An analysis of the application of Unrelated Diversification strategy by the Major oil companies in Kenya

By

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A management research project submitted in partial fulfilment of the requirements of the degree of Masters of Business Administration.

Faculty of Commerce
University of Nairobi

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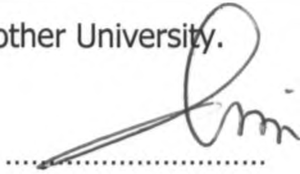
DECLARATION

This research project is my original work and has not been presented for a degree in any other University.



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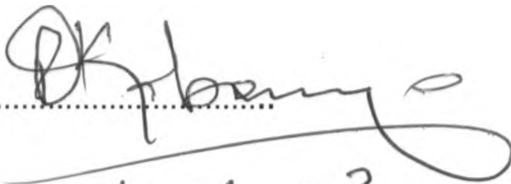
PETER KIRIMI MWINDI

This project has been submitted for examination with my approval as the University Supervisor



Signed..................................

Date 4-11-03

Professor Peter K'Obonyo
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DEDICATION

I dedicate this project to all scholars in the field of strategic management.

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ACKNOWLEDGEMENT

Compilation of the text of a research project of this nature that covers such a broad concept as diversification, is by no means a mean achievement. At times it may even leave one in considerable difficulties especially when it comes to reviewing literature on already documented literature on the same field, which is non existent in local libraries. However, owing to the immense experience that Professor K'Obonyo has in this field, his comments guidance and encouragement came in very handy no wonder I made it this far.

Secondly, I would like to register my heartfelt gratitude to my entire family, David, Anne, Ken and Dad and Mum. For being there for me when I needed support both financially and morally.

My thanks also go to my classmates and friends especially Evans Nzola, Catherine Mwangi, Wilfred Musau among others for their academic support. Finally, I wish to thank most sincerely Benson Theuri (Kenya Shell), Evans Kinyua (Kenol/Kobil), Patrick Mwamburi (Mobil K) and Emmanuel Kitusa (Caltex) for their co-operation in filling the questionnaires.

ABSTRACT

This research is titled: An analysis of the application of unrelated diversification strategy by major oil companies in Kenya. The study aimed at analysing the reasons why the major oil companies engage in non fuel business, a major departure from their core business of vending petroleum products.

The study, utilised data collected using a questionnaire from five major oil companies. The data was analysed using frequency distribution tables, percentages graphics and cross tabulations.

The research findings revealed that the concept of non-related diversification as it is applied in the retail networks of Kenyan oil companies lends itself more towards enhancing customer satisfaction than improving the financial performances of the major oil companies.

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ABBREVIATIONS

BP	: British Petroleum
COMESA	: Common Market for East and Southern Africa
GOK	: Government of Kenya
KEBS	: Kenya Bureau of Standards.
LPG	: Liquefied Petroleum Gas
MNCs	: Multi- National Corporations
OPEC	: Organisation of Petroleum Exporting Countries
ROA	: Return on assets

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CHAPTER ONE

INTRODUCTION

1.1 Background

Central to the concept of strategic management is the concept of strategy. According to Ansoff and McDonnell (1990), the concept of strategy entered business vocabulary from the 1950s , when response to environmental discontinuities became important. The dictionaries did not help, since following military usage, they still defined strategy as 'the science and art of deploying forces for battle.' At first, many managers and some academics questioned the usefulness of the new concept. Having witnessed half a century of miraculous performance by American industry without the benefit of strategy, they asked why it had suddenly become necessary, and what it could do for the firm.

The term strategy can be defined in as many ways as there are scholars and researchers in this field. However Johnson and Scholes (1999), have given a very enriching one in their book 'Exploring Corporate Strategy' Fifth Edition, Prince Hall pp. 10. Their definition of strategy is;

> *"Strategy is the direction and scope of an organisation over the long term: which achieves advantage for the organisation through its configuration of resources within a changing environment, to meet the needs of markets and fulfil stakeholder expectations".*

Corporate strategy on the other hand is concerned with the overall purpose and scope of the organisation to meet the expectations of owners or major stakeholders and add value to the different parts of the enterprise (Johnson and Scholes, 1999).

According to Porter (1998), competition is at the core of the success or failure of firms. Competition determines the appropriateness of a firm's activities that can contribute to its performance, such as innovations, a cohesive culture, or good implementation. Competitive strategy is the search for a favourable competitive position in an industry, the fundamental arena in which competition occurs. Competitive strategy aims to establish a profitable and sustainable position against the forces that determine industry competition.

Many companies are revising their overall strategy due to new technologies, products, techniques and systems that are intensifying local, international and global competition. A major pattern of reaction are efforts to differentiate by understanding better each customer's needs and to increase customer loyalty. Strategies like mergers and acquisitions, strategic alliances, joint ventures, diversification or customer relationship management are being seen as viable weapons in today's competitive landscape (Ramirez, 1999). Besides the maximisation of the shareholder value is the new , intense customer centric view. The customer is seen as a partner of value creation, products and services are not being mass produced for an anonymous market but provided after a process of interacting with the customer. These new customer centric approaches are based on some distinctive common principles (Milgrom and Roberts, 1990; Ramirez, 1999).

With recent developments into regionalisation and globalisation, many firms have found themselves in very vulnerable situations as competition intensifies. This has led to some firms being faced with the risk of losing their hard won market shares and therefore not being able to satisfy their owners expectation of profitability. In the face of such developments many have sought to move from the one-business to multiple-business concentrations.

Strickland (1993), likened big risk of single-business concentration to the old adage of putting all firm's eggs in one industry basket.

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If the industry stagnates, declines, or otherwise becomes unattractive, a company's future outlook dims, growth rate becomes tougher to sustain, and superior profit performance is much harder to achieve. As observed earlier, changing customer needs, technological innovation, or new substitute products can undermine or wipe out a single-business firm. For this reason most single-business companies turn their strategic attention to diversification when they start to show signs of peaking.

Figure 1.1 overleaf tries to explain when a single-business company needs to consider diversification. In the figure are two distinct variables that are plotted against each other to create four distinct strategic situations that might be occupied by an undiversified company i.e. competitive position of the company as compared to various rates of market growth.

Table 1: Matching Corporate Strategy Alternatives to fit an Undiversified Firm's Situation

COMPETITIVE POSITION

	STRONG	WEAK
RAPID	**STRATEGY OPTIONS** (in probable order of attractiveness) • Reformulate single-business concentration strategy (to achieve turnaround) • Acquire another firm in the same business (to strengthen competitive position) • Vertical integration (forward or backward if it strengthens competitive position) • Diversification. • Be acquired by/sell out to a stronger rival. • Abandonment (at last resort in the event all else fails)	**STRATEGY OPTIONS** (in probable order of attractiveness) • Continue single-business concentration – international expansion (if market opportunities exist) • Vertical integration (if it strengthens the firm's competitive position) • Related diversification (to transfer skills and expertise built up in the core business to adjacent businesses).
SLOW	**STRATEGY OPTIONS** (in probable order of attractiveness) • Reformulate single-business concentration strategy (to achieve turnaround). • Merger with a rival firm (to strengthen competitive position) • Vertical integration (only if it strengthens competitive position substantially). • Diversification. • Harvest/divest • Liquidation (a last resort in the event all else fails)	**STRATEGY OPTIONS** (in probable order of attractiveness) • International expansion (if the market opportunities exist). • Related diversification. • Unrelated diversification. • Joint ventures into new areas. • Vertical integration (if strengthens competitive position. • Continue single-business concentration (achieve growth by taking market share from weaker rivals).

