). A part from commercial banks and non-financial institutions, the financial sector in Kenya comprises leasing and financing companies, investment banks, micro lenders, savings, and corporative societies, asset managers, insurance companies, and capital markets comprising principally of Nairobi Stock Exchange. (CBK, June 2005).

Banks have the prime responsibility of providing for financing requirements of businesses and carry the overriding responsibility of deposit safety. The industry occupies the key position in a financial system that supplies credit needed for a country's economy. Working through the constraints established by the monetary authorities,

commercial banking through its many credit decisions create the deposits that act as the effective money supply for carrying on business actively while fulfilling this prime responsibility to provide for the financing requirements of the economy. (Baughn and Walker, 1997). According to Ford (1989), banks fulfill the role of a financial intermediary. This means that they act as vehicles for moving finance from those who have surplus money however temporarily to those who have a deficit. In everyday banking, terms the banks channel funds from depositors whose accounts are in credit to borrowers who are in debit.

Competition within the banking sector in Kenya is very stiff; this is due to the number of players in the industry (Aosa, 1999; Maleche, 2004), resulting from CBK's encouraging the non-bank financial institutions to convert into commercial banks and more companies entering the banking industry (Aosa, 1999). This has called for innovation and creativity to maintain a competitive edge above the others. The economic trends in the world have had an impact on the Banking industry in Kenya too. The impact this has had on erosion of market share is tremendous. Companies have increased their use of Information Technology (IT) in their operations and creative use of computers in business has led to the impressive reduction in costs as well as injecting increased flexibility, speed and convenience in conducting business (Aosa, 1999).

Banks have also changed their focus in the business from managing customer savings to managing the financial requirements and needs of their customers, while shifting the focus to the totality of the customers' financial requirements. According to Aosa (1999), this led to the realization that banking business is not about crowd control; rather it was prudent account management. The liberalization of the

banking industry has led to many banks merging, making strategic alliances, forming partnerships, making acquisitions and even taking to the drastic measures such as downsizing (Aosa, 1999). Evidently, the market has now been flooded with the entry of many new products (Maleche, 2004) that have been introduced to the market via intensive and extensive promotional strategies (Ngahu, 2001).

The diverse challenges in the business environment call for a different approach, shifting away from the traditional strategies, of product differentiation, aggressive marketing campaigns, and promotional strategies and re-branding (Maleche, 2004). For most industries, it is no longer enough to concentrate these basic strategies. The use of customer service to provide a competitive edge is fast becoming everyone's strategy. Attention should be on the role of other investment alternatives like product diversification where by banks attempt to grow by simultaneously focusing on new services, in an endeavor to pursue 'newness' outside the main stream of present products e.g. by offering an integrated house buying service to include conveyance and estate agency, or business activities by linking with pension or insurance brokers, stockbrokers etc.

Diversification was the official theme of the 35th International Banking Summer School, held at St. Andrews, Scotland in June 1982. Most of them made the point that banking is no longer the exclusive province of bankers. Traditional specialization is being demolished and even the financial services sector no longer has clear boundaries. Most papers referred to this as diversification of financial services (Maycraft S.R, 1982).

1.2 Statement of the problem

The Banking industry occupies a key position in the Kenyan economy, fulfilling the role of financial intermediaries besides provision of employment opportunities (Kamanu, 2004). Banks in Kenya have not been spared the business challenges that have dogged many companies today, which require organizations to build new capabilities to maintain a competitive edge. Intense competition has led to erosion of market share while the traditional forms of competitive advantage and specialization are being copied and demolished. Banks have to continually review their strategic operations in the light of this challenging environment to ensure competitiveness. Threats to their core businesses and the presence of numerous opportunities leads almost inevitably to consideration of product diversification strategy in order to strengthen their revenue mix and to find new sources of profitability.

Product diversification brings about strategic fit across value chain activities, potential gain to gain a foothold in an attractive industry and reduction of overall business portfolio risk. According to Doyle (1994), diversification is the most risky of the four grand strategies since it requires both product and market development and may be outside the core competences of the firm. However, diversification may be a reasonable choice if the high risk is compensated by a chance of high returns. Kotler (2000) stated that diversification growth makes sense when good opportunities can be found outside the present. This is when the industry is highly attractive and the firm has the mix of business strengths to be successful.

The processes and mechanisms relating to product diversification strategy to performance have been the focal interest of empirical

research in the corporate strategy. Harrigan's pioneer work (1998) focused on product diversification and its implications on performance on international joint ventures in the United States of America. This study has been done mainly in the developed nations and cannot be generalized to the situation in Kenya. Local studies on diversification include a study on the extent of application of Ansoff's growth strategies (Kiilu, 2004) and unrelated diversification strategies in oil companies (Mwindi, 2004). Studies on financial Institutions by Ndegwa (1996), Kanjane (2000), Gathoga (2001), Mbogo (2003), Musyoka (2004) and Ethagatta (2005) mostly focused on customer service, financial performance, competitive strategies, strategic change management, relationship between quality improvement and financial performance and New product development respectively. None of the above studies focused on product diversification strategies in the Kenyan Commercial banks. This study therefore sought to determine the industry's experience with product diversification and it aimed at answering the questions; what is the extent of using product diversification strategies by commercial banks in Kenya? What are the benefits of employing such strategies? What are the challenges faced by commercial banks in adopting the product diversification strategies?

1.3 Objectives of the Study

The objectives of the study were to: -

(i) Establish the extent to which commercial banks in Kenya have adopted product diversification strategies

(ii) Determine the benefits of employing product diversification strategies by banks.

(iii) Establish the challenges faced by banks in Kenya that has adopted product diversification strategies.

1.4 Importance of the Study

(i) The research adopts an integrated suite of empirical assessment to enable senior management in the Banking industry in Kenya, Strategic Management scholars and consultants to gain a data oriented view of product diversification strategies. They will appreciate that diversification, as growth strategy is critical factor in the success of the firm.

(ii) Future researchers and scholars in using the study as a source of reference and stimulating interest for future research.

(iii) Bench mark to other industries.

CHAPTER TWO

LITERATURE REVIEW

2.1 Concept of Strategy

All organizations are an open system. They depend on the environment for their provision of inputs and the disposal of their outputs. They are an integral part of the environment. Thus for an organization to achieve its objective and ultimately success, realistic approaches that are considerate of the environment must be taken into account (Rue and Holland, 1996). Organizations cannot survive if they cannot match their capability to the environmental requirements. The framework that links an organization's capability to its environment is referred to as strategy (Ansoff, 1990). Jaunch and Gueck (1988) view strategy as the framework of choices that helps an organization to respond appropriately to environmental requirements to achieve success. Therefore, one can say that strategy defines an organization, in terms of its future, nature and direction (Johnson and Scholes, 2002).

If strategy were defined as above, corporate strategy would then be seen to be concerned with the purpose and scope of an organization as a whole. According to Johnson and Scholes (2002) corporate strategy is concerned with the overall purpose and scope of an organization in meeting the expectations of its owners and add value to the different parts of the enterprise. It looks at the entire firm and specifies the firm's overall approach to achievement of its mission and objectives. It also explores the way in which a firm can develop a favorable portfolio strategy for its activities (Wheelen and Hunger, 1989).

Corporate strategy is composed of three grand strategies, that is, stability, retrenchment and growth. Stability strategies are concerned with maintenance of the status quo and involve stretching what the

organization has been doing in the past into the future. Usually they work well for relatively successful firms that operate in reasonably predictable environments. Retrenchment strategies on the other hand are concerned with steering an organization back to track. In most cases, the firm might be experiencing or potentially facing a decline in profitability. This can be achieved through turnaround or divestment strategies. Turnaround strategy is appropriate when a firm is in highly attractive industry and its problems are pervasive but not critical. Divestment on the other hand, involves selling major part of the business. To consider divestment usually, problems of a firm are critical and poor performance can be attributed to a business unit or a product line, which is unable to synchronize itself with the rest of the corporation (Wheeler and Hunger 1989; Byars, 1987). Finally, when the competitive domains and the growth potential starts to wane, strategic options are either to attempt a more intensive implementation of the current line of business, or to begin research for more opportunities in other industries or markets (Thompson and Strickland, 1990). In such a case, taking this perspective would reflect the firm's adoption of the growth strategy and must choice for that considerate survival (Wheeler and Hunger 1989). Growth strategies are therefore partly a reaction to environmental turbulence besides other factors into other industries (Grant, 1998).

