RESPONSE STRATEGIES OF SMALL AND MEDIUM AUDIT FIRMS IN NAIROBI TO REGULATORY CHANGES AFFECTING THE AUDIT INDUSTRY

By Richard Maina Kamaml

A Research Project Submitted In Partial Fulfillment of the Requirements f o r tho Aware of the Dogree of Masters of Business Administration, University Of Nairobi

November 2008

DECLARATION

I his research project is my original work and has not been submitted for a degree in this or any other university.

Signed. Dale...

Kuimimi Richard
D6I/IVK564/05

I Ins rcscarch project has been submitted for examination with my approval as a University supervisor

Signed.......................... ..19/11/2008

Dr. Mnrtin Ogutii
Department of Business Administration
School of Business
University of Nairobi

DEDICATION

I dedicate this project to my dear Polly rose for all her support all through this worthy cause.

ACKNOWI.F.DC.KMKNT

I would like 10 extend my gratitude to my supervisor. L)r Ogutu for his support, guidance and encouragement all through this paper. Professor Aosa deserves special mention for his invaluable guidance through the task

to the respondents, ICPAK members of staff and all my colleagues lor all their support. (iod bless you all.

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1.1ST OF AHHKKVIATIONS

AQA.........Audit Quality Assurance

ICPAK.......Institute of Certified Public Accountants of Kenya

I-CSAFA.... F.astern (entral & South Africa Federation of Accountants

PwC..........Pricew atcrhousecoopcrs

ABSTRACT

The laci thai organizations' actions are related to what happens in their environment cannot IK* downplayed. I he evolution of the phrase 'strategy' has its origins in man's desire to read favorably to the changes occurring in his external environment. Many organizations' activities are also geared towards maintaining a 'strategic fit' or 'line of best tit' with their environment which is known to be ever turbulent. Audit firms are no different and their environments too are not known to be static. As such, they have to regularly re-adjust their strategies to enable them lit in within their environments.

the audit industry one of the industries that is known to be growing rapidly across the globe In Kenya, the industry is regulated by the Institute of Certified Public Accountants of Kenya (I('IWK) and currently has over 1000 person authorized to practice. This number has been growing at an average annual rale of 10%. I lie importance of this industry to an economy cannot be gainsaid Auditors help install confidence in the financial statements by ensuring that the information presented therein is true and fair.

Recent event across the globe have seen various large corporations across the globe collapse; events which in one way or another have been attributed largely to the omission or commission by the auditors. In the United Stales, we have had the collapse of Unron, in Italy we have had the collapse of Parmalat while in Kenya, we have had the collapse of Nyaga Stockbrokers.

I he downturn of these events has been thai the regulators have zeroed in on the activities of the auditors lo ensure that they play bv the rules. Various legislations have hem passed all with the aim of regulating this industry. I his turbulent environment within which auditors continue to operate has been a concern to many stakeholders and therefore it was deemed neccssary to conduct a research to establish how auditors arc coping when faced with such turbulence. I he study's objective was 10 analyze the various approaches used by auditors lo combat the forces that threaten their existence This was aimed at analyzing the various strategic responses auditors would employ to remain afloat in light

of the turbulent environment within which they operate. The output from the research will assist existing and upcoming auditor*, by guiding them on how best to survive in turbulent times and guide policy makers in developing favourable policies that will benefit the audit industry as a whole.

Hie research was conducted by administering a questionnaire to 16 small and medium sized audit firms focusing on tl»e audit partners and senior managers. I he questionnaires sought to find out general information on the organization, how they rate various environmental factors and how they responded to the turbulent environment.

From the findings, it was evident that all lirms have responded both operationally and strategically. Some «>f the operational strategies include training of staff, marketing, research and development amongst others, Strategic responses have involved product development, changes in systems and processes, culture shirts among other responses.

The Study also points to the fact that most firms are more reactive than proactive to changes. I he study will assist policy makers respond favorably to criticism pointing their way I imitations encountered in the course of the research included nbsentee managing partners und over-delegation of responsibilities on the pari of senior personnel in audit firms. Some respondents were of the opinion that some information was too confidential to share with the researcher.

Addition.il areas for research have also been identified. Key among them would he the need to undertake a study to identity the various strategics employed by the clients to changes in their external environment Similar studies need to he undertaken in other sectors of the economy.

CHAPTER ONE: INTRODUCTION

I.I Hack^roiiud

Organizations depend on their external environment for survival The link between the organization and its environment depends on how stable such forces are to the institutions immediate environment. An organizations* external environment includes economic factors, social cultural, political, demographic* and technical factors while its internal environment includes organic systems, policies, resource capability and corporate culture. (Pearce & Robinsons. 1977)

Audit firms all over the world as is the case with other professions, are governed by a set of rules and regulations which they arc required to adhere to if they ore to remain in existence. Over the last one decade or so. the audit profession has been struggling to justify its existence in the wake of the numerous scandals happening in all corners of the globe. These scandals have seriously dented the image of the profession which in turn has resulted in stringent regulations being passed by relevant authorities to rein in rogue auditors.