Source: Adopted from figure 7-1 in the Strategic Management: concepts & cases seventh Edition by Thomson Strickland pp. 165.

As depicted above a company has a number of strategy options that it could choose from depending on which quadrant that it falls within in the light of the two key variables considered above.

In order to create a competitive advantage a company needs a hybrid position combining the benefits of various strategies. Companies which wish to operate successfully under these conditions apparently have to start out from both.

However, if a firm decides to diversify, the type of market chosen for entry should be such that it provides the firm with a competitive advantage (Chatterjee & Werner felt, 1991).

Diversification involves directions of development which take the organisation away from its present markets and its present products at the same time (Johnson and Scholes, 1999). Diversification is traditionally considered under two broad headings: related and unrelated diversification.

- **Related diversification** is the development beyond the present product and market, but still within the broad confines of the 'industry' (i.e. value chain) in which the company operates. It may take several forms such as;
- **Backward integration,** which refers to development into activities which are concerned with the inputs into the company's current business (i.e. are further back in the value chain). For instance raw materials, machinery and labour are all important inputs into a manufacturing company.
- **Forward integration,** which refers to the development into activities which are concerned with a company's output (i.e. are further forward in the value chain), such as transport, distribution, repairs and servicing.
- **Vertical integration,** describes either backward or forward into adjacent activities in the value chain.
- **Horizontal integration** refers to development into activities which are competitive with, or directly complementary to, a company's present activities.
- **Unrelated diversification** is where the organisation moves beyond the confines of its industry. Unrelated diversification may be divided into three categories;

1. It may involve extension into new markets and new products by exploiting the current core competencies of the organisation.

2. Diversification by the exploitation of core competencies may go beyond simply moving into markets which already exist: it may involve the creation of genuinely new markets.
3. The most extreme form of unrelated diversification is where new competencies are developed for new market opportunities. No wonder, this extreme end of diversification spectrum is less common.

They further observe that the commonly cited reason for both related and unrelated diversification is *synergy*. Potentially, synergy can occur in situations where two or more activities or processes complement each other, to the extent that their combined effect is greater than sum of the parts.

Strickland (1993), on the other hand argues that, companies that are strongly positioned in a slow growth industry should consider using their excess cash to begin diversifying. Diversification into businesses where a firm can leverage its core competencies and competitive strengths is usually the best strategy. But diversification into totally unrelated business opportunities offers attractive profit prospects.

He goes further to suggest that, the decision on when to diversify partly is a function of a firms competitive position and partly a function of the remaining opportunities in its home base industry.

There really is no well defined point at which companies in the same industry should diversify. Indeed, companies in the same industry can rationally choose different diversification approaches and launch them at different times.

Strickland (1993), suggests that corporate strategists can make before-the fact assessment of whether a particular diversification move is capable of increasing shareholder value by using three tests. First, *the attractiveness test*; the industry chosen for diversification must be attractive enough to produce consistently good returns on investment.

True industry attractiveness is defined by the presence of favourable competitive conditions and a market environment conducive to long term profitability.

Second, *the cost of entry test*; the cost to enter the target industry must be so high as to erode the potential for good profitability. The more attractive the industry the more expensive it is to get into. Costly entry undermines the potential for enhancing shareholder value.

Third, *the better-off test*; the diversifying company must bring some potential for competitive advantage to the new business it enters, or the new business must offer some potential for added competitive advantage. Where none existed before means there is also opportunity for added profitability and shareholder value.

Diversification moves that satisfy all three tests have the greatest potential to build share holder value over the long term diversification moves that can pass only one or two are highly suspect.

Within the Kenyan oil industry, diversification has led companies into introducing new product lines that are completely different from the core of their business, that is, petroleum related products. These products include, but not limited to the following: cafeterias, convenience shops, car wash, bars, motor garages, pharmacies, tyre centres. These non-fuel services are all geared towards extending the range of products and services available for consumption by the motorists and also augment the earnings from the fuel sales for both the operators and the host companies. This later concept of offering non-fuel services is central to the study in this paper.

1.2 Statement of the problem

Threats to core business and the presence of numerous opportunities leads almost inevitably to consideration of a diversification strategy in order to strengthen the firm's revenue mix and finding new sources of profitability.

Studies already done in the field of diversification strategy have presented contradictory results. However majority of these studies have concluded that there is a very weak link between the financial performance a company and its diversification intensities. Sera Mwanzi (1991) in her MBA research project, Diversification Strategy and Performance: A case study of the Kenyan life insurance industry, concluded that there lacked significant difference between the performance of low, medium and highly diversified insurance companies that she studied in Kenya.

Sera's findings were consistent with some of the research findings of other previous studies concerning the relationship between diversification and profitability as measured by the return on assets. McDongall and Round (1984) studied the motives for diversification and compared the performance of diversifying Australian industrial firms and found no significant difference in the profitability of the groups of companies. They also used the ROA as a measure of performance.

Despite the declining popularity of the diversification strategy, retail infrastructure development of service stations in Kenya is reflecting a new approach. Unlike in the past, when small service stations were built purely for the purpose of retailing petroleum fuels new services stations are not only large but also include a variety of additional services such as restaurants, mini supermarkets which stock foodstuffs amongst other items and stores for motor vehicle accessories and spare-parts (Nyoike et al, 1999).

This new trend seems to be moving against the trend whereby most firms have been restructuring and eliminating all non-core businesses. The reason for the decline in the popularity of diversification strategy is that the firms often do not have adequate competence in such non-core business and thus often do not do well in them. That is, the benefits accruing from running such businesses do not justify the associated costs. Therefore, it would be interesting to find out why the strategy is attractive to oil companies.

This study endeavours to analyse and document the reasons for level of success of the unrelated diversification strategy by the major oil companies in Kenya as a source of competitive advantage. The key questions that the research will seek to answer are:

Why do the oil companies choose to engage in non-fuel business?

Is unrelated diversification by the major oil companies in Kenya related to their financial performance?

1.3 Scope of the study

The scope of this study will be limited to studying of the success of the diversification activities, that is, the non-fuel services such as tyre centres, cafeterias, convenience shops, franchises such as Steers and Nandos and car wash services, as value adding activities within the major oil companies in Kenya.

The study will involve assessing the pre-diversification expectations both in monetary and non-monetary terms and the achievement of such goals by the targeted companies.

The study will be limited to the major oil companies, that is, subsidiaries of the multinationals and the big local companies with market share of over 10%, as guided by the reports from the ministry of energy through government publications such as the Economic survey of 2001.

1.4 Objectives of the study

The study has two main objectives:

- To determine why the major oil companies are venturing into unrelated diversification of their product lines, that is, tyre centres, cafeterias, convenience shops, workshops etc.

- To determine the relationship between unrelated diversification and the performance of the major oil companies.

1.5 Importance of the study

The study will be important to the following parties;

1.5.1 To managers involved in formulating corporate strategies

The study will be important to the managers involved in strategy formulation within the oil industry and other companies that are seeking to venture into unrelated business arenas.

1.5.2 The Academic Community

The research is expected to add on to the many researchers that are currently being carried out the world over in the field of diversification as a corporate strategy.

1.5.3 To the Researcher

In addition to this study being a requirement for the fulfilment of the requirement of the Master of Business Administration degree, it will benefit the researcher understand better the challenges facing strategy managers who are charged with the responsibility of implementing the unrelated diversification strategy in the various companies.