2.2 Growth Strategies

Growth strategies focus resources on seizing opportunities for profitable growth. According to Brian (1996), evidence suggests that profit grown through raising revenues can boost stock prices 25 to 100 percent higher than profits grown by reducing costs. Growth strategies assert that profitable growth is a result of more than good luck – it can be activity targeted and managed. Growth strategies alter a company's goals and business processes to challenge conventional wisdom,

identify emerging trend and build or acquire profitable new business adjacent to the core business. In some cases these strategies involve redefining the core.

According to Charan et al. (1998), there are a number of different methods by which growth can be achieved. Deciding how to develop the chosen strategy is the next step in strategic choice. Growth strategies include: internal development – this means developing the strategy by the firm themselves. For example if the company's strategic direction is market development into another region, this would mean raising finance, setting up an operation base, marketing and selling in the new region and building up the organization's market share from zero base. Acquisition – This is the acquisition of new business as defined by Pearce and Robinson (2001). When the long-term strategy of the firm is based on the growth through acquisition of one or more similar businesses, operating at the same stage of production – marketing chain, its grand strategy is called horizontal integration. When a grand strategy of a firm involves the acquisition of a business that either supplies the firm with inputs or serves as customer for the firm's output, then vertical integration is involved (Johnson and Scholes, 2002).

Acquisition is the most popular means of diversifying into another industry. It is a quicker way to enter the target market and offers an effective way to handle entry barriers like acquiring technological experiences, establishing supplier relationships, and becoming big enough to match rival's efficiency (Thompson and Strickland, 2002). Growth by joint development involves two or more organizations sharing resources and activities to pursue a strategy. Types of joint development include joint ventures- arrangements where organizations remain independent but set up newly created organization jointly

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owned by the parents, strategic alliances, franchising- a franchise holder undertakes specific activities such as manufacturing or distribution but the franchiser is in responsible for the brand name and marketing, and licensing – production rights for a product are sold to a firm in return for a license fee, (Charan et al., 1998).

2.3 Ansoff's Growth Strategies

This well-known marketing tool was first published in the Harvard Business Review in 1957; Ansoff's growth strategy matrix remains a popular tool for analyzing growth. This is a strategic grid that helps firms identify their future strategic direction, and is often used when the firms are planning for growth. Ansoff's matrix categorizes four separate strategies but importantly also emphasizes the degree of risk inherent in each approach. To portray alternative corporate growth strategies, Igor Ansoff presented a matrix that focused on the firm's present and potential products and markets. By considering growth via the existing products and new products, and existing and new markets, four possible products – market combinations from Ansoff's matrix presents four main strategic choices – market penetration, market development, product development and diversification.

Market penetration is a strategy of expanding sales based on existing markets (Lancaster, 1998). Essentially the same good or service is being promoted into the same target customer group. This strategy is reliant on the fact that there is some untapped potential to increase sales in the same market. This may mean that customers can be persuaded to buy the product more regularly, switch from a competitor, or encourage customers in the target market who may not have yet started to buy the product to do so. In this cell the products remain unchanged and no new customer segments are pursued; instead, the

company repositions the brand, launches new promotions or otherwise tries to gain market share and accordingly, increase revenue (Kotler, 2000). This is the easiest strategy to pursue in the introduction and growth stages of an industry, as all competitors can grow together and the perceived level of rivalry is low. Johnson and Scholes (2002) argue that this strategy is the least risky since it leverages many of the firm's existing resources and capabilities. The strategy also probably requires the least amount of finance for expansion, although resources may need to be channeled into the promotional campaigns to appeal to and then persuade customers.

According to Pearson and Robinson (2001), product development strategy involves new products to existing customers. The company grows by innovating, gradually replacing old products with new ones, marketing them through established channels. This strategy may be appropriate if the firm's strengths are related to its specific customers rather than to the specific product itself. In this situation, it can leverage its strength by developing a new product targeted to existing customers. New product development carries more risk than simply attempting to increase market share (Gultinan and Madden, 1997). When product life cycle is short – as with software or consumer electronics product development becomes as essential requirement of an organization's strategy (Thompson and Strickland, 2001). The product development strategy is also adopted either to prolong the life cycle of current products or take advantage of favorable reputation and brand name to attract satisfied customers to new products as a result of their positive experience with the company's initial offering.

Market development is where existing products are offered to new markets (Johnson and Scholes, 2002). It can include entering new segments, exploiting new areas for the products, or spreading into new

geographical areas (BanerJee, 1999). Typically, management will employ market development strategy when existing markets are stagnant and when market share increase is difficult to achieve due to intense competition (Joseph et al.,). Additionally, in capital-intensive industries many of the company's assets (money, plant and skilled people) will be especially devoted to technology that produces a particular product or products. These assets cannot be easily switched to produce any other product. In this case the company's distinctive competences lie with the product and not the market and hence the continued exploitation of the product by market development would be a viable option. The risk involved in this strategy is higher than both market penetration and product development alternatives. The biggest problem comes from moving into new segments, which are not well understood. There will be a lot of learning to do for the organization that embarks on market development activities (Paul, 1998).

The fourth growth strategy as postulated by Ansoff is the diversification strategy. There are two dimensions of diversification strategy: Product diversification and Market diversification. Product diversification refers to deployment of resources across lines of businesses or industries. Market diversification refers to deployment in different regions or countries (Grant et al., 1988).

2.4 Product Diversification Strategy

Johnson and Scholes (2002) define diversification as a strategy that takes the organization away from its current market or products or competences. It addresses two basic strategic questions, namely, *which product markets* should the firm enter and *how should the company enter* these products to avoid to failure and maximize returns. It is a corporate level strategy, which is based on the task of crafting and

implementing action plans to improve on the attractiveness and competitive strategies of a company's business product portfolio. Further, it is seen as a means of widening a firm's stock of products by expanding the perimeter of value action, which it participates in. Best product diversification strategy is one, which reinforces the firms existing resources and strengths as well as creating the basis for new ones (Porter, 1996). It involves taking steps such as what moves to use to enter new businesses, initiate actions to boost combined performance of products, find ways to capture synergy among products and steer resources into most attractive products.

According to Ansoff and McDonnel (1990), there are three key reasons why firms think of or opt to pursue product diversification. These include: First, when their objectives cannot be achieved by continuing to operate with the existing products. Secondly, the business environment changes, both threatening the future of current strategies and throwing up new opportunities. There appears to be better opportunities presented to the firm by new products than they accrue from the existing ones. Finally, a business tends to have excess financial resources beyond these necessary to satisfy its existing plans hence it sees it fit to invest these resources in new products rather than retaining liquid cash. Expectations of powerful stakeholders may also drive diversification. For instance investors may press for excess cash to be invest somewhere even if the current product and market development opportunities seem limited.

The overriding purpose of product diversification is to build shareholder value. Product diversification does not create shareholder value unless a diversified group of businesses perform better under a single corporate umbrella than they would perform as operating as independent, stand-alone businesses. A diversifying company must get

into products that can perform better under common management than they could perform as stand-alone businesses. (Thompson, and Strickland, 1998). Product diversification has different impact on corporate performance (Hitt, Ireland and Hoskisson, 1995). There are three tests for judging whether a diversification move will have enhanced shareholder value. The industry chosen must be attractive enough to yield consistently good returns on investment. Secondly, the cost to enter the target industry must not be so high as to erode the potential for good profitability. Thirdly the better-off test-the diversifying company must bring some potential for competitive advantage to the new business it enter, or the new product must offer added competitive advantage potential to the company's present business. Product diversification moves that satisfy all three tests have the greatest potential to build shareholder value over a long term.