In Kenya the scenario has not been any different given that we have had our share of sennduh such JIS the F.uro-bank saga, collapse of Ucluimi Supermarket to name but a few. Although u myriad of factors can be attributed to failure of these organizations, the actions/inactions in the whole scheme of things is what many players in the industry arc questioning. Ibis paper seeks to review the strategies auditors are employing in light of these stringent rules so as to remain afloat.

I.I.I Response Strategics

Most of the scandals thai have been witnessed globally have largely been attributed to negligence or in some instances, sheer incompetence on the part of the auditor. In Italy we have had the Parmalat scandal, in U S we have had the Enron scandal. In Kenya, the collapse of Nyaga stockbrokers is still very Ircsh in our minds. In an effort to minimize the repeat of such events, governments worldwide have passed into law stringent requirements that auditors have to adhere t«». if they are to continue practicing. In the U.S for example, the Sarban-Oxlcy Act was passed in 2002. in United Kingdom, they have introduced n new Financial Reporting council and under the European Union, the law on regulation of auditors has been reviewed. In Kenya, the Institute of Certified Public Accountants of Kenya (I.CM'A.K) which is the body mandated to regulate auditor* has introduced a programme that entails constantly reviewing work done by the auditors. The Companies Act. Cap 18h is currently under review and it is expected to cause monumental changes in the way auditors carry out their operations.

The impact of these new rules has been immense especially on the work done by auditors Many have been forced to merge; others have been known to close down, while others have sought international affiliation so as to keep themselves abreast of these changes and be in a position to respond favorably to these challenges. In some instances, audit linns have been forced to bring on board expertise while in others, loosely knit associations have been formed. In Kenya the trend has been the same. Ihe market is largely dominated by the large four (4) firms. (I rnst & Young. PriccwatcrhouseCoopcrs Uelotttc and KPM(i). I he four firms audit 00% of listed companies while the rest (10%) are audited by medium tier firms.

Report?, from ICPAK indicate that some firms have shut down their operations following the introduction of the Audit Quality Assurance Programme. Many others have had to revamp and sometimes shift their strategics to incorporate functional strategics such as marketing, new product development, human resource strategies, financial strategies, legal strategies and information technology linked strategies. Other firms have be**1 forced to introduce a radical shift in ihcir operations which has necessitated a twin shift in their operational strategics.

Some firms on the other hand have redone their corporate strategics in some cases leading to a complete shin from the audit market. Ihc> have ventured into new markets altogether

1.1.2 Audit Regulations

Prior to the financial scandals that have rocked the world over the last one decade, the audit profession was largely a self regulating profession l"he effect of the scandals as highlighted earlier has been to focus the spotlight on the work performed hy the auditors. Various countries have introduced different pieces of legislations all aimed at enhancing more vigilance on the work done by auditors In tlie U.S for example, we have had the enactment of the Sarhan Oxley Act. while the supreme accounting body globally, the International Federation of Accountants (II'AC) has made the program on audit quality assurance mandator)' for its members, which is where ICPAk falls in

In the U.K. prior to the pre Companies Act of 1989, audit work was restricted to qualified accountants while professional bodies investigated complains and effected discipline on its errant members I lowevcr. the post Companies Act period has seen the emergence of a professional body licensing system and audit monitoring visits. In Kenya, auditors are required to comply with a number of regulations. The governing legislation is the Companies Act. Cap 4X0 and the Audit Quality Assurance programme by ICPAK which on the overall reviews work done by auditors reviewing all sectors.

Other subsidiary legislations that have come up or have been improved over the Inst one decade include Retirement Benefits Authority regulations for auditors who audit pension "chemes and provident funds. Capital Market Authority and Nairobi Stock Exchange regulations for auditors auditing listed companies and Ministry of Cooperative regulations for auditors auditing cooperative societies

1.1.3 Small UlKI Medium Audit Firms in Nairobi

I he audit profession 111 Kenya can he broadly classified as consisting of three categories uf audit firirs: these are large firms, medium firms and small firms. In total we have 565 audit films in the country out of which 4 can he categorized as large. 30 of them can he classified as medium and the rest (over fall in the category that can be referred to as small

I he basis of classifying audit firms is normally, the number of partners that a firm has All small firms are run by one partner while medium si/ed firms have on board between 2-5 audit partners. Large linns on the other hand have more than 5 partners. The other basis of classification is market share, Although data on this not readily available, it is common knowledge that the large five firms control ᵗ>5°u of the companies listed on the Nairobi Slock Rxchange. The remaining of the market is handled by the medium sized firms while the small audit firms cater for the rest of the market consisting of small and medium si/ed companies.

What needs to be appreciated at ibis junctuic is that due to inherent structural weaknesses, small and medium audit firms faced a lot of challenges during the prc-regulation era and continue to do so now- more so in the post regulation era. Some of the challenges they lace include lack of resources including knowledge based networks, a depressed market, high turnover of staff, among many others. Some of the challenges are not »o pronounced in the large firms as they are in the small and medium si/ed firms.

I argc firms have access to international networks of auditors whereby they are able to access resources and more so relevant knowledge to enable them elTcctively carry out their mandate They command a good share ol the market comprising of blue chip companies and are able to attract and retain highly qualified and experienced stall'. Work done by large firms is highly computerized making their operations more effective and efficient However, for majority of the small and medium si/ed firms, most of their operations are largely manual making their work sluggish, inefficient and sometimes expensive.