1.5.4 To business Community

The research is expected to shed light to the businessmen wishing to venture into service station business with additional services such as those herein referred to as diversification activities.

CHAPTER TWO

LITERATURE REVIEW

2.1 Definition

Diversification refers to seeking unfamiliar products, markets or both in pursuing growth. Every company is best at certain products; diversification requires substantially different knowledge, thinking, skills and process (Cravens et al, 1996). Thus, diversification is at best a risky strategy and a company should choose this path only when current product/market orientation does not seem to provide further opportunities for growth.

The term "Diversification" must be differentiated from integration and merger. Integration refers to accumulation of additional business in a field through participation in more of the stages between raw materials and the ultimate market, or through more intensive coverage of a single stage. Merger implies a combination of corporate entities which may not result in integration. Diversification of course, is a strategic alternative, which implies deriving revenues and profits from different products and markets.

Diversification may be used in many different ways and may be defined in as many ways as there are scholars and researchers. For purposes of this research paper, it will be used to identify directions of development which take the organisation away from its present markets and its present products at the same time.

2.2 Dimensions of diversification

According to Johnson and Scholes (1997), diversification may be divided into two broad types, that is, related and unrelated diversification.

2.2.1 Related diversification

A related diversification strategy involves diversifying into business that posses some kind of 'strategic fit'. Strategic fit exists when different businesses have sufficiently related activity-cost chains that there are important opportunities for activity sharing in one business or another. According to Strickland (1993), companies choosing which industries to diversify into, can pick related or unrelated to the organisation's core business

He (Strickland), furthers observes that fit relationships can arise out of technology sharing, common labour 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 the 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 activities. The fit or relatedness can occur anywhere along the businesses' respective activity-cost chains. He further identifies the following as being some of the most commonly used approaches to related diversification:

- Entering businesses where sales force, advertising, and distribution activities can be shared.
- Exploiting closely related technologies.
- Transferring know-how and expertise from one business to another.
- Transferring the organisation's brand name and reputation with consumers to a new product/service.
- Acquiring new businesses that will uniquely help the firm's position in its existing business.

Related diversification may also be defined as the development beyond the present product or market, but still within the broad confines of the 'industry' (i.e. value chain) in which the company operates (Johnson and Scholes, 1990). Related diversification may also take several forms such as backward integration, forward or concentric integration or horizontal integration.

2.2.2 Concentric diversification

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).

Forward integration refers to development into activities which are concerned with a company's outputs (i.e. are further forward in the value chain), such as transport, distribution, repairs and servicing. While a diversification move may be perceived risky, concentric diversification does not lead a 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 product to the firm's existing products, however, may or may not mean much. All that the realisation of synergy does is make the task easier, it does not necessarily make it successful (Kotler, 1999).

2.2.3 Horizontal diversification

Horizontal diversification refers to 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. In horizontal diversification, the customers for the new product are drawn from 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 favourably disposed toward the company and if one can expect this loyalty to continue for the new product (Kotler, 1999).

Horizontal diversification is not without its failures, it should not be regarded as a route to success in all cases. 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.

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Put it in another way, horizontal diversification tends to increase the company's dependence on a few market / product segments.

2.2.4 Backward integration

Backward integration refers to development into activities which are concerned with the inputs into the company's current business (i.e. are further back in the value chain) for instance, raw materials, machinery and labour are all important inputs into a manufacturing company (Kotler, 1999).

2.2.5.1 Unrelated diversification

Despite the benefits of strategic fit that are associated with related diversification, a number of companies opt for unrelated diversification strategies. Srickland (1993), suggests that, in unrelated diversification, the corporate strategy is to diversify into any industry where top management spots a good profit opportunity. There is no deliberate effort to seek out businesses where strategic fit exists. While firms pursuing unrelated diversification may try to ensure that their strategies meet the industry attractiveness and cost-of-entry tests, the conditions needed for the better-off test discussed in chapter one are either disregarded or relegated to secondary status.

He further observes that, decisions to diversify into one industry versus another are based on an opportunistic search for 'good' companies to acquire-*the basic premise of unrelated diversification is that any company that can be acquired on good financial terms represents a good business to diversify into.*

Typically, corporate strategist screen candidate companies using such criteria as:

- Whether the business can meet corporate targets for profitability and return on investment.
- Whether the new business will require substantial infusions of capital to replace fixed assets, fund expansion, and provide working capital.

- Whether the business is big enough to contribute significantly to the parent firm's bottom line.
- The potential for union difficulties or adverse government regulations concerning product safety or the environment.
- Industry vulnerability to recession, inflation, high interest rates, or shifts in government policy.

Strickland, (1993) and Johnson and Scholes, (1990) concur that, corporate strategy is directed at identifying companies that offer opportunities for financial gain because of their 'special situation'; three types of companies make particularly attractive acquisition targets:

- *Companies whose assets are 'under undervalued-* opportunities may exist to acquire such companies for less than full market value and make substantial capital gains by reselling their assets and businesses for more than their acquired costs.
- *Companies that are financially distressed-* such businesses can often be purchased at a bargain price, their operations turned around with the aid of the parent companies' financial resources and managerial know-how, and then either held as a long-term investment (because of their strong earnings potential) or sold at a profit, whichever is more attractive.
- *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.

Firms that pursue unrelated diversification nearly always enter new businesses by acquiring an established company rather than by forming a start-up subsidiary within its own corporate structure. Their premise is that growth by acquisition translates to enhanced shareholder value.

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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 most extreme form of unrelated diversification is where new competencies are developed for new market opportunities (Craven and David, 1990).

2.3 Rationale for diversification

Economic and intellectual growth is essential to every enterprise. But the resources needed to achieve this growth must be identified, understood, and known to be available.

Porter (1997), suggests that a firm can gain such competitive advantage if it has skills or resources that it can transfer into new market. Resources have long been recognised to be one of the key factors in explaining diversification (Penrose, 1959). Most organisations are originally formed to engage in one activity, such as selling merchandise or producing a single product. As organisations grow and diversify they seek new systems and structures to deal with complexity of multiple products of multiple products and sustained growth. Eventually many large corporations adopt some type of M-Form (Multidivisional) structure (Chandler, 1962, Rumelt, 1974, 1982; Williamson, 1975, 1985).

Diversification is such an unpredictable high stakes game for the following reasons; Companies usually face the decision in an atmosphere not conducive to thoughtful deliberation; Diversification as a corporate strategy goes in and out of vogue on a regular basis. In other words there is little conventional wisdom to guide managers as they consider a move that could greatly increase shareholder value or seriously damage it (Markides, 1997).

Markides (1997), suggests that managers wishing to consider diversification require to ensure that the following questions are adequately addressed before embarking on the strategy in earnest in order to substantially reduce the gamble of diversification:

First, *what strategic assets do the company need in order to succeed in the market or product offering?* Excelling in one market does not guarantee success in a new and related one. Managers considering diversification must ask whether their company has every strategic asset necessary to establish a competitive advantage in the territory it hopes to conquer.

Secondly, *can we catch up or leapfrog competitors at their own game?* This calls for assessment of a company's assets against the critical factors for success in the market or whether in their absence the company can purchase them, develop them, or make them unnecessary by changing the competitive rules of the industry.

Thirdly, *what can our company do better than any of its competitors in its current markets?* This involves identifying a company's unique and unassailable competitive strengths or strategic assets. When facing the decision to diversify, however managers need not think about what their company does but what it does better than competitors.