2.5 Dimensions of Product Diversification Strategies

Johnsons and Scholes (2002) have highlighted different product diversification options available for most organizations. These include: strategies for entering new industries, related diversification strategies, unrelated diversification strategies, divestiture and liquidation strategies, corporate turnaround, and retrenchment and restructuring strategies and of course multinational diversification strategies. For the purposes of this research project, we shall discuss two broad categories for product diversification; that is related and unrelated diversification.

2.5.1 Related Diversification Strategies

In choosing which markets and products to diversify into, the two basic options are to pick industries in related or unrelated to the organization's core business (Rumelt 1974). A related diversification strategy involves diversifying into the business that posses some kind

of "strategic fit ". Strategic fit exists when different businesses have sufficiently related value chains that there are important opportunities, for example transferring skills and expertise from one product to another or combining the related activities of separate businesses into a single operation and reducing costs. A diversified firm that exploits these value-chain interrelationships and captures the benefits of strategic fit achieves a consolidated performance greater than the sum of what the businesses can earn pursuing independent strategies Porter (1995). Strategic fit relationships can arise out of technology sharing, common labor skills and requirements, common suppliers and raw material sources, the potential for joint manufacture of parts and components, similar operating methods, similar kinds of managerial know-how, reliance on same types of marketing and merchandising skill, ability to share a common sales force, ability to use same wholesale distributors or retail dealers, or potential for combining after-sales service (Strickland, 1993).

Related product diversification also refers to where the firm develops beyond its present products but still within the confines of its industry. It may also be termed as organic growth or 'sticking to the knitting' (Bernerjee, 1999). Chandler (1962) noted that firms with product orientation tended to diversify into related products whereas those with technological orientation moved into diverse products. New products have meaningful commonalities with the core products. Meaningful commonalities can involve in the sharing of customers, sales force, channels of distribution, brand names, Research and Development efforts, technology, marketing skills and research (Aaker, 1998).

Related diversification may take several forms such as vertical integration (backward and forward), horizontal integration or concentric integration. *Vertical integration* describes either backward

or forward into adjacent activities in the value chain. *Backward integration* refers to development into activities, which are concerned with the inputs into the company's current business i.e., is further back in the value chain. For instance, raw materials, machinery, and labor are all important inputs into a manufacturing company. *Forward integration* also referred to as concentric integration involves development into activities that are concerned with a company's output. These are further forward into the value chain, such as transport, distribution, repairs and servicing. Concentric diversification bears a close synergistic relationship to either the company's marketing or its technology. These products that are introduced share a common thread with the firm's existing products either through marketing or production. Usually the new products are directed to a new group of customers (Kotler, 1999). While a diversification move may be perceived, risky, concentric diversification does not lead the company into an entirely new world since in one of the two major fields (technology or marketing); the company will operate in a known territory. The relationship of new products to the firm's existing products, however, may or may not mean much. All that the realization of synergy does is make the task easier; it does not necessarily make it successful.

Horizontal integration refers to development into activities, which are competitive with, or directly complementary to, a company's present activities (Johnson and Scholes, 2002). New products, which technologically are unrelated to a company's existing products, but can be sold to the same group of customers to whom existing products are sold. Customers for the new product are drawn in the same ranks as those of the existing product. In a competitive environment, the horizontal diversification strategy is more desirable if the present customers are favorably disposed toward the company and if one can

expect this loyalty to continue for the new product (Kotler, 1999). An important limitation of horizontal diversification is that the new product is introduced to be marketed in the same economic environment as the existing product, which leads to rigidity and instability. Put it in another way, horizontal diversification tends to increase the company's dependence on a few market/product segments.

Two notable issues of the related diversification are linked and constrained diversification. The constrained diversification refers to the case where the firm diversifies into industries that are all related through its core business serving as the main provider of shareable resources. Honda's diversification from motorcycles, automobiles and other products like marine engines and generators is a prime example. On the other hand, in the linked diversification, a firm increases it industry scope sequentially, leveraging resources acquired through the process of diversification, not necessarily those the firm had in the core at the onset of diversification. Canon is a good example. It is argued that in related diversification there is the possibility of resource sharing, however, is not limitless.

From the foregoing, it is clear that effectiveness of resource sharing increases with the similarity of industries a firm has its product portfolio. Reasons as to why a firm may opt to pursue the related diversification strategy are many but the most ones could be because of supplies quality and quantity, markets, access of information, building on the core competencies, spreading of risks and of course resource utilization. It is the industry competition that indeed forms the basis for the persuasion of any product diversification strategy (Porter, 1985). Porter adds that business potential and the valuable type of relatedness

in diversification is a crucial component of overcoming key entry barriers.

2.5.2 Unrelated Product Diversification Strategies

Unrelated diversification is an organization moving beyond its current value system or industry (Johnsons and Scholes, 2002). Despite the benefits of strategic fit that are associated with related product diversification, a number of companies opt for unrelated product diversification strategies. Strickland (1993) suggests that in unrelated diversification, the corporate strategy is to diversify into any industry where top management spots good opportunity. There is no deliberate effort to seek out business where strategic fit exists. While firms pursuing unrelated diversification may try to ensure that their strategies meet the industry attractiveness and cost entry tests, the conditions needed for better-off test are either disregarded or relegated to secondary status.

Typically, corporate strategists screen candidate companies using such criteria as profitability, return on investment, capital requirements, growth potential, potential government regulations, vulnerability to adverse macro economic factors like inflation, and ultimately the potential contribution to the parent firm's bottom line (Thompson and Strickland, 1998).

Sometimes companies with unrelated diversification strategies concentrate on acquisition candidates that offer quick opportunities for financial gain because of their "special situation." Three types of business may hold such attraction. First, for companies whose assets are undervalued, opportunities may exist to acquire such companies for less than full market value and make substantial capital gains by

selling their businesses for more than their acquired costs. Secondly, companies that are financially distressed are often purchased at a bargain price, their operations turned around with the aid of the parent company's financial resources and managerial expertise, and then either held as long-term investment or sold at profit, whichever is more attractive. Finally, companies that have bright growth prospects but are short on investment capital, capital-poor, opportunity-rich companies are usually coveted diversification candidates for a financially strong firm.

Companies that pursue unrelated diversification nearly always enter new businesses by acquiring an established company rather than by forming a start-up subsidiary within their own corporate structures. Their premise is that growth by acquisition translates into enhanced shareholder value. Unrelated diversification may also involve a company extending into new products by exploiting the current core competencies, or may involve creation of genuinely new markets. The extreme form of unrelated diversification is where new competencies are developed for new market opportunities (Craven and David, 1990).

Unrelated diversification is fundamentally a finance-driven approach to creating shareholder value whereas related diversification is a strategic approach to building shareholder value. Related diversification is predicated on exploiting the linkages between the value chains of different business to lower costs, transfer skills and technological expertise across businesses, and gain other strategic-fit benefits. The added competitive advantage a firm achieves through related diversification is the driver for building greater shareholder value. In contrast, unrelated diversification is principally a financial approach to creating shareholder value because it is predicated on

astute deployment of corporate financial resources and executive skill in spotting financially attractive business opportunities.

2.6 Benefits of Product diversification

A related diversification strategy clearly has considerable appeal. It allows a firm to preserve a degree of unity in its business activities, reap the competitive advantage benefits of skills transfer or lower costs because of economies of scope and still spread investor risks over a broader business base. These enable the diversifier to earn greater profits from its business than businesses could earn operating independently.