1.2 The Research Problem

This research will generally rotate around the linkage between organizations and the environment. Organization* depend on their environment for their survival and the linkages between these two entities arc usually very strong. Organizations will always try to align their strategies to be in tandem with the turbulence occurring in the external environment. Audit firms are no different from other organizations. I heir environments are equally as turbulent and as such they have to employ appropriate strategies if they arc to cope with it.

At the end of this study, the reactions by medium and small sized audit firms to changes occurring in their external environment will clearly IK- evident. I he study will focus more on regulations as the stimuli from the external environment of these firms and seek to find out which strategics are being employed by these firms to achieve u 'strategic fit' with their environment.

I he fact tlut small and medium sized audit firms are lacing imminent collapse due to the stringent regulation regimes springing all over is reason to cause everyone to gel concerned The importance of audit an economy is critical. Auditors are able to provide greater assurance to the various users of financial statements via the services they offer thereby providing stability in the markets. The population of audit firms in Kenya has been growing over the last one decade by 111 average annual rate of 10%. If not well managed, the rules and regulations being formulated to check 'rogue' auditors may end being counterproductive.

I he change in regulations has imposed serious constraints on the way auditors perform their duties To continue operating as required, they will be forced to incorporate a new way of doing things. Coupled with that, other aspccts of the external environment too have not been static. ITic political, economic, legal and social environment too have been g«»ing through rapid changes which has required that the audit firms go back to the drawing boards to rc-stratcgize on how to cope with these changes. This study will seek to gain an understanding of the regulatory changes that have come into plav and also understand ihe strategies employed b\ these auditors to remain in business amidst these challenges. Strategies employed by auditors to changes iit regulations as Held of Study can he said to he a relatively new. field given that it has attracted few scholars.

Changes in regulations have attracted a lot ol interest from the scholars. Ochumbo (1982) analyzed the changes in the Income tax regulations since 1973. Njugurta (2006). on the other hand analyzed the extent of compliance with CMA guidelines. Other scholars who have done studies on this area include Kinya. (1983) who conducted a study on adherence to mandatory financial disclosure requirements by companies listed on the bourse.

Small and medium audit firms have attracted scholars. Muragu (1981) conducted a study on the need and scope of independent audit while Wambui (2006) on the other hand conducted a study on the usefulness of auditor's report in investment decisions. Other scholars who have conducted research on responses by various non-audit organizations to changes in the external environment include: Njorogc. 2006; I eseketi, 2006; I alampaa. 2006; Kimani. 200ft; Muttinga, 2006)

None of the scholars have conducted a study on the responses by auditors to regulatory changes necessitating the need to undertake this research given that a knowledge pap exists. Ihe study will seek to gain an understanding of the response strategies employed by auditors to remain in operation in light of the turbulent regulatory environment.

Ihe research question to be addressed is:

(a) What are the response strategies employed b\ small and medium sized auditors to remain afloat in light of the turbulent external environment?

1.3 Research Objective

To determine the response strategics of small and medium audit firms to regulatory changes

1.4 Importance of the Study

It is envisaged that data from this study will IK* shared with the hodies regulating the accounting profession in Kenya (ICPAK) and Rastern and Central Africa I-.astern Central South Africa federation of Accounlants-(IiCSAIA) w ith the aim of encouraging them to come up policies that will ensure the survival of the small and medium si?ed practitioners. Reports of this study will help influence lawmakers to amend laws regulations that may work negatively against the objectives within which these regulations were set for.

It is also envisioned that the study will assist upcoming auditors learn from the experiences of the seasoned auditors on how best to respond to challenges from the external environment and more specifically, rules and regulations governing them

CHAPTER TWO: LITERATURE REVIEW

2.1 OrRuniMlion* unil Environment

The Wikipcdia online dictionary defines an organization as a social arrangement which pursues collective goals, which controls its own performance and which has abundance separating it from its environment It can he described as a collection of structures and mechanisms of social order and co-operation governing the behavior of a set of individuals. Institutions are identified with a social and permanence, transcending individual human life and intentions, and which the making and enforcing of rules governing cooperative human Iwhavior. Lnvironmcnt may refer to the physical biological and social surroundings of an entity. In the biophysical context, the environment is the biological and physical factors along with their chemical interactions that affect an organism In other contexts, environment may also be used to refer to the immediate surroundings, to a milieu or to the environs within a system or topic, for instance computer science.

Organizations exist in a complex commercial, economic, political, cultural and social environment. I his environment is not static Hut is under constant change which invariably affects the organizations that operate in it. These environmental changes arc more complex to some organizations than in others. I or survival, an organization must maintain a strategic fit with the environment I lie environment is an important and nn organization has to respond to its dynamism, heterogeneity, instability and uncertainty. (rhomas. I«XS7)

In addition, the competitive environment has been and continues to be driven by technological innovation, globalization, competition and extreme emphasis on price, quality an«l customer satisfaction. As a result, organizations must continually create and innovate in order to stay relevant and be successful \ sustainable competitive advantage is achieved when there is u strategic fit between the external and internal environment.