Fourthly, *will diversification break up strategic assets that need to be kept together?* Too many companies mistakenly assume that they can break up clusters of competencies or skills that, in fact, work only because they are together, reinforcing one another in a particular competitive context. Such a move can doom a diversification move.

Fifth, *will the company be simply a player in the new market or will it emerge a winner?* Even if companies storm into new markets with all the required competencies –put together in the right combination – they still can fail to gain a foothold.

This is usually because to achieve a sustainable advantage, diversifying companies need to create something unique. A company's competitive advantage will be short lived, and diversification will fail, if competitors in the new industry can imitate the company's moves quickly and cheaply, purchase the necessary strategic assets in the open market, or find an effective substitute for them. In other words, there is no point rushing into a new market unless you have a way to beat the existing players at their own game. It is therefore important for the managers to establish beforehand whether; if the strategic assets they intend to introduce into the market are rare; if the strategic assets can be imitated; or if the strategic asset they plan to export can be substituted.

Finally, *managers need to ask what is it that their company can learn by diversifying, and whether the company is sufficiently organised to learn it.* Often, companies can use what they have learned from the one diversification move to enter a third market more quickly and cheaply. Managers also should examine whether a diversification move will allow them to learn competencies that can be reapplied in their existing businesses. Managers should ask themselves if their organisation is doing all it can to transfer relevant information and competencies from one line of business to another. For such a flow to take place, companies need to have processes that facilitate and promote learning across different functions and divisions.

According to McDougall and Round (1994), the justification of diversification as a corporate strategy appears to be based on three related themes;

First, *diversification has been related to profit maximising behaviour on the part of firms.* It may enable a firm to obtain economic power and profits through for instance predatory pricing behaviour, the advantages of size per se, or reduction of competition by removing potential rivals through mergers and acquisitions. It also may enable a firm to achieve higher profits through economies of scale or through the exploitation of complementaries in production distribution, marketing, research and development, purchasing, finance and management.

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Second, *a strategy of diversification can be linked to managerial theories of the firm.* Diversification provides opportunities for growth in profits, sales and assets that are not possible through horizontal expansion.

Third, diversification can be linked to risk reduction with the object of the firm being the reduction of relative or total risk associated with a firm's earnings and the exploitation of related benefits.

According to Ansoff (1990), firms diversify when their objectives can no longer be met within the product/ market scope defined by expansion. Specifically:

- A firm may diversify because the retained cash exceeds the total expansion needs.
- A firm may diversify when diversification opportunities promise profitability than expansion opportunities.
- A firm may continue to explore diversification when the available information is not reliable enough to permit a conclusive comparison between expansion and diversification.

According to Hill & Jones (2001), diversification offer creates value through:
Economies of scale, in the following ways:

- Sharing of resources and function by business units creates value in high asset utilisation and lower operating costs.
- Economies of scope and scale are closely related. Greater operational capacity and larger markets can help a competitor attain low-cost position.
- Resource sharing creates significant competitive advantage when it outweighs co-ordination costs.

However, Hill and Jones (2001) go further to mention costs and limitations of diversification which include:

- Number of businesses information overload can lead to poor resource allocation decision and can be sources of inefficiencies.

- Co-ordination among businesses: as the scope of diversification widens, control and bureaucratic costs increase. Resource sharing pooling must be balanced with its bureaucratic costs.

They further, observe that diversification may dissipate value by:-

- Pooling risks – An ineffective attempt to offset the cyclical effects of business by merging their income streams; downturns in one business are intended to be offset by upturns in another business.
- Achieving greater growth – the concept focuses on growth (which is normally a by-product of diversification) and not value creation.

Strickland (1993), on the other hand postulates that unrelated or conglomerate diversification promises the following financial benefits:

- Business risk is scattered over a variety of industries, making the company less dependent on any one business. While the same can be said for related diversification, unrelated diversification places no restraint on how risk is spread. An argument can be made that unrelated diversification is a superior way to diversify financial risk as compared to related diversification.
- Capital resources can be invested in whatever industries that offer the best profit prospects; cash from businesses with lower prospects can be diverted to acquiring and expanding businesses with higher growth and profit potentials. Corporate financial resources are thus employed to maximum advantage.
- Company profitability is somewhat more stable because hard times in one industry may be partially offset by good times in another-ideally, cyclical downswings in other businesses the company has diversified into.
- To the extent that corporate managers are astute at spotting bargain priced companies with big upside profit potential, shareholder wealth can be enhanced.

He (Strickland) further observes that, while diversification into unrelated business can often pass the attractiveness and cost-of-entry test (and sometimes even the better-off test), unrelated diversification has drawbacks.

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First, it poses a big challenge on the corporate-level management to make sound decisions about fundamentally different businesses operating in fundamentally different industry and competitive environments. The greater the number of businesses a company is in and the more diverse they are, the harder it is for the corporate managers to oversee each subsidiary and spot problems early, to become expert at evaluating the attractiveness of each business's industry and competitive environment, and to judge the calibre of strategic actions and plans proposed by business-level manager.

Second, without some kind of strategic fit and the added measure of competitive advantage it offers, the consolidated performance of a multibusiness portfolio tends to be no better than the sum of what the individual units could achieve independently. And, to the extent that corporate managers meddle unwisely in business-unit operations or hamstring them with corporate policies, overall performance can even be worse. Except for the added financial backing from a cash-rich corporate parent, a strategy of unrelated diversification does nothing to enhance the competitive strength of individual business units.

Third, although in theory unrelated diversification offers the potential for greater sales-profit stability over the business cycle, in practice attempts at countercyclical attempts fall short of the mark. Few attractive businesses have opposite up-and-down cycles; most are similarly affected by cyclical economic conditions. There is no convincing evidence that the consolidated profits of broadly diversified firms are more stable or less subject to reversal in periods of recession and economic stress than the profits of less diversified firms.

He finally concludes that , despite these drawbacks, unrelated diversification can be a desirable corporate strategy. It certainly makes sense when a firm needs to diversify away from an unattractive industry and has no distinctive skills it can transfer to related businesses. Also, some owners prefer to invest in several unrelated businesses instead of a family of related ones.

2.4 Research on diversification

Several studies have been done since 1974, when Drucker made the following observation: "on the whole, broadly diversified firms do not outperform less diversified firms over the course of the business cycle" (Strickland, 1993)

A research conducted by Constantinos C. Markides on diversification and whose findings were published in the Havard Business Review November- December 1997, agree with the observation that is cited above by Peter Drucker. In his closing statement in the article titled 'To diversify or not to diversify', Markides states that *"Diversification will never be an easy game, and managers must study their cards carefully. It takes smart players to know when it's best to raise their bets and when it's best to fold".* The results summarised here were based on a series of experiments that Markides carried out with 120 executives attending the Accelerated Development Programme at London Business School between 1993 and 1996.

In recent studies of diversification, market structure and firm performance, Montgomery (1985) and Montgomery and Wernerfelt (1988) suggest that diversified firms may not have higher market share in their respective markets than less diversified firms and that the strategy of diversification does not contribute to firm performance. In particular, Montgomery (1985) contrasts this view of the firm's individual markets with traditional market power theory emphasising global rather than specific market power of diversified firms (Rhoades, 1973; Rumelt, 1974). The findings of these studies may, however not be contradictory given the lack of distinction between technologically related diversification and conglomerate strategies.