Diversification brings about strategic fit across value-chain activities. While strategic-fit relationships can occur throughout the value chain, most fall into three broad categories; market-related fit, operating fit and management fit. When the value chains of different business overlap such that the products are used by the same customers, distributed through common dealers and retailers, then the businesses enjoy market related strategic fit. This can also generate opportunities to transfer selling skills, promotional skills and product differentiation skills from one business to another. Operating fit is also achieved when there is potential for activity sharing in procuring materials, conducting R & D, mastering a new technology, assembling finished goods, or performing administrative support functions. Management fit emerges when different business units have comparable types of entrepreneurial, administrative, or operating problems, thereby allowing managerial know how in one line of business to be transferred to another.

Unrelated or conglomerate product diversification has appeal from several financial angles. First, business risk is scattered over a variety of industries, making the company less dependent on any one business. Second, capital resources can be invested in whatever industries offer the best profit prospects. Corporate financial resources are thus employed to maximum advantage. Third, company profitability is somewhat more stable because hard times in one industry may be partially offset by good times in another. Lastly, to the extent that corporate managers are exceptionally astute at spotting bargain-priced companies with big upside profit potential, shareholder wealth can be enhanced.

Additionally, unrelated diversification can balance the cash flows of strategic business unit (SBU) entities. A firm with many SBUs that merit investment might buy a firm with cash cow products to provide source of cash. This reduces the need to raise debt or equity over time. Conversely, a firm with a cash cow may enter new areas seeking growth opportunities to ensure future earnings if its core cash cow eventually falters. Diversification may also provide a basis for refocus. An organization may provide a basis for a refocus of the acquired business or both. The objective is to change the thrust of the business from one set of products to another. Not incidentally, the thrust change may result in investors perceiving a firm to be in industries that are more attractive.

Analyzing the Kenyan examples, there are evidences that the key performing organizations have tended to diversify in related organizations. For example, the First Chartered Securities Group (FCS), which has diversified into insurance, reinsurance brokerage and banking businesses, has turned out to be the leading financial provider in the country. Further, the CFC group has also danced to the same

tune by diversifying into both related and unrelated products as evidenced in the insurance, financial services, bank and of course the CMC motor assemblers. This has in turn given them a strong financial base as evidenced by the purchase of the Giant Alico Kenya Life fund.

2.7 Challenges of Product Diversification Strategy

According to Doyle (1994), diversification is the most risky of the four growth strategies since it requires both product and market development and may be outside the core competences of the firm. In fact, this quadrant of the matrix has been referred to as suicide cell. Various problems have been cited to the product diversification options, which are taken by different firms as noted by Johnson and Scholes (2002).

Lack of a clear set up strategy is one shortcoming of firms engaging in product diversification strategy. This is attributed to the fact that many firms pick up strategic management just on the way and they do not have established departments for pursuing it. Moreover, most of them tend to pursue the related diversification strategy because their competitors have done so. Thus, they tend to imitate their competitor's strategy but when it comes to implementation part, they fail terribly.

Further, management more often than not appears to be somehow optimistic in respect of its ability to manage varied interests or insufficiently well prepared for differences between the new venture that it undertakes and the condition on its principal market. In this regard, the managers will tend to stick to status quo and will not give full attention to the new ventures as proposed by the parent or the holding firm. Moreover, the management is a bit over-optimistic regarding the rate at which the diversified interests will generate

profits. There also occur problems adopting uncritical, passive attitudes to the management of the varied interest. While product diversification is fine as the matter of abstract principle, it can result in so many different eggs in one basket than nothing significant is hatched out of them (Johnson and Scholes 2002).

Additionally, conglomerate product diversification places a big demand on corporate level management to make sound decisions regarding fundamentally different businesses operating in fundamentally different industry and competitive environment. Without the competitive advantage potential of strategic fit, consolidated performance of an unrelated multi-business portfolio tends to be better than the sum of what the individual business units could achieve if they were independent, and it may be worse to the extent that corporate managers meddle unwisely in business-unit operations.

Research on the product diversification-performance link suggests several pitfalls we should try to avoid. One is the effect of firm's industry affiliation on diversification. It is known that firms in different industries have different propensities to diversify due to various industry traits (e.g. Lemelin, 1982; Montgomery and Hariharan, 1991). Such industry-level heterogeneity in product diversification behaviors obscures the effects of diversification and industry on performance (Montgomery (1985). The above experiences do suggest that companies undertaking diversification should do so in the context of explicit policy regarding what the objectives of such should be. Peterson and Waterman (1982) suggests that companies should try to 'stick to the knitting' as they pursue their product diversification strategy.

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Despite these drawbacks, diversification can sometimes be a desirable strategic choice if the high risk is compensated by high return. Whether firms promote this strategy will depend on the situation of the market, the business's cash reserves and skills of the staff to take on new product lines. Kotler (2000) stated that diversification growth makes sense when good opportunities can be found outside the present. A good opportunity is one in which the industry is highly attractive and the company has the mix of business and product strengths to be successful

2.8 Summary of Literature Review

The current unprecedented change in the environment has resulted to organizations taking into considerations all environmental factors within their operations in an attempt to adapt their activities and internal configuration to reflect new external realities. The framework that links an organization's capability to its environment is referred to as strategy. (Ansoff, 1990). Strategy is composed of three strategies i.e, stability, retrenchment and growth. Growth strategies focus resources on seizing opportunities for profitable growth. One of the growth strategies available to the firms is product diversification. This entails deployment of resources across lines of product either related or unrelated. Efforts have been made to assess the extent to which product diversification is related to company success with the evidence that a more diversified firm grows faster than less diversified firms (Bernejee, 1990). However, it is necessary to sound a note of caution against unrestrained product diversification. It is tempting to show that diversified firms can be profitable but it has to be pointed out that the process of diversification is very difficult and costly.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Research Design

The research design used in this study was descriptive and it aimed at establishing the extent to which commercial banks in Kenya have adopted product diversification strategies. A descriptive study, according to Cooper and Schindler (2003) is concerned with finding out what, why, who, where, when and how of a phenomenon, which is the concern of the current study. Nganga (2004) has used the design in a related study.

3.2 The Population

The population of study consisted of all banks operating in Kenya under the Banking Act, chapter 487. According to the Central Bank of Kenya report of January 2006, there are 44 banks operating in Kenya (see appendix 3). Given the small number of banks, a census study was being conducted.

3.3 Data Collection

Primary data was collected by use of a semi-structured questionnaire, which was administered using a drop and pick-up later method. The respondents to the questionnaire included the Strategy and Planning managers or their equivalents. A follow up by phone and electronic mail was done to enhance the response rate. The questionnaire was also pre tested to determine clarity of the questions. The questionnaire was divided into two sections. Section I consisted of questions intended to provide general information about the banks. Section II was having like art type questions aimed at obtaining information

relating the extent to which commercial banks in Kenya have adopted product diversification strategies.

3.4 Operationalizing the Product Diversification Dimensions

The determinants of product diversification dimensions were defined to operationalize the variables. The activities involved in each of the dimensions were expounded in the table below. The questionnaire used the 5-point Likeart scale to measure the extent to which the banks practiced the activities.