Suave. <2<K)2) noted that the environment is a critical factor for any organizations* survival and success. It should be seen as a biosphere in which individuals and organizations l>vc o v c r die long term and as a community project in which it is actively involved

Ansoff & McDonncI, (1990) stated 'hat the changes in the organizational behavior are necessary to ensure success in the transformation of the future environment. They noted that such changes which touch on organizations strategy and capability need to be systematically identified through the siratcgic success hypothesis which states that a firms performance potential is optimum when the aggressiveness of the firms' strategic behavior matches the turbulence of its environment and the responsiveness of the firms' Capability are supportive of one another. When any of these three aspects arc lacking, then the lirms' performance potential will be less than optimum.

The real time is response the specific action that is chosen and implemented in order to re-align the organizations' strategic aggressiveness to the environmental turbulence
Porter < 1985) explains the concept of strategic fit lie states that firm's create and sustain competitive advantage because of the capacity to continuously improve, innovate and upgrade their competitive advantage over time Upgrading is the process of shilling advantage through out the value chain to more sophisticated types and employing higher level of skill and technology

2.2 Ucgulatnry Fnvlronmcnt

According to Trairatnirakul (1998). regulations are normally set up in accordance with four main principles namely• fairness, accountability, transparency and responsibility.

2.2.1 Fairness

Protection of shareholder right is a primary aim of regulations. Shareholders specially minority ones need to he assured that their assets are protected against fraud, managerial or controlling shareholder self dealing and insider wrongdoing. In this regard, most regulating authorities closely monitor ami investigate suspicious cases of management wrong doing and insider trading and consequently impose both civil and criminals actions against wrongdoers.

2.2.2 Accountability

As the agency problem tends to divert managerial incentives from being accountable to shareholders, regulations could play a role in aligning the interests of management with those of shareholders. I he primary measure is to create the appropriate structure of the board of directors equipped with check and balance mechanisms to monitor management, guard against fraud and alleviate other agency problems. One such structure is the audit committee which helps in overseeing a company's financial information, review of internal control procedures and ensuring the companies comply w ith all relevant laws.

2.2.3 Transparency

The disclosure of accurate and comprehensive information about corporate performance is vital to promote investor confidence and marketing efficiency. Provided with sufficient and timely information, investors incur lower cost in evaluating investment alternatives and monitoring the performance of companies in their portfolios. This is o!" benefit to the investing public because they will be in a position to rely on the financial information authenticated by auditors to make belter decisions. Market prices imperatively incorporate complete information and reflect the actual picture of a company. Investors therefore have more confidence and are willing to commit greater capital to the more transparent market International Standards on Auditing is the minimum standard requirement for the preparation of financial statements lor listed companies, which enhances comparability of financial performance between companies in different countries.

2.2.4 Responsibility

Businesses have responsibilities to not only shareholders but also other stakeholders such as creditors, government and society. Regulations therefore need to ensure that they ahidc by all relevant laws and rules including those regaoling tax. environmental protection, health and safety. Ilence social responsibility has to be put into account as a criterion for granting approval of public offering and of listing on the exchange

fhough the regulatory requirement is necessary to establish good governance, it has its limitations. The formal enforcement is often costly, time consuming and inflexible. Besides, it may be met by resistance from the regulated. Thus, a 'voluntary approach' is at limes used as a complementary means to promote good governance.

2.3 Audit Regulations

I he objective of an audit of financial statements is to obtain evidence which the auditor will be able to express an opinion as to whether the statements are prepared in accordance with an acceptable financial reporting framework as identified in the International l-inancial Reporting Standards. Financial statements are ordinarily prepared and presented annually and should meet the specific needs of users such as shareholders, employees, suppliers, employees and other stakeholders.

Hoolcy. (2000) notes that in the same way as a patient can trust his doctor to abide by the Hypocratic oath, a client can rely on his auditors to follow the procedures and related guidance laid out in the standards.

For many organizations, the financial statements need to be audited in accordance with International Standards on Auditing (ISA s) Ihe auditor's opinion enhances credibility of financial statements by providing a high but not absolute level of assurance. A key regulation governing auditors' conduct is the Accountants Code of Ethic. I he ethical principles that govern the auditors professional responsibilities are independence, objectivity, integrity, confidentiality, professional competence and due care, professional behaviour and technical standards. Ihe Code of Ft hies prepared by IFAC ethics (ommittee provides a framework to assist accountants to identify, evaluate and respond to threats of compliance with fundamental principles of integrity and objectivity.

In line with changes in the business environment over the last decade over the last decade, there have been significant changes in the audit practices and rules. Maina. (2004) The move has been away from substantive testing towards more of compliance testing and analytical reviews. Auditors arc expected to make use of the knowledge they have gained while performing audit to provide feedback that will help clients improve their businesses I hese new requirements require a high level assurance of internal controls.

I he move towards paper free technology driven audits means that more and more reliance is being placed on computer assisted audit techniques whereby audits arc driven by computer based programmes. Gatu, (2(M)7) notes that auditors are already beginning to offer attestation ser\ices on web content Other services will follow in light of economic ami real time banking. The auditor's role is expanding. Public demand is persuading companies to become more transparent. In addition, internet is encouraging wider circulation I he trend is towards producing more and more information all of it requiring independent verification, flic environment under which audit services are being offered continue to change and it is only prudent for auditors to change with it if they are to remain relevant.