If the global degree of firm diversification is not related to performance the strategy of technologically related diversification may create additional synergies related to economies of scope. When joint output production incurs lower costs than production of separate outputs.

The optimal firm level of diversification balances economies of scale and scope where diseconomies of scope may arise from the inability of the internal organisational control system to allocate resources and outputs better than the market (Rumelt, 1982).
Diversification at the industry level may also increase barriers to entry, thus enhancing the opportunity for successful predatory pricing and reducing the markets pool of information on high profits industries (Scherer, 1980; Amit and Livnat, 1988). The potential for predatory pricing poses a threat to new entrants since diversified firms in the industry may sustain losses in one activity while maintaining overall profitability.

The loss of profit information in high-performing industries due to consolidated financial reporting by diversified firms serves to reduce the motivation for new entry. A similar study conducted by The Hiep Nguyen et al (1988) on "Diversification strategy and performance anain Cdian manufacturing firms" showed support for the hypothesis that degree of technologically related diversification is positively associated with firm performance and provide several important additional insights to this effect. First, extent of technologically related diversification, including all strategies, is significantly and positively related to firm profitability, contrary to Montgomery's (1985) finding of no effect when controls are introduced for market share and primary industry concentration. Thus, while specific market power of the firm is significantly associated with value-based and accounting measures of firm performance extent of technologically related diversification is also highly significant. This result points to a synergistic effect where technologically related diversification as suggested by Montgomery (1985) and consistent with other studies (Montgomery and Wernerfelt, 1988; Wenerfelt and Montgomery 1986, 1988).

While Montgomery and Wernerfelt (1988), report a negative association between diversification and firm performance measured by Tobin's q, this result is founded upon critical theoretical assumption that 'natural economies of scope, affecting all firms in a pair of industries do not exist' (Montgomery and Wernerfelt 1988:631).

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Other researches conducted in the field of diversification include one by Kochar and Hitt (1998) that sought to examine the relationship between corporate strategy and capital structure, specifically the diversification and financing strategies of a firm. The results show that equity financing is preferred for related diversification and debt financing for unrelated diversification. Additionally, firms diversifying through acquisitions are more likely to use public sources of financing and those emphasising internal development of new businesses depend primarily on private sources of financing.

In Kenya, some researches have so far been conducted by several scholars in the field of strategic management within the oil industry among them, Isaboke (2001), sought to know what strategic responses have the major oil companies in Kenya adopted to circumvent the threat of new entrants.

He (Isaboke) identified cost leadership, differentiation, market focus, segmentation, penetration and development of new markets as the key strategies being employed by the major oil companies in a bid to circumvent the threats posted by new entrants.

Wamathu (1999), sought to know the strategic postures and action evaluation in the Kenyan oil industry. In his research nothing in relation to diversification in the oil companies was featured and therefore a gap in this field has been left void.

2.5 Kenyan oil industry

The petroleum industry, which falls under Kenya's Ministry of Energy is a key sector in the country's economy as it affects both its relative terms of trade and domestic prices of myriad of products. Petroleum fuels are used widely in the productive sectors of the economy. According to the Economic Survey (2001), it constitutes about 63% of the total energy consumption in the commercial sector alone.

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The petroleum sub-sector has been developed through a mixture of investment which involved both the public and private sectors. Whereas the public sector has been involved in the development of refining and transportation facilities, the private sector has been more involved in the development of the distribution facilities such as retail service stations (Nyoike et al, 1999).

The main products distributed by all companies include: Liquefied Petroleum Gas (LPG), Gasolines – Premium (Super) and Regular, dual-purpose Kerosene, Jet A1 and illuminating Kerosene, Industrial Diesel, Fuel Oils (120cs, 180cs, 280cs), Bitumen, Lubricants (gear oils, brake fluids, greases, engine oils, etc), petroleum based spray oils, petroleum jelly, etc.

According to Nyoike et al (1999), there has been a notable shift from the traditional small sized filling stations of the seventies to large service stations with not only huge underground tanks but also incorporating a host of other non-fuel services. This trend has not been in vogue within the multinational companies but its currently observable also among the new entrants that are herein referred to as independents.

The government of Kenya plays a critical role in setting rules and regulation that bind the industry. Particularly, The Petroleum Act contained in chapter 116 of the 'Laws of Kenya' that came into commencement on 31st August, 1948 was enacted by the parliament to make provision for restricting and regulating the importation, transport and storage of petroleum products. Therein, the Act stipulates the petroleum rules that guide the ministry of energy in as far petroleum industry. The sub-sections of this provides details on transportation, storage, installations storage sheds, kerbside sheds, and numerous other special regulations applying to various classes of handlers of the products. Before the liberalisation of the industry in October 1994, the government was heavily involved in determining both the pricing and the supply of the petroleum products.

Competition within the oil industry like any industry, resulted in lower profits due to downward price adjustments to match the independent dealers (Isaboke, 2002). Faced with this fierce competition and the resulting drop in profitability, the multinational companies started engaging in serious jockeying to increase market share through advertising, increased customer care and venturing by others into little known areas which may be collectively referred as diversification.

2.5.1 The role of oil industry in Kenya

Kenya relies entirely on the import of both crude and refined petroleum products. Crude oil and imported petroleum products in 2001 accounted for 25.7% of the total country bill compared with 19.8% in 1999. Petroleum fuel recorded a remarkable drop of 29.6 per cent from 627,3000 tonnes in 1999 to 441,900 tonnes in 2000. Export earnings went up from KSh 9391 million in 1999 to KSh. 9,445.3 ,million in 2000. Sales of petroleum products went up by 5.9 per cent, from 2,311,500 tonnes in 1999 to 2,448, 100 tonnes in 2000.

The transport sector is the main consumer of petroleum products. It accounted for 69.1 per cent of the total net sales of 2,448.1 thousand tonnes in 2000. Sales through retail pump outlets and road transport increased by 6.8 per cent.
The following table reveals the domestic sale of petroleum fuels by consumer categories in thousands of tonnes.

TABLE 2: DOMESTIC SALE OF FUEL BUY CONSUMER CATEGORIES

CATEGORY	1999	2000
Agriculture	89.6	90.7
Retail Pump Outlets and Road Transport	1109.7	1184.8
Rail transport	15.7	12.8
Tourism	10.6	10.7
Marine	103.5	68.7
Aviation	421.0	424.4
Power Generation	279.3	289.3
Industrial, Commercial & Other	355.9	413.8
Government	18.6	21.9

Source: Central Bank of Kenya (2001). Quarterly Economic Survey.

The table 3 below shows Kenya's petroleum supply and demand in thousands of tonnes.

TABLE 3: DEMAND AND SUPPLY OF PETROLEUM PRODUCTS

DEMAND	**1999**	**2000**
Liquefied Petroleum Gases	32.2	33.4
Motor spirit (Premium & Regular)	384.6	355.7
Aviation Spirit	2.5	2.2
Jet/Turbo fuel	418.7	432.2
Illuminating Kerosene	406.8	383.7
Light Diesel Oil	601.7	712.8
Heavy diesel oil	25.7	28.1
Fuel Oil	439.4	490.0
Total	2311.6	2448.1
SUPPLY		
Crude oil	2139.3	2452.3
Petroleum fuels	1250.9	874.9
Total	3390.2	3327.2

Source: Central Bank of Kenya (2001). Quarterly Economic Survey.