Table 1: Operationalizing the product diversification dimensions

Product diversification dimensions	Extended definition	Associated activities	Relevant questions
Concentric product diversification	New product lines. Products have technological, marketing or commercial synergies with existing product lines. Products may appeal to a new customer group. The objective is therefore to benefit from synergy	Jumbo savings account Safari Junior savings High value current accounts Executive Banking Expatriate Banking Student accounts Biashara loans Cooperative loans Prestige banking Priority banking	

	effects due to the complementarities of activities	Money gram Western union Home loans Unsecured lending Business solution accounts Asset Finance Invoice discounting Supplier finance Letters of credit Bills of Exchange Travelers cheques Education Loans Mavuno loans Maziwa Loans Commercial paper Bond trading Investments services Electronic Banking Corporate Finance Foreign Exchange Visa Gold credit	

		cards Solar Loans Mobile top-up Utility bill payments	
Horizontal product diversification	Products and services are competitive and / or complementary to a company's present activities. The company adds new products or services that are technologically or commercially unrelated to current products. Products may appeal to current customers.	Life Insurance Personal accident insurance cover. Insurance Brokerage services Unit trusts Share registration Stock brokerage Pension management Fund management Financial Advisory services Insurance premium finance Lease Financing Asset Financing Tax advice Travel agency	1 – 4,6,7
Conglomerate product	New product and services	Motor assemblies Cafeteria	5, 6,8

diversification	No technological or commercial synergies with current products. Products may appeal to new groups of customers.	Franchised partnerships like retail outlets. Supermarkets and petrol stations Convenience shops Property construction Business Club seminars Business Magazines Corporate service centres Commercial property management Residential property management Real estate agency Hire Purchase	
Benefits of product diversification		To make use of excess financial resources Sharing sales agents Sharing research	9

		and development Optimum use of technology Transfer of management skills To improve customer loyalty To build Brand names Increase in profitability Increase market share Spread risks Stability of product earnings Increase customer base Spread of risks	
Challenges of product diversification		Shift focus from core products Shortage/Strain on resources Lack of skill to manage new products Difficult in integration of systems Difficult in	10

		integration of personnel Complex branch rationalization	

3.5 Data Analysis

Descriptive statistics were used to analyze the data. Frequency tables were used to analyze the general information data in part I, while data in part II was analyzed using mean score tabulations and standard deviation to determine the extent to which commercial banks in Kenya have adopted product diversification strategies. The results were then summarized using tables, and measures of central tendency.

CHAPTER FOUR

DATA ANALYSIS AND FINDINGS

4.1 Introduction

In this section data pertaining to the product diversification strategies used by banks in Kenya and the benefits and challenges that they face, is analyzed and interpreted.

A total of 40 questionnaires were distributed to respondents, out of which 33 responded by completing and returning the questionnaires. Seven did not respond. This gave a response rate of 82.5% and a non-response rate of 17.5%. All the leading banks in Kenya including the multinationals responded to the questionnaires, hence the percentage of non- respondents consist mainly of the small banks.

The questionnaires, after being filled by the respondents were edited and coded. Data was analyzed using frequencies, percentages, Mean Scores (MSc.) and Standard Deviations (Std. Dev). Mean Scores were used to determine the extent to which commercial banks practiced each variable of product diversification strategy, the benefits and challenges faced, on five point Likert scale ranging from "very large extent" (5) to "no extent" (1). Frequencies and percentages were used to analyze the general information in part 1

The scores "Small Extent" and "No Extent" represented a diversification strategy variable practiced to a "Small Extent" (SE). This was equivalent to 1 to 2.5 on the continuous likert scale ($1 \leq SE < 2.5$). The scores "Moderate extent" represented a diversification strategy variable practiced to a "Moderate Extent" (ME). This was

equivalent to 2.6 to 3.5 on a likert scale ($2.6 \leq ME < 3.5$). The scores of Large Extent" and "Very Large Extent" represented a diversification strategy variable practiced to a "Large extent" (LE). This was equivalent to 3.6 to 5.0 on a likert scale ($3.6 \leq LE < 5.0$).

Table 2: Analysis of ownership of banks

Ownership	Frequency	Percentage
Foreign owned	18	55
Locally owned	10	30
Mixed (local & foreign)	5	15
Totals	**33**	**100**

Source: Response Data

Results from Table 2 show the comparison of banking sector. 55% of the total banks are foreign owned. In contrast, 30% of the banks in the financial sector are locally owned and the rest are of the two in varied proportions.

Table 3: Branch Network Distribution

Network	Frequency	Percentage
Nairobi	3	9
Countrywide	15	45
Regional	4	12
International	11	33
Totals	**33**	**100**

Source: Response Data

Results from Table 3 indicate that 33% of the banks in Kenya have international presence, 12% have regional network, and 45% have countrywide distribution while 9% operate within Nairobi only.

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Table 4: Number of years in operation

Number of years	Frequency	Percentage
Less than 6yrs	1	3
<6yrs less than 10yrs	3	9
More than 10yrs	29	88
Total	**33**	**100**

Source: Response data

From the results above, 88% of the banks have been in operation for more than 10 years implying that they have established themselves longer in the market. 9% of the banks have been in business for a period of between 6 to 10 years. Only 3% of the banks have been in business for less than 6 years.

Table 5: Pre-tax profits (Prior three years)

Profits (Ksh)	Frequency	Percentage
Less than 100m	6	18
<101m less than 500m	11	33
<501m less than 1bn	10	30
More than 1billion	6	18
Total	**33**	**100**

Source: Primary and secondary data

The researcher sought to establish the pre-tax profits earned by banks to establish if the profitability of the organization was one of the main drivers of moving into product diversification. 18% of the banks have earned and average of less than Ksh 100 million for the last three years. 33% have registered between Ksh 101 million and 500 million. 30% are in the range of Ksh 501 million and Ksh 1 billion while 18% have average earnings of above Ksh 1 billion.

4.2 Extent to which commercial banks in Kenya have adopted Product Diversification

Product diversification involves moving away from current products. The respondents were asked to indicate whether their bank has ever moved away from its core business, to focus on other new products. The majority of banks (30) have moved away from their core products to engage in product diversification while three have not.

4.2.1 Reasons for product diversification

There are various reasons why firms think of or opt to pursue product diversification strategy. Respondents were asked to cite the extent to which the following reasons drive their bank into product diversifications as shown in table 6 below:

Table 6: Why banks pursue product diversification

Reasons	Mean	Std. Deviation
Changing customer preferences	3.62	0.16
Re-branding	2.38	1.01
To increase profitability	4.20	0.81
Liberalization	3.43	1.14
Central Bank regulation	2.20	0.98
Invest excess resources	3.62	1.09
Competition	3.80	0.70

Source: Response data

Results in the Table 6 are indicative that the overriding reason for product diversification by banks is to increase profitability (Msc > 3.6). The degree of this factor does not vary significantly between banks.

Changing customer preferences, excess resources utilization and competition also form some of the main factors that will drive banks to

move away from their core products to a large extent (Msc > 3.6). However, the results from investment of excess resources as one of the main factors varied significantly with standard deviation of greater than 1.

Re-branding and liberalization was cited to contribute to product diversification to a small extent by banks (Msc < 2.5) and with significant variation in the results. Central bank regulation however contributes to the diversification to a smaller extent and with no variance in results as per the results in the Table.

4.2.2 Forms of product diversification

This was aimed at determining whether banks engage in product diversification through carrying out new product lines that are related and complimentary to the existing ones or not. Respondents were required to indicate the extent of each category as shown below:

Table 7: Categories s of product diversification strategies

Category	Mean	Std. Deviation
New product lines complementary and related to the banks existing products. i.e. the new products use or share existing Banking systems, Sales agent and management skills	4.17	0.70
Carry out a new product and services not related to the existing Product lines.	2.71	1.21

From the results in Table 7, product diversification through related a channel is used largely by banks (Msc >3.6) and the degree of practice does not differ significantly among banks (Std.Dev < 1.0). The extent to which banks carry introduce new products that are not related to existing products is Moderate (Msc < 3.5) but this differed among banks (Std. Dev > 1.0).

4.2.3 Concentric product diversification

When introducing new products and services, banks may consider *existing technological, marketing or production synergies with existing* product lines. Products may appeal to a new customer group. The objective is mainly to benefit from synergy effects due to the complementary activities.

Table 8: Concentric diversification strategies

Factor	Mean	Std. Deviation
Share banking and software systems	4.32	0.21
Share direct sales representatives	3.53	0.92
Share customer relationship managers	3.80	0.81
Share advertising campaigns	2.34	0.14
Share existing branch network distribution	4.47	0.35
Share existing ATM network	3.62	0.38
Share existing brand names	3.57	1.03
Share administration and support functions	4.02	0.19
Research and development personnel	3.80	1.26

Source: Response data

From the results in Table 8, banks largely use the existing systems; sales force, branch, and ATM network distribution, and administration while introducing new products that may not necessarily appeal to

existing customers (Msc > 3.50). The standard deviation was less than one, hence indicating less variation in the results.