2.4 Organizational Responses in Environmental Changes

In the context of turbulent business environments strategic management plays a key role in facilitating the deployment of n linn's resources in an efficient manner to facilitate the optimization of its long-term performance. Implementation of strategics bccomcs critical especially in light of the increasing competition and complexity of today's world that can make it extremely difficult to assess and take advantage of opportunities open to a firm, liennet. (1999) Due to the changing environment that brings with it increased competition for the limited resources and market share, implementation of new competitive strategies is critical. I his helps a lirm to find less threatening ways of doing business, keep customers loyal and develop strategies that enable the firm to seize strategic initiatives and maintain a competitive edge in marketing. (Mac Millan 1998. Porter, I948»

In many large corporations there arc several levels of strategy. Strategic management is the highest in the sense that it is the broadest, applying to all parts of the firm It gives direction to corporate values, corporate culture, corporate goals, and corporate missions. I Jnder this broad corporate strategy there arc often functional or business unit strategies.

2.4.1 functional strategics

I unctional strategies include marketing strategies, new product development strategies, human resource strategies, financial strategies, legal strategies, supply-chain strategics, and information technology management strategies Porter. (1998). The emphasis is on short and medium term plans and is limited to the domain of each department's functional responsibility, I ach functional department attempts to do its part in meeting overall corporate objectives, and hence to some extent their strategics are derived from broader corporate strategies.

Marketing strategies may differ depending on the unique situation of the individual business. Ohinal. (1983). However there are a number of ways of categorizing some generic strategies- A brief description of the most common categorizing schemes is presented below: Strategies based on market dominance - In this scheme, firms arc classified based on their market share or dominance of an industry. Typically there are three types of market dominance strategies which include a leader, challenger and a follower

Porter. (l«>80) describes generic strategies based on the dimensions of strategic scope and strategic strength. Strategic scope refers to the market penetration while strategic strength refers to the firm's sustainable competitive advantage and includes product differentiation and market segmentation.

Johnson and Scholes. (2002) on the other hand describe innovation strategies as those that deal with the firm's rate of the new product development and business model innovation They question whether the company is on the cutting edge of technology and business innovation. I here arc three types which include pioneers, close followers and followers.

Under growth strategies, the question that is asked is. "I low should the firm grow?" There are a number of different ways of answering that question, but the most common gives four answers that a re provided include horizontal integration, vertical integration, diversification or intensification. Mint/berg, (I*>S5).

Many companies feel that a functional organizational structure is not an cflkient way to organize activities so they have reengmeered according to processes or strategic business units (called SBUs). A strategic business unit is a semi-autonomous unit within an organization. It is usually responsible for its own budgeting, new product decisions, hiring decisions, and price setting. Thompson, (1997). An SHU is treated as an internal profit centre by corporate headquarters. Each SBU is responsible for developing its business strategics, strategies that must be in tune with broader corporate strategies.

2.4.2 Operational Strategy

I he "lowest" level of strategy is operational strategy. It is very narrow in focus and deals with day-to-day operational activities such as scheduling criteria It must operate within a budget but is not at liberty to adjust or create that budget. Operational level strategy was encouraged by Peter Drucker. (1985) in his theory of management by objectives (MHO). Operational level strategics are informed by business level strategies which, in turn, arc informed by corporate level strategics. Business strategy, which refers to the aggregated operational strategies of single business firm or that of an SBU in a diversified corporation, refers to the way in which a firm competes in its chosen arenas. Andrews, (1971)

2.4.3 Corporate strategy

I orporatc strategy, then, refers to the overarching strategy of the diversified firm. Such corporate strategy answers the questions of "in which businesses should we compctc?"

am! "how docs being in one business add to the competitive advantage of another portfolio firm, as well as the competitive advantage of the corporation as a whole?"

Since the turn of the millennium, there has been a tendency in some llrms to revert to a simpler strategic structure. Mint/herg. (1985) this is being driven by information technology. It is felt that knowledge management systems should l>e used to share information and create common goals. Strategic divisions are thought to hamper this process. Most recently, this notion of strategy has been captured under the rubric of dynamic strategy which portrays tirm strategy, both business and corporate, as necessarily embracing ongoing strategic change, and the seamless integration of strategy formulation and implementation. Ohrnal. (I'>83) Such change and implementation are usually built into the strategy through the staging and pacing facets.

2.5 Strategy Types

Johnson and Scholes. (2W)2) defines strategy .is the direction ami scope of an organization over the long term, which achieves advantage for the organization through its configuration of resources within a changing environment and to fulfill stakeholder expectations. An organization matches the resources and activities to the environment to achieve strategic lit.

Strategic fit is developing strategy by identifying opportunities in the business environment and adapting resources and competencies so as to take advantage of these. The development of the concept of strategy as an explicit tool for making economic and social decisions in organizations is fairly recent in both management theory and practice and is traced to the post world war II period (Holer. I'>79).