The following market analysis is confined to the buying behaviours of customers. The main petroleum business lines are retail, consumer/industrial, wholesales/distributors and international (aviation, marine and export).

Although industrial buyers pose the threat of integrating forward, that is, import their own refined oil, the current regulatory structure prevents this from happening and leaves control entirely within the established oil marketers. Complete liberalisation of the industry may require lifting restriction on the requirement that licensed importers must import 70 per cent of their requirements in the form of crude oil to allow for easy forward integration by industrial buyers and increase buyer power.

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2.5.2 Structure of the oil industry in Kenya

The global oil industry can be broadly put into two categories: the upstream (exploration and production) and the downstream (refining and marketing). Kenya's is purely a downstream industry. Although there has been exploration in the northern and coastal parts of the country, no commercially viable deposit have been discovered.

According to the ministry of energy, in Kenya, the energy sector is divided into two sectors: the traditional and modern energy sectors. The traditional sector is dependent on fuel wood and charcoal and accounts for 68 per cent of the country's energy needs. Up to 80 per cent of the population is dependent on this source. The modern sector depends on petroleum, fuel, solar, bio-gas, wind and electricity. Petroleum meets about 70 per cent of the needs (Economic Survey,2001).

The Kenyan oil industry is dominated by five major players. These are;

- Caltex, whose parent company are Chevron & Texaco that merged recently.
- Total Kenya, a subsidiary of TotalFinaElf, whose parent companies are Total, Petrofina of Belgium and Elf of France.
- Shell/BP, a joint venture between Shell (a subsidiary of Royal Dutch company Shell) and British Petroleum (a subsidiary of British Petroleum) who also acquired Agip (K) Ltd.
- Mobil (K) a subsidiary of the largest oil corporation in the world, ExxonMobil both companies are incorporated in Delware, USA.
- Kenol/Kobil who have the largest local shareholders. Kenol is, managed by Kobil, the company is publicly quoted and Kenol/Kobil recently acquired a controlling interest in Mid-Oil Africa and later sold them back in March 2003.
- Other players in the market are Petro (K) Ltd, Engen (K) Ltd, Fuelex Oil (K) Ltd, Jovenna (EA) Ltd, Galana, Mafuta products, National Oil Corporation of Kenya (KNOCK), Petro (K) Ltd and host of other smaller companies popularly known as the "independents" within the oil industry fraternity. The total number of oil companies are currently estimated to be over two hundred (GOK, 2003).

The industry is segmented structurally as shown below:

- Multinational oil companies i.e. Shell/BP, Caltex, Mobil and Total
- Big local companies – Kenol / Kobil and National Oil Corporation.
- The independents.

The major oil companies are consisted of the subsidiaries of the multinational oil companies and the big locals. Together the major oil companies control about 75% of the total market according to the statistics that are obtainable from the ministry of Energy while the rest enjoy the balance of 25% (GOK, 2002). The multinationals own and run most of the retail and trade outlets. The independents use the low price and investment strategy to penetrate the market.

Buyers in the petroleum industry can be segmented into three broad categories viz. industrial buyers, commercial buyers and consumers. Each customer segment derives different benefits from consuming oil. Industrial buyers use oil to run production plants, commercial buyers use oil for public transport, cargo transport etc. while final consumers use it to satisfy various non-commercial needs.

These different categories of buyers exert different levels of influence. The industrial and commercial buyer passes any price increases that are likely to offset his profit margin to the ultimate consumer of his products or services. In terms of relative power, the consumer has no influence on the prices of oil and has to take the set price by the oil marketers.

The market leadership is defined in terms of product and service quality. In terms of product and service quality, Total Kenya is the leader, followed by Shell/BP, then Caltex. In terms of mind awareness, it is Caltex leading, then, Shell-BP and Total comes third (Steadman Research, 2002).

According to ministry of Energy investment in retail business line is quite high, approximately KSh. 40 million, per station It is mainly a cash business.

This is sometimes supplemented with other incoming-generating but supporting activities such as convenience shops and cafeterias (Nyoike and Okech, 1999).

THREE

RESEARCH METHODOLOGY

3.1 Research design

The research was conducted using the survey method. This is basically because the nature of the research calls for analysis of primary data and also because there has not been any other research in the field of unrelated diversification conducted here in Kenya to form a source of secondary data. Other researches in the field of strategic management such as the one conducted by Isaboke (2001) and Wamathu (1999) used the same type of research design.

3.2 Population

The population of the study consisted of all the major oil companies that have substantial retail market share in Kenya of (over 10%). Respondents were drawn from the diversification managers and or strategy managers from five major oil companies, that is, Total Kenya, Mobil oil (K), Shell &.BP (K) Ltd, Kenol & Kobil (K) Ltd and Caltex oil (K)Ltd.

3.3 Data collection

3.3.1 Type of data

Primary data was used in the study. A structured questionnaire (see appendix II) was used. The questionnaire was administered by the researcher using a 'drop and pick' method. The questionnaire is divided into three parts, A, B and C. Part A comprises the general information about the responding company, part B consists of information on why the responding company is involved in the non-fuel business and part C comprises of information on the financial performance of the responding company in relation to diversification.

3.3.3.1 Data Analysis

The data collected was both quantitative and qualitative in nature and therefore descriptive statistics and non parametric methods such as chi-squared test were used.

CHAPTER FOUR

DATA ANALYSIS AND INTERPRETATIONS

This chapter presents the research findings from questionnaires completed by managers from five oil companies chosen for the study. The findings are presented mainly in frequency tables, cross tabulations and graphs.

4.1 Profile of the responding companies

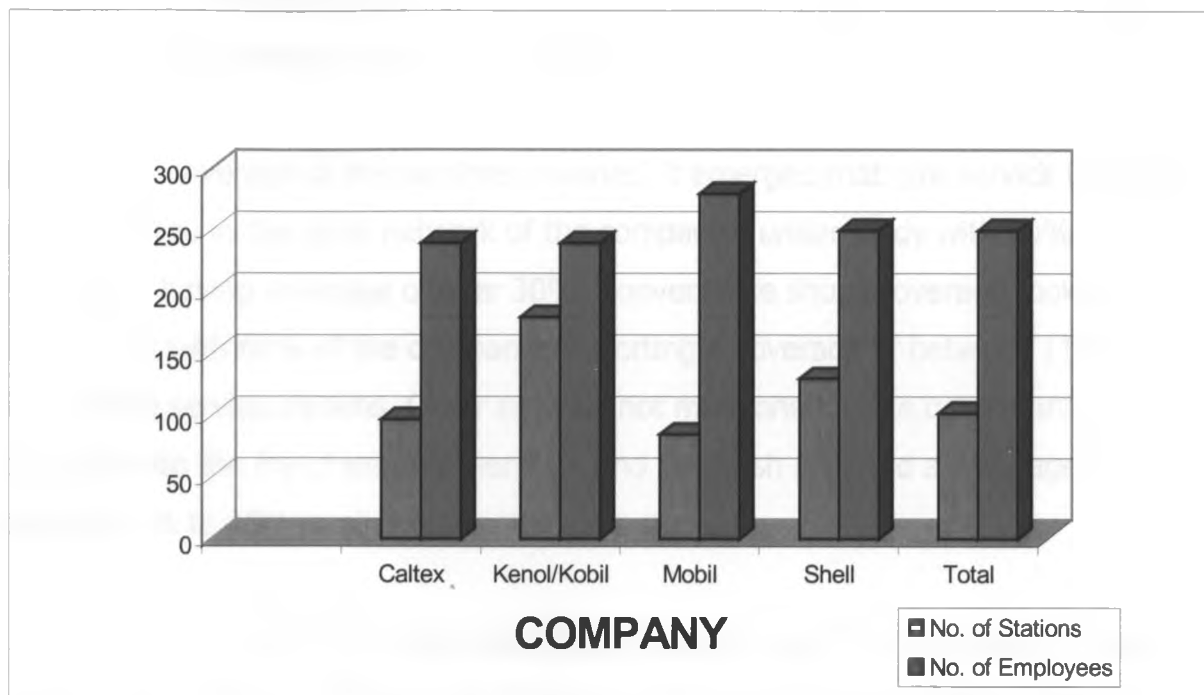
The study obtained five completed questionnaires, out of the targeted five, denoting a 100% response rate. Out of the five companies that were studied four were international while the remaining one was a locally owned.