Use of existing research and development personnel and brand names are also practiced to a larger extent (Msc > 3.5) but with significant variations (Std. dev > 1) across the banks.

However, use of existing advertising campaigns to launch new products is used to a small extent (Msc < 2.5) and the results did not vary across the banking industry.

4.2.4 Concentric diversification strategy

Companies normally introduce new products and services that may even appeal to new customer groups. Respondents were asked to indicate the products introduced.

Table 9: Concentric diversification strategies

Product	No.
Savings and Current accounts	31
High value current accounts	12
Mortgages	13
Car Loans	25
Unsecured loans	30
Children accounts like Jumbo, and Safari Junior	19
Executive accounts	13
Expatriate Accounts	5
Debit and credit cards	18
Micro Finance loans	9
Education Loans	21
Corporative loans	6

Table 9 contd;

Insurance premium financing	7
Business Solution accounts like cash and document pick up	12
International and local money transfers	28
Utility payments like mobile top-up or electricity bill payments	11
Gift cheques like for weddings and bonus for employees	2
Call centers	21
Treasury bills and bonds	25

Source: Response data

Results in Table 9 indicate that banks offer various products when undertaking a new product range. Majority of banks will offer current and saving accounts (31), car loans (25), unsecured loans (30), money transfers (28) and treasury bills and bonds (25) Very few banks offer expatriate accounts (5), micro finance loan (9), corporative loans (6) and gift cheques (2). A considerable number of banks offer mortgages (13), high value accounts (12), children accounts (19), cards (18), and business solutions accounts (12).

4.2.5 Horizontal diversification strategy

Organizations may add new products and services that are not technologically or commercially related to the existing ones. However, the products may appeal to the existing customers. Respondents were asked to indicate the extent for such activities as follows:

Table 10: Horizontal diversification strategies

Product	Mean	Std. Deviation
Life insurance	3.62	0.62
Personal accident cover	2.65	1.09
Insurance brokerage	3.43	0.98

Table 10 contd;

Product	Mean	Std. Deviation
Share registration services	2.78	1.27
Unit trusts	2.61	1.02
Financial advisory services	3.74	0.76
Pension management	2.60	1.94
Lease Financing	3.71	0.58
Asset Financing	3.67	0.83
Travel advisory services	2.57	1.62

Source: Response data

Results in the above Table shows that, life insurance, financial advice, asset, and lease financing products are normally introduced to existing customers to a large extent (Msc > 3.5). There was low variation across the respondents (Std. dev < 1). Personal accident cover, share registration services, unit trusts and pension management are added to existing product lines to a moderate extent. ($2.6 \leq$ Msc < 3.5) There was a wide variation in response as indicated by standard deviation of more than one.

4.2.6 Conglomerate diversification

Firms will sometimes diversify into products with no technological or commercial synergies with existing products. Products may appeal to new customer groups. Respondents were asked to indicate the extent to which they undertake the following:

Table 11: Conglomerate diversification

Product	Mean	Std. Deviation
Motor assemblies	1.13	0.98
Property construction	1.59	0.84
Commercial property management	1.60	0.83
Residential property management	1.60	0.83

Table 11 contd;

Business Club seminars	3.78	0.46
Business Magazines	3.62	0.90
Corporate service centers	4.50	0.67
Cafeteria	1.31	0.57
Convenience shops	1.18	0.56
Client IT system maintenance	2.73	1.21
Hire purchase	2.97	1.02
Consultancy services	2.13	0.38

Source: Response data

From the results in Table 11, respondents indicate that business seminars, magazines and corporate centers are new products and services pursued to large extent ((Msc > 3.5) with no variations across banks. System maintenance and hire purchase are normally introduced to a moderate extent (2.6≤ Msc < 3.5 with reasonable variation (Std. Dev > 1). Motor assemblies, property construction and management, consultancy services, cafeteria and convenience shops are pursued to a less extent (Msc < 2.5) with standard deviation of less than 1.

4.3 Benefits of product diversification

Product diversification clearly has a considerable appeal. Respondents were asked to indicate the benefits associated with this strategy. Findings were presented as follows:

Table 12: Benefits of product diversification

Benefit	**Mean**	**Std. Deviation**
Improved return in investment/profits	4.01	0.47
Increased customer base customer	3.74	0.69
Brand name is strengthened	3.66	0.82
Efficient use of sales calls and reduced	4.50	0.57

Table 12 contd;

Larger and more qualified staff	3.69	1.39
Transfer of skill to similar activities	4.53	0.57
Efficient utilization of research and	3.60	0.55
Access to information like	3.61	0.78
Reduce the cyclical nature of existing	3.97	0.31
Refocuses the business of the firm	3.63	0.21
Beat competition	4.21	1.29
Increase power and prestige of	3.42	0.56
Obtain liquid products especially for	3.32	0.21

Source: Response data

Improved profits, customer loyalty, strengthening brand name, skills transfer, efficient use of sales force and research and development, access to information, reduced cyclical nature of product earnings, and refocus of the business incase of a merger were to a large extent cited by banks as main benefits from product diversification (Msc > 3.6) with less variance among the respondents (Std .Dev < 1).

Large and more qualified staff departments and beating competition were also cited to a large extent (Msc > 3.6) but with significant variance) Std. Dev > 1.0).

Obtaining liquid products and increase in prestige of executives were to a moderate extent cited as benefits of product diversification (Msc < 3.6). The extent did not differ significantly among banks (Std. Dev < 1)

4.4 Challenges faced by banks when undertaking product diversification

Product diversification is the most risky of the four growth strategies since it requires both product and market development and may be outside the core competences of the firm. Respondents were asked to

identify the challenges they face when pursuing the product diversification strategies. Results were given as follows.

Table 13: Product diversification challenges

Challenges	Mean	Std Deviation
Shortage of required skill to market new products.	2.84	1.34
Strain on existing resources	3.72	0.68
Competition between various products for resources	3.81	0.95
Attention is diverted from core products	2.65	1.67
Poor performance of new products may result in losses	3.64	1.24
Difficult in integration of systems and management styles	2.87	1.07
Increase in coordination costs due to more businesses	3.57	0.87
Administration problems associated with unrelated products	2.57	1.31

Source: Response data

Strain on existing resources, competition between various products for resources and increase in coordination costs were cited as the challenges of product diversification to a larger extent (Msc > 3.5) with less variance across the banks (Std Dec < 1). Poor performance as result of losses from thee product is a challenge faced to a large extent but with significant variance across the banking industry (Std. Dev > 1)

Shortage of skills, diversion of attention from core products, difficult in integration of systems and administration problems associated with

unrelated products were to a moderate extent cited by banks as the main challenge they face when pursuing product diversification to a moderate extent ($2.6 \leq Msc < 3.5$). However, the extent differed significantly between banks (Std. Dev > 1.0).

CHAPTER FIVE

DISCUSSIONS, CONCLUSIONS, AND RECOMMENDATIONS

5.1 Introduction

The objectives of this study were to establish the extent to which commercial banks in Kenya have adopted product diversification strategies, determine the benefits of employing product diversification strategies by banks, and establish the challenges faced by banks as they adopted product diversification strategies. Having analyzed the data, in this chapter, discussion of findings, conclusions, and recommendations are presented.