Alter the world war II. the vast majority of US companies diversified into other industries as well as expanding overseas. Diversification resulted in additional complexity and hence the creation of multidimensional structure. Increased roles of environmental change and competitive pressure added the complexity of managing lending US companies. I his also led to the development of the concept of corporate strategy as a tool for integrating firms' diverse functional area policies. I)rucker, (1046) through his book set the strategy hall rolling, lie looked at general motors (CiM) General Electric (GE), international business machines (IRM) ami scars Roebuck.

Chandler (1962) highlighted the close relationship between strategy and structure. He stated thai (he role of lite salaries manager and technician was vital and talked about the 'visible' hand According to chandler, strategy is the determination of the basic long-term goals and objectives of an enterprise, and the adoption of courses of action and ihe allocation of resources for carrying out the goals. On the other hand, structure is the design of organization through which the enterprise is administered Corporations should develop their strategy before deciding their structure

Quinn. (I9R0) identifies strategy as the pattern or plan that integrates organizations' major goals, policies and action sequences into a cohesive whole. A well formulated strategy helps to marshal and allocates an organizations resources in a unique and viable posture based on its relative internet competencies and shortcomings, anticipated changes in the environment and contingent moves by intelligent opponents.

Mint/berg. (1975) defines strategy as a plan or some sort ol consciously intended course of action, a guideline to deal with a situation Strategy as a play really is just a specific maneuver intended to outwit an opponent or competitor. Strategy is a pattern-specifically in a stream of actions (Mint/berg and Waters, 1085) according to this definition, strategy is consistency in behaviour, whether or not intended-strategy is n position-specifically a means of locating an organization in an environment. This means that strategy is the mediating force or match between organizations and external context. Strategy is a perspective, its content consisting not just of a chosen position, but of an ingrained way of perceiving the world. I his definition suggests that strategy is a concept.

Porter. (1980) states that strategy is basically about competition and the means by which [a]n organization tiies to gain competitive advantage lie further states that a competitive strategy is « broad formula for how a business is going to compete, what its goals should he ami what policies will he needed to carry out these goals. According to Ohmal, (1983) the only purpose of strategic planning is to empower an organization to efficiently gain a sustainable competitive advantage over its competitors.

Andrews, (1971) defines corporate strategv as the pattern of major objectives, purposes or goals and essential policies and plans for achieving those goals, stated in such a way as lit define what business the company is in or is to be in and the kind of company it is to be According to Ansoff. (|99<». a strategy is a set of decision making rules for guidance of organizational behaviour. The first being yardstick by which the present and future performance of the lirm is measured. The quality of these yardsticks is usually goals. I he second is rules for developing the firm's relationship with its external environment. What product, technology the llrm will develop, where and to whom the products core to be sold and how the firm will gain advantages over competitors. This set of rules is called the product market or business strategy. I he third is rules for establishing the internal relations and processes within the organization, this i$ frequently callcd the organizational concept Ihe fourth are the roles by which Ihe firm conducts its day to day business called operating policies

Strategy is a potentially very powerful tool lor coping with the conditions of change which surround the firm today but it is complex, costly to introduce or/and use. Nevertheless, there is evidence that it more than pays for itself. A strategy is an action a company takes to attain one or more of its goals Hill and Goeth, (1999) for most if not all organizations, an overriding goal is to achieve superior performance. Thus a strategy can orten be defined more precisely as an action a company takes to achieve superior performance

Ihompson, (1997) states that strategies arc means to ends and these ends concern the purpose and objectives of the organization. I hey are things business do. the paths they follow and the decisions they lake, in order to reach certain points and levels or success. According to Thomson and Strickland. (1992) an organizations strategy consists of the moves and approaches desired by management to product* successful organization performance. Strategy in effect is management's game plan for the business. Managers develop strategies to guide how an organization conducts its business and how it will achieve its target objectives. Without strategy, there is no established course to follow, no roadmap to manage by and no cohesive action plan to produce the intended result.

Rumelt et al (1985) states that strategy is about the direction of organizations, and most often, business firms, firms if not all organizations are in competition. Competition for factor inputs, customers anil revenues to cover the costs of their chosen manner of surviving.

2.6 Strategic Decision Making

Strategic Decision Making in any organization is very important because it distinguishes the characteristics of strategic management According to Henry Mintzberg (1973) the most typical approaches of strategic decision making arc:-

2.6.1 Kntreprcneurial Mode

Strategy is made by one powerful individual. The locus is on opportunities, problems arc secondary, (I'earce ami Robinson, 1099)
argue that strategic responses are a set of decisions and actions that result in formulation and implementation of plans designed to achicve a firm's objectives. Senior (1997) notes that's there are various catalysts to organizational change such as restructuring. These catalysts may include the purchase of new IT equipment, business process intensification/extensions, redesign of group jobs, staff right sizing and subsequent staff cat backs as well as redundancies.

Ansoll and Mc Donnel (1990) note that strategic responses may take many forms depending on the organization's capability anil the environment in which it operates. Well developed and targeted strategic responses are formidable weapons for the firm in acquiring and sustaining a competitive edge, These strategic responses include restructuring, marketing, IT. culture changes (Kiptugen, 2003)

2.6.2 Adaptive Mode

Sometimes referred to as "muddling through" This decision making mode is characterized by reactive solutions to existing problems, rather than a proactive search for new opportunities. Strategic management is an innovation.il term that presupposes the existence ol strategic programming of the resources and activities of an organization for the achievement of specific goals w ithin the framework of a given undertaking. Rumelt et al. (I«>KS). Under the adaptive mode, an organization reacts to the environment by-developing strategies to deal w ith scenarios in an as it happens* basis.