Each of the five companies, had over two hundred employees; however, in terms of the number of outlets that each company has within its retail network, the results were quite diverse as shown in the table 4 below.

Table 4 Company Profile

Company	No. of Stations	No. of Employees	Ownership
Caltex	97	240	International
Kenol/Kobil	180	240	Local
Mobil	85	280	International
Shell	130	250	International
Total	102	250	International

Figure 1: Company Profile



4.2 The concept of non-fuel service

The concept of non-fuel service was examined by studying the provision of non-fuel products/service at service stations in five major oil companies in Kenya. Table 5 below indicates the various products/services that were studied and the extent of their coverage in the retail networks of the various oil companies.

Table 5 Non- Fuel Product Lines

VARIABLE	PRESENCE IN %AGE	ABSENT IN %AGE
Tyre Centre	100	-
Convenience Shop	80	20
Car wash	100	-
Franchised partnership	80	20
Cafeteria	40	60

From table 5 it is evident that the concept of non fuel product/service has gained root in most of the oil companies in Kenya. All services under study are actually being offered by almost all the oil companies.

In terms of coverage of the services provided, it emerged that tyre service is more widely offered in the retail network of the companies under study with 60% of the companies having coverage of over 30%. Convenience shops coverage took a second slot with 60% of the companies reporting a coverage of between 11% to 20% of the service stations. Other services not mentioned in the questionnaire together with the franchised partnerships and car wash reported a coverage of between 1% to 10% in all the oil companies studied.

It can therefore be deduced from the above statistics that the most prevalent type of non-fuel business in the service stations is the tyre services and convenience shops. In regard to the underlying reasons for the involvement in the non-fuel business, the desire to enter into other profitable arenas was reported as the most important reason by 80% of the companies studied. Other factors included the need to stabilise profits, pursuit of growth, customer convenience, reaction to competition and corporate strategy.

From the foregoing finding, it can be deduced that the key underlying reason for venturing into non-fuel business by the oil companies is mainly to improve on their profits.

In reference to the challenges that these companies encounter in the process of implementing this strategy, it emerged that management support ranked number one followed by financial budgetary allocation for these services.

It would appear therefore, the top management of these companies do not consider this strategy as a priority, hence limited support both in financial terms and morally. In fact, 60% of the companies studied allocate annual budgets of below 10 million for this endeavour.

Table 6: Association between Unrelated Diversification and station performance

VARIABLES	Calculated χ^2 95%	Df.	Standard Chi square value
Convenience shops vs. Increased volume.	2.222	2	5.991*
Convenience shop vs. increased customer convenience.	2.222	2	5.991*
Convenience shop coverage vs. improved station profitability	5.00	2	5.991*
Convenience shop coverage vs. improved dealer margins	6.662	4	9.488*
Convenience shop coverage vs. increased fuel sales linkage	10	4	9.488
Bar coverage vs. increased sales volume	.139	1	3.841*
Bar coverage vs. increased convenience	5.00	1	3.841
Bar coverage vs. improved station profitability.	0.83	1	3.841*
Tyre service vs. increased sales volume.	2.222	2	5.991*
Tyre service vs. increased customer convenience	2.222	2	5.991*
Tyre service vs. increased profitability.	5.00	2	5.991*
Other services (car wash) vs. increased sales volume	1.875	1	3.841*

TABLE 6 CONTINUED

VARIABLES	Calculated χ^2 95%	Df.	Standard Chi square value	Association
Other services vs. increased customer convenience.	1.875	1	3.841*	There is an association
Other services vs. improved station profitability	1.313	1	3.841*	There is an association
Other services vs. improved dealer margins	1.875	1	3.841*	There is an association
Other services vs. increased fuel sales	0.833	2	5.991*	There is an association

* $P \leq .05$

In all the variables studied there was an indication of an association of one type or another as deduced by use of the chi-square calculated and depicted in the Table 6 above. Table 6 shows that there is an association between unrelated diversification and the performance of the companies under study as measured by various performance indicators. The performance variables under study were increased sales, improved profitability, customer convenience and increased dealer margins. All, except bars and convenience shops had a positive association with reasons for engaging in unrelated diversification. The variables that depict lack of association, that is, the bars and the convenience shops, could be as a result of some companies not having those services in some of their stations.

4.3 Financial Performance

Of the companies studied, 80% have a targeted return on investment in the area of non-fuel sales. 60% of these companies have a targeted return of over 15%, denoting a very high demand on the strategy.

40% of the respondents felt that diversification into non-fuel business has had an excellent contribution to the overall performance of the business while another 40% felt that the contribution was just satisfactory, the remaining 20% felt that contribution was good enough.

80% indicated that there was an annual budgetary allocation, for the purposes of developing the non-fuel business within their retail outlets. However all, except one, have these allocations in excess of KShs 25 million. There was an indication that in all the companies that allocate funds towards this venture, there was an expectation that the funds so invested should offer a predetermined return on investment (ROI).

It was also evident that the most popular mode of earnings from the investment in non-fuel business was through rents paid by the occupants of the various facilities such as tyre centers, convenience shops and all other variables under study.

CHAPTER FIVE

DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary of findings and conclusions

The study sought to understand why major oil companies are venturing into businesses that are unrelated to their core business of vending petroleum products to include in their portfolio of offering, products and services that are completely unrelated to their core business. The data was collected from five major oil companies, that is, Total, Caltex, Shell/BP, Mobil and Kenol/Kobil. The objectives of the study were to determine why major oil companies are venturing into unrelated diversification by engaging in such product and service lines such as cafeterias, tyre centres, convenience shops among others. The second objective was to relate the financial performance of these companies to their levels of diversification.

From the findings, it emerged that contrary to what the diversification managers had indicated to be the underlying reason for oil companies to engage in non-fuel business, that is to enter profitable arenas, customer related phenomena such as convenience tended to take more prominence as an outcome from these undertaking. It can therefore, based on this premise, be concluded that the concept of unrelated diversification in the service stations lends itself more towards enhancing customer satisfaction than improving on the financial performance of the companies.

These findings are discordant with what is conceived in the boardrooms of these companies where decisions of strategic nature like this are normally mooted and deliberated upon before their eventual implementation.

The findings from this research, however, tend to agree with findings from other researches that have been conducted elsewhere in the field of diversification. Here

in Kenya, a study conducted by Sera Mwanzi (1992) on diversification in the insurance industry had similar findings. In her research, she found out that the difference in the financial performance of companies that exhibited, high, medium and low levels of product diversification, was not significantly different. This therefore meant diversification did not play a significant role in ensuring superiour performance of these companies.