5.2 Discussion

The study established that 90% of the banks often engage in product diversification. The main reasons driving banks into product diversification includes change in customer values, improvement of returns and competition. Additionally, it was discovered that re-branding, investment of excess resources and liberalization are further reasons but with reasonable variance. Although new products offer great potential in terms of returns, they are inherently more risky since they require a much higher-level investment, the use of different and new technologies and possible moves into areas in which the organization is comparatively inexperienced (Ennew, 1990). Majority of banks therefore pursue related product diversification where the products have some kind of strategic fit. Strategic fit relationships can arise out of technology sharing, similar operations, similar kinds of managerial know-how, reliance on same types of marketing and merchandising skill, ability to share a common sales force, ability to use same wholesale distributors or retail dealers, or potential for combining after-sales service (Strickland. 1993). The study discovered that variables like sharing of banking system, branch distribution

network, staffing and research and development used to large to provide synergies to new products.

The study revealed that banks also add new products and services that are not technologically or commercially related to the existing ones. However, the products may appeal to the existing customers. Insurance, financial advice, asset, and lease financing are some of the products introduced to appeal to the existing customer group. Banks to a moderate extent normally introduce share registration services; unit trusts, pension management, travel advisory services and personal accident cover though with significant variation among banks.

Despite the benefits of strategic fit that are associated with concentric and horizontal product diversification, a number of companies opt for conglomerate product diversification strategies; moving away from their current value systems and industry. Strickland (1993) suggests that in conglomerate diversification, the corporate strategy is to diversify into any industry where top management spots good opportunity. There is no deliberate effort to seek out business where strategic fit exists. The study discovered that business club seminars, magazines, and corporate centers are such products introduced to a large extent. Hire purchase and client system maintenance are largely pursued but with reasonable variability across the banks. Real estate and commercial property construction and management, convenient shops and consultancy services are practiced to a small extent to existing products.

Product diversification strategy clearly has considerable appeal. Improved profitability, customer loyalty, and efficient use of sales force, transfer of skills to similar activities and stability of product

earnings were cited as the main benefits for product diversification. This study also revealed that brand strengthening, access to market and technological information, research and development and refocusing the business were also cited to a large extent. Other benefits include larger and more qualified departments and competitiveness were cited to a larger extent but with significant variance across banks. It was also discovered to a moderate extent that increases in prestige of bank executives and access to more liquid products formed part of product diversification benefits.

While pursuing product diversification, banks encounter various challenges. According to Doyle (1994), product diversification is the most risky of the four growth strategies since it requires both product and market development and may be outside the core competences of the firm. In fact this quadrant of the matrix has been referred to as suicide cell. Various problems have been cited to the product diversification options, which are taken by different firms as noted by Johnson and Scholes (2002). According to this study, increase in coordination costs and competition for existing resources are the main challenges that banks face while introducing new products lines to the existing ones. Erosion of profits by losses from new products was cited to large extent but with reasonable variability. Shortage of skills, strain on existing resources, diversion of attention from core products, and difficult in integration of systems were to a moderate extent cited by banks as the challenges faced while pursuing product diversification. However, the extent differed significantly between banks.

5.3 Conclusion

According to Doyle (1994), although product diversification is the most risky of the four grand strategies, it may be a reasonable

choice if the high risk is compensated by a chance of high returns. Kotler (2000) stated that diversification growth makes sense when good opportunities can be found outside the present. This is when the industry is highly attractive and the firm has the mix of business strengths to be successful.

Johnson and Scholes (2002) define product diversification as the strategy, which takes the organization away from its current markets or product or competencies. It concerns the scope of industries and markets in which the firm competes and how managers buy, create and sell different products to match skills and strengths with opportunities presented to the firm. It refers to the deployment of resources across lines of products.

The research established that commercial banks in Kenya undertake product diversification strategy. The widely practices form of product diversification is concentric diversification. A practice where new products and services with technological, marketing and operational synergies with existing product lines are introduced. Horizontal product diversification is also practiced but with varying extents. According to Thompson and Strickland (1998), the overriding purpose of product diversification is to build shareholder value. A diversifying company gets into products that can perform better under common management than they could perform as stand-alone businesses.

There are various benefits of product diversification. According to this research, the majority of banks indicated increase in returns and profitability, customer loyalty and stability of product earnings as main advantages of introducing new products to existing lines. The research also indicates various challenges

experienced by banks as they pursue product diversification. Increase in coordination costs and strain on existing resources were cited as the main pitfalls of product diversification.

5.4 Recommendations

The research established that banks largely adopt product diversification strategies. With banking services being in a customer driven environment, banks need to assess the preferences of the customers and tailor the new products to those preferences. Research on the product diversification suggests several pitfalls banks should try to avoid. It is known that banks with different profitability and sizes have different propensities to diversify (Lemelin, 1982; Montgomery and Hariharan, 1991). This suggests that banks undertaking diversification should do so in the context of explicit policy regarding what the objectives of such should be. Peterson and Waterman (1982) suggest that companies should try to 'stick to the knitting' as they pursue their product diversification strategy. This will enhance shareholder value.

5.5 Limitations of study

Most banks did not respond citing inability to offer internal information.

5.6 Suggestions for further research

This study was based on commercial banks and therefore further research incorporating other companies should be carried out to determine extent of product diversification across other industries. There was also a clear demand for further research to enable a comparison to be made between the performances of diversified firms as opposed to those non-diversified firms.

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APPENDICES

APPENDIX 1: Introduction letter

Winfred Wakwoma

University of Nairobi

P.O. Box 30197-00100

Nairobi

August 20, 2007

Dear Sir/Madam

RE: REQUEST FOR RESEARCH DATA

I am a postgraduate student at the University of Nairobi, School of Business. I am conducting a management research on " The extent of product diversification in the Kenyan Banks".

In order to undertake the research, you are have been selected to form part of the study. This is therefore to request your assistance in filling the attached questionnaire as truthfully as you can. The information you give will be treated in confidence and is needed purely for academic purposes. Even where a name has been provided, it will not under any circumstances appear in the final report.

A copy of the final report will be made available to you upon request.

Your assistance and cooperation will be highly appreciated.

Yours Sincerely,

Winfred Wakwoma	Margaret Ombok
....	....
(Student)	(Supervisor)

APPENDIX 2: Questionnaire

Part I:

(A) Organization Profile

(1) Name of the Organization.

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(1) Please indicate the position that you hold in your organization

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(2) Using the categories listed below, indicate the ownership of your bank

Foreign ownership	
Local ownership	
Mixed (Local and Foreign) ownership	

(3) What is the extent of your bank's network of branches?

Nairobi only	
Nationwide (Kenya)	
Regional (Africa) net work	
International network	

(4) How many branches does your bank have?

Less than 5	
Between 6 and 20	
Between 21 and 40	
More than 40	

(5) Using the categories below, please indicate the number of years that your bank has been in operation.

Less than 10 years	
Between 11 and 20 years	

Between 21 and 30 years	
Between 31 and 40 years	
More than 40 years	

(6) Using the categories listed below; please indicate your average pre-tax profits over the last three years?

Less than Ksh 100m	
Between Ksh 101m and Ksh 500m	
Between Ksh 501m and Ksh 1 bn	
More than Ksh 1 bn	

(B) The Extent of Product Diversification

1 (a) Which of the following products do you regards as core to your business? (Please tick appropriately)

Account services: Savings, current, term deposits	
Loans and overdrafts	
Mortgages	
Letters of credit	
Trade guarantees and bonds	
Bills of Exchange	
Transmission/ Transfer of money	
Unit trusts	
Investment services	
Foreign Exchange services	
Interest rate/ currency swaps	
Cash management services; standing orders, bank drafts and salary processing	
Card services; Credit, debit, visa cards	
Off-shore services	
Commercial paper	

Treasury bills and bonds	

Others (Please specify)

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(b) Has your organization ever moved away from its core business, to focus on other new products?

YES	
NO	

(c) If the answer to question (b) above is yes, please indicate the extent to which the following factors have contributed to your organization moving away from its core products and services?

	Very large Extent	Large Extent	Moderate Extent	Small Extent	No Extent
Changing customer preferences					
Re-branding					
To increase profitability					
Liberalization					
Central bank regulation					
To invest excess resources					
Competition					

Others (Please specify)

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(d) Indicate the extent to which each of the following factors is considered by your bank in determining the extent to which your organization pursues product diversification strategy.