2.6.3 Planning Mode

This decision making mode involves the sy stematic gathering of appropriate information for situation analysis, the generation of feasible alternative strategies, and the rational selection of the most appropriate strategy. In Kenya, it looks like all these approaches are applicable in public institutions and sometimes it is referred to as logical instrumentalism, while private institutions, entrepreneurial mode and planning mode are often used.

Strategics are valuable only if they arc effectively translated into action. This execution needs to be controlled and evaluated for successful implementation of strategy and adjustment to changing conditions. Plans arc more likely to be implemented successfully when there is a close alignment and linkage among the business strategy, operating plan and such established systems as budgets and rewards. Judson (19%). According to Grant (?000) survival and success occurs when an organization creates and maintains a match between its strategy and environment, and also between its internal capabilities and the strategy . The environment is not static but turbulent, discontinuous and uncertain.

Strategic responses call lor organizations to change their strategies to match the environment and also to transform or re-design their internal capability to match this strategy. It involves identifying changes taking place in the environment and establishing how they affect the organization and its activities. It also entails determining resources and competencies of the organization and ascertaining whether these provide special advantages or yield new opportunities.

Strategy decisions making/responses Ansoff and YloDonnel < 1990) note that strategic response involves changes to the organizations strategic behaviour. Such responses may take many forms depending on the organizations capability and the environment in which ii operates. We 11-developed and targeted strategic responses are formidable weapons lor a (irm in acquiring and sustaining a competitive edge. I he strategic responses include new products, new markets, new processes, new services and new strategics for attacking the markets.

Markets penetration refers to gaining market share for the business involved and usually entails fundamental changes to the competitive position. Mwarania (2003) Market penetration can be achieved through differentiation or cost leadership.

Porter < I«>85) advocates that differentiation is achievable by either becoming more individual in performing its existing activities or by reconfiguring its value chain in such a way that enhances it's individually. However, the organization must control the cost of differentiation so that it translates into superior performance.

Market development involves the business in exploiting products in new areas. This option means that the organization is retaining the security of its competencies in the development of new market areas. Product development is an option for product innovation for existing markets. This may involve new product types desired from technical development or adaptations and improvements. Product development may be v'lal if ihc enterprise is to survive. (Njorogc. 2006)

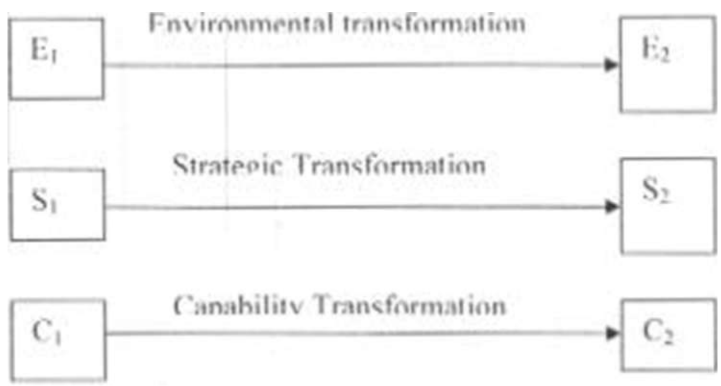
Diversification implies that the organization will develop into areas beyond the current products and markets at the same time. The two types of diversification arc related and unrelated. Related diversification moves the enterprise from existing markets and products while remaining within the same industry and encompass vertical and horizontal integration into quite different industries which probably bear little or no relation to each other

According to Warcgi (2004). the insurance industry has responded to the external environmental changes through such initiatives such as new product development, development of distribution channels, diversification, organizational restructuring, investment in human resources, customer service improvements, adoption of information technology and lobby the government through association of Kenya insurance (AKI).

According to Mwarania (2003). Kenya Re has responded to changes in the environment in many ways I here has been deliberate and focused staff training programmes developed. Retrenchments were done three times to rationalize staff Investments were done in real estate to generate rental income and underdeveloped land acquired for future speculative sale. Technology lias been embraced including computerization and creation of a website. Financial investments have been spread out between short and long term ones Mugamhi (20(H) established that as a result of the economy's progressive decline and liberalization, tourist hotels in Nairobi have responded by restructuring their activities, marketing, cost management and outsourcing of non-core activities.

(hepkwonv (2001) found that liberalization of the Kenya oil industry has w itnessed a lot of competition among the major players, to remain competitive, the oil companies have responded by making substantial adjustments in tin: markets served, goals prioritization, and redesigned their organizational structure with a view of making them flatter and hence increase efficiency. Strategic alliances have begun to set foot in form of shared depot facilities. Strategic responses result in restructuring the organization and adopting changes in information technology changes in marketing of products or services and culture changes.