Elsewhere, Montgomery and Wenerfelt (1988), reported a negative association between diversification and firm performance measured by Tobin's q. Their findings suggested that diversified firms may not have higher market share in their respective markets, than less diversified firms and that the strategy of diversification does not contribute to firm performance.

Managers seeking to steer their companies away from their core business, petroleum business in this case , need to understand that, this strategy as it were, does not necessarily lead to improved financial performance of the company. However, they need to understand that such a strategy may work very in a very competitive market whereby,marketers are jostling for market share and therefore the need to maintain their customers is very critical.

More robust strategies geared towards improving the performance of their company may however be built upon the premise of this research's findings. Based upon the reported contribution of such ventures towards the overall financial performance of the company, clear strategies could be crafted to steer the company into more profitable arena while still building on the strategy of maintaining customer relations which are very critical to the survival of any business.

It was evident from the findings that, there exists a positive association between services such as convenience shops, bars, tyre centres and others services and increased customer convenience and increased sales volume. These type of associations to a very great extent, go a long way towards improving the service station dealers profitability than the profitability of the oil companies themselves.

As indicated from the findings, the oil companies in most cases benefit from the rent that the occupants of the facilities pay to them and this therefore means that their earnings may only be limited to that level of the rent payable. However, it may be interpreted that customer satisfaction should be at the core of this strategy and any earnings from such ventures should be treated as supplementary income.

However what requires to be confirmed, through further research, is whether there is a way that this strategy could be used by oil companies to satisfy the need of improving their financial performance as it featured in the responses as being one of the key reasons why they venture into non-fuel business in their service stations.

5.2 Research recommendations

Emerging out of the findings of the study, were two clear areas that demand further research to establish a clear cause and effect relationship amongst certain variables.

First, it would be important to establish in detail why some services such as bars and convenience shops exhibited little or no association to the reasons for diversification. Whereas other variables under study exhibited a positive association the two variables had a different result and therefore this would call for further study.

Secondly, researchers in the field of finance could further study why the contribution to the overall turnover for the companies by the non-fuel venture was so little and whether allocating more funds to this end would lead to improved financial performance of the companies in the industry.

Finally, it would be important for researchers in the field of strategic management to conduct further research that would enable a comparison to be made between the performance of diversified oil companies as opposed to those that closely stick to their knighting and deal only with petroleum products.

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APPENDIX I: LETTER OF INTRODUCTION

June , 2003

Dear Respondent,

RE:MBA RESEARCH PROJECT

As part of the fulfilment of the requirement for the degree of Master of Business Administration of the University of Nairobi, the undersigned, who is a student in the faculty of Commerce at the University is required to undertake a Management Research Project.

Being one of the leading oil companies in the country, your organisation has been listed among others, for purposes of the intended study. For your convenience, a questionnaire has been constructed to enable you provide the information requested.

All responses will be treated in strict confidence, to be used only for purposes of this study, and in no circumstances will your name or that of your organisation be mentioned in the report.

Thank you for your contribution towards enhancing our insights of the concept of Diversification in the oil companies.

....

P.K. MWINDI **PROF. K'OBONYO**

MBA STUDENT **PROJECT SUPERVISOR**

*APPENDIX II:*QUESTIONNAIRE

SECTION A:

I. Date of interview: This .... day of ....2003.

II. Name of the company...

III. Name of respondent..

IV. Position held in the organisation...

V. Number of retail service stations countywide...................................

VI. Number of employees ....

VII. Is the company locally owned or international?................................

SECTION B:

1. Which of the following non-fuel services do you offer within your retail network of service stations?

- ☐ Tyre service
- ☐ Cafeteria
- ☐ Convenience shop
- ☐ Bar
- ☐ Car wash
- ☐ Franchised partnership e.g. Steers, Nandos etc
- ☐ Others specify ...., ..., ..., ..., ...

2. Of the stations in part A (V) above, please show the extent of coverage by the non-fuel services identified in question 1 above by ticking against the appropriate range provide below.

	1-10%	11-20%	21-30%	Above30%
Cafeteria	☐	☐	☐	☐
Convenience shop	☐	☐	☐	☐
Bar	☐	☐	☐	☐
Tyre service	☐	☐	☐	☐

Franchised partnership	☐	☐	☐	☐
others	☐	☐	☐	☐

3. Please score the following reasons for the decision to offer the above services according to their level of importance.

	Very important	Important	Not important
Means for attaining economies of scale	☐	☐	☐
To enter profitable arenas	☐	☐	☐
To stabilise profits	☐	☐	☐
For growth	☐	☐	☐
To increase customer convenience	☐	☐	☐
In reaction to competition	☐	☐	☐
Driven by HQ (Corporate Strategy)	☐	☐	☐
Others,specify	☐	☐	☐

4. Do you perceive there to be any linkage between non-fuel services and fuel sales in your service stations?

☐ Yes

☐ No

5. If yes to 4 above, please indicate the key linkages by ticking against the appropriate attribute provided below.

	Very important	Important	Not important
Increased fuel sales volumes	☐	☐	☐
Increased customer loyalty	☐	☐	☐
Increase customer convenience	☐	☐	☐
Improved station profitability	☐	☐	☐
Improved dealer margins	☐	☐	☐
Others specify	☐	☐	☐

6. What challenges has your company encountered in the process of implementing the non-fuel sales strategy in your service stations?

- [ ] Management support
- [ ] Development of skills and competence
- [ ] Design of the concept
- [ ] Additional cash requirement
- [ ] Implementation of the concept
- [ ] Controls
- [ ] Lack of relevant knowledge in the services

Others, specify....................., ..., ..., ...

SECTION C

1. Do have annual financial budgetary allocations for diversification development in your organisation?

- [ ] Yes
- [ ] No

2. If yes above, please indicate the level of budgetary allocation by ticking on the appropriate range provided below;
   (a) Below KShs 10m
   (b) Between KShs 11m and 15m
   (c) Between KShs 16m and 25m
   (d) Above KShs 25m.

3. Does your company have any targeted return on the above investment?

- [ ] Yes
- [ ] No

4. If yes to question 3 above, please indicate the by ticking the appropriate range provided below;

(a) Below 5%

(b) Between 5% and 10%

(c) Between 10% and 12.5%

(d) Between 12.5% and 15%

(e) Above 15%

5. In what form does your company collect the above returns. Please tick on the appropriate states as provided below;

	1-10%	11-20%	21-30%	Above30%
Rent	☐	☐	☐	☐
Royalties	☐	☐	☐	☐
Management fee	☐	☐	☐	☐
Operating profits	☐	☐	☐	☐

6. What is your company's annual turnover. Please tick against the appropriate range provided below.

a) Below 5b
b) Between 5b and 7b
c) Between 7b and 10b
d) Between 10b and 15b
e) Above 15b

7. What is the contribution of the earnings of non-fuel business to the above turnover? Kshs ....

8. Is the level of contribution in item 7 above :

☐ Excellent
☐ Very good
☐ Good
☐ Satisfactory

☐ Unsatisfactory

9. How would you compare the profitability of the stations with non-fuel fuel business to those with only fuel services. Please tick on the appropriate attribute provided below.

   ☐ Excellent
   ☐ Very good
   ☐ Good
   ☐ Satisfactory
   ☐ unsatisfactory

NOTE.

The above information shall be treated with utmost confidence and shall not be divulged to any other party without seeking prior authority from you.

Thank you for your co-operation.