	Very large Extent	Large Extent	Moderate Extent	Small Extent	No Extent
Carry out new product lines complementary and related to the banks existing products. i.e. the new products use or share existing Banking systems, Sales agent and management skills					
Carry out a new product and services not related to the existing Product lines. The bank uses different					

systems, management and commercial skills					

2 (a) The bank may sometimes move away from its core business to introduce new products in addition, services that share same banking systems, marketing personnel and management. These products may appeal a new customer group. Please indicate the extent to which the following factors are considered as the bank pursues this strategy on the scale of 1-5

	Very large Extent	Large Extent	Moderate Extent	Small Extent	No Extent
Use existing banking system to introduce new products					
Use existing relationship managers to market new products					
Sharing advertising campaigns to launch new products					

Use existing direct sales managers to market new products					
Use existing direct branch managers to market new products					
Use of existing branches to market products					
Use of existing ATM networks to market products					
Use of the existing brand to market new products					
Share operations, administration and					

management skill to introduce new products					
Share product development personnel to introduce new products					

(b) Which of the following products has your bank diversified into as it pursues the strategy in 2(a) above? (Please tick appropriately)

Savings and Current accounts	
High value current accounts	
Mortgages	
Car Loans	
Unsecured loans	
Children accounts like Jumbo, and Safari Junior	
Executive accounts	
Expatriate Accounts	
Debit and credit cards	
Micro Finance loans	
Education Loans	
Corporative loans	
Insurance premium financing	
Business Solution accounts like cash and document pick up	

International money transfers like western union and money gram	
Utility payments like mobile top-up or electricity bill payments	
Gift cheques like for weddings and bonus for employees	
Call centres	
Treasury bills and bonds	

Others (Please specify)

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(3) The bank may sometimes move away from its core business to introduce new products and services that are not technologically, commercially or market related to target the existing customer group. Please indicate the extent of diversification into the following activities by your bank on a scale of 1-5

	Very Large Extent	Large Extent	Moderate Extent	Small Extent	No Extent
Life insurance					
Personal accident cover					
Insurance brokerage					

Share registration services					
Share registration					
Unit trusts					
Financial advisory services					
Pension management					
Fund management					
Lease Financing					
Asset Financing					
Travel advisory services					
Tax advise					

4 (a Sometimes, the organization may totally move away from its core business to introduce new products and services. These products may not share the existing Information technology systems, distribution channels like ATMs and sales agents, management skill and operations unit. The products may even appeal to a new group of customers. Please indicate the extent to which the products below are adopted by your organization

	Very	Large	Moderate	Small	No

	Large Extent	Extent	Extent	Extent	Extent
Motor assemblies					
Property construction					
Commercial property management					
Residential property management					
Business Club seminars					
Business Magazines					
Corporate service centres					
Cafeteria					
Convenience shops					
Franchised partnerships like supermarkets & petrol stations					
Computer maintenance					
Hire purchase					

Consultancy services					

4(b) In carrying out the actions in 4 (a) above, kindly indicate extent to which the following

	Very large Extent	Large Extent	Moderate Extent	Small Extent	No Extent
Links with supermarkets to establish new distribution outlets like ATM					
Links with supermarkets introduce new products like cash back services					
Liaise with petrol stations to establish new ATM kiosks					
Forms a subsidiary to introduce and market new products					
Acquire a license to market new products					
Merge with other banks to access and expand new product lines					

5) Which of the following represents the benefits that accrue to your organization as it engages in the product diversification strategies in 1- 4 above?

Improved return in investment. Lower average unit costs from the bank's ability to spread costs across many products	
Increased customer base as customer loyalty is enhanced through introduction of new services hence a one –stop- shop for customer needs	
Share of brand name and advertising campaigns to introduce a new product and hence the brand strengthened	
Sharing of sales agents and customer service managers hence efficient use of sales calls and reduced travel times	
Reduced costs and increased efficiencies due a firm spreading the costs existing banking systems like ATMs. operations and administration costs across wide product range	
Larger and more qualified staff departments like marketing and research	
Transfer of skill to similar activities. Knowledge gained from one product is applied to problems being experienced in other products.	
Efficient utilization of Research and Development capability	
Access to information like technological change and market trends.	
Reduce the cyclical nature of existing product	

earnings. Diversifying into businesses with different seasonal patterns like school fees loans, agricultural loans, and import loans stabilizes earnings.	
Refocuses the business of the firm. Opportunities in the bank's existing business may be limited. Thus may acquire or merge with another bank with attractive products	
Beat competition	
Increase power and prestige of executives	
Obtaining liquid products especially for the banks that are in real estate businesses.	

Others (Please specify)

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6) Which of the following shortcomings have been faced by your organization as it engages in product the above product diversification strategies?

Shortage of required skill to market and position new products.	
Strain on existing resources as the product range expands for example cash drain as a result of facility expansion.	
Competition between various products for resources may entail shifting resources away from one product to another. Such a move may	

create rivalry and between the product heads	
Attention is diverted from core products to new products	
Eroding market share. Poor performance of new products may result in losses	
Difficult in integration of management styles for various products especially when the two banks merge. Managers from different divisions may have different background s and may be unable to work together effectively	
Bureaucratic costs due to increase in the number of businesses in the bank's portfolio and hence extent of coordination between various businesses	
Increase in administration problems associated with operating unrelated products	
Difficult in integration of computer systems to take care of new product features	

Others (Please specify)

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Thank you very much for your cooperation

APPENDIX 3: List of Commercial Banks in Kenya

	LIST OF COMMERCIAL BANKS IN KENYA
1	African Banking Corporation
2	Akiba Bank Ltd
3	Bank of Africa (Formerly Credit Agricole)
4	Bank of Baroda Ltd
5	Bank of India (K) Ltd
6	Barclays Bank of Kenya Ltd
7	CFC Bank Ltd
8	Charterhouse Bank
9	Chase Bank (K) Ltd
10	Citibank N.A
11	City Finance Bank Limited
12	Commercial Bank of Africa Ltd
13	Consolidated Bank of Kenya Ltd
14	Co-operative Bank of Kenya Ltd
15	Credit Bank Ltd
16	Daima Bank Ltd
17	Development Bank of Kenya
18	Diamond Trust Bank of Kenya
19	Dubai Bank Ltd
20	Equatorial Commercial Bank Ltd
21	Equity Bank
22	Fidelity Commercial Bank Ltd
23	Fina Bank Limited
24	First American Bank of Kenya Ltd
25	Giro Commercial Bank
26	Guardian Bank
27	Habib Bank A.G. Zurich

28	Habib Bank Ltd
29	Imperial Bank Limited
30	Industrial Development Bank Ltd
31	Investments & Mortgages Bank Ltd
32	Kenya Commercial Bank Ltd
33	K-Rep Bank
34	Middle East Bank Kenya Ltd
35	National Bank Of Kenya
36	National Industrial Credit Bank
37	Oriental Commercial Bank (Formerly Delphis Bank)
38	Paramount -Universal Bank
39	Prime Bank
40	Southern Credit Banking Corp.
41	Stanbic Bank Kenya Ltd
42	Standard Chartered Bank (K) Ltd
43	Trans-National Bank Ltd
44	Victoria Commercial Bank Ltd

Source: Central Bank of Kenya Report-January 2007

APPENDIX 4: List of foreign owned commercial Banks in Kenya

1. Citibank N.A
2. Habib Bank AG Zurich
3. Habib Bank
4. Bank of India
5. Barclays Bank of Kenya
6. Standard Chartered Bank
7. Development Bank of Kenya Limited
8. Stanbic Bank Limited
9. Bank of Baroda Limited
10. Diamond Trust Bank Kenya Limited
11. Bank of Africa

Source: www.centralbank.go.ke

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