2.6.3.1 Managing the firm's adaptation to the environment



Source: Ansoff & Me Donnel 199(1 pp *AW-From strategic planning to strategic management.*

figure I clearly indicates the environmental dependence of the organization. When there is an environmental shi(\ from I I to 12. then the organizations' strategy has to he changed from SI to S2 in order to adapt to the changed environmental conditions. However, this is only possible when organizations capability is changed from CI to C2. Thereafter, an organization has to monitor its environment continuously so that it can identify shifts that require it to adjust its strategies in response to such changes. I his requires that a firm's capabilities be constantly updated to ensure that they support the chosen strategy As the organization's environment changes, it is necessary thut the firm adapts its activities and internal configurations to rellcct the new external situations, failure to do this endangers the future success of the organization (Aosa. 1998)

CHAPTER THREE: METHODOLOGY

3.1 Research Design

I he study was conducted through a survey via the use of an interview guide containing a number of questions. The survey technique is a qualitative approach for research which is gaining prominence. According to Mugenda and Mugcnda (1090), qualitative approaches in research are increasingly being used to address social and economic problems in recent years. Mugenda argues that in developing countries like Kenya, qualitative research is still not very understood

However, despite this limitation, qualitative approach is slowly gaining acceptance b> scholars in Africa because of its effectiveness in addressing social issues that affect individuals and families. By using qualitative methods, researchers arc able to collect data and explain a phenomenon more deeply and exhaustively. In qualitative research, data collection and analysis go hand in hand und are done simultaneously Mugenda and Mugenda (1000), Survey techniques are preferred bccausc they are relatively inexpensive (especially self-administered surveys) and the fact that many questions can be asked about a given topic giving considerable flexibility to the analysis. I he survey technique was suitable in this research because of the need to t*et a comprehensive understanding of the response strategies employed b> audit linns to cope with changes in their external environment and for comparison purposes. It was easy to administer the research from remote locations using mail, email or telephone

J.2 Target population

I he population of the study comprised of small and medium sized audit firms operating in Nairobi. In total, there arc five hundred and sixty one audit firms which constituted the sampling frame (K'PAK 2(107/ 2008) Four can be categorized as large while thirty of them can be described as medium sized firms, I ive hundred and thirty one firms arc the small sized firms. The basis of classifying firms is normally the number of partners that a firm lias All llrms categorized us small arc manned by one partner while those categorized as medium are manned by between 2-5 partners. I he large firms on the other hand have more than 5 partners, l our hundred of the small and medium sized firms arc located in Nairobi representing 80% of the entire population. The sample si/e constituted of 16 firms, small and medium size in nature.

3.3 Sample Design

A probability sampling technique was used to select the sample from the population. Simple random sampling was used to select the auditors to be interviewed The study targeted a sample of sixteen registered audit firms. Within these firms, the decision to identify persons to be interviewed was made using a non-probability sampling method referred to as judgmental sampling I he focus was on the rank of a staff member w ithin the firm; the main reason being the kind of data required by the researcher could only be gotten from employees abo\e a particular rank.

Out of the 16 firms targeted for data collection, the researchcr interviewed 2 respondents from cach lirm The respondents were partners and senior managers of the firms. Authority to interview the senior employees was sought from the partners ofeach firm.

3.4 Diila Collection

The researcher collected data in its primary form through an interview guide which contains both open ended and close ended questions. Such questions were preferred because they provided an opportunity for in-depth probing of issues. The interview guide is divided into two sections. Section I sought to capture biographical data, section 2 captured conditions of work at the firms, challenges facing them and how they have responded to the identified challenges. The data was collected via interviews where ''1C researcher interviewed partners and senior manager* using the questionnaire as a guide- Interview was chosen as a technique of collecting data to ensure that all the inform'?'00 was obtained.

3.5 Data Analysis

The problem under investigation was social in nature and therefore the qualitative approach in research was used I his approach allowed getting a deeper understanding of the response strategics applied by auditors when faced hy changes in the environment. Before processing the data, the completed interview guide was edited for completeness and consistency. The data was coded to enable the responses to be grouped into categories. The researcher used data analysis lools such as percentages and appropriate measures of central tendency such as the mean score This helped the researcher identify the most popular strategy applied by auditors in an effort to overcome challenges facing them from the environment. I he mean score helped the researcher identify the least popular strategy as applied by the auditors. Data was presented using tables, graphs and bar charts.

CHAPTER FOUR: FINDINGS AND DISCUSSIONS

4.1 Introduction

The simly utilized a combination of both quantitative and qualitative techniques in the collection of data The study covered twenty audit firms that are registered members of the Institute of Certified Public Accountants of Kenya as at December 2007. fhe managing partners or senior personnel responsible for shaping the strategic direction of the audit firms gave their responses and the relevant documentation relating to the operations of the audit firms were collected. Out of the twenty questionnaires sent out, sixteen were returned completed, an 80 % response rate.

I"hc data was analyzed by employing descriptive statistics such as percentages, frequencies and tahles. Statistical Package for Social Sciences (SPSS) was used to aid in analysis. The researcher preferred SPSS because of its ability to cover a wide range of the most common statistical and graphical data analysis. In addition, the package is also systematic. Computation of frequencies in tables, charts and bar graphs was used in data presentation. I he information is presented and discussed as per the objectives and research questions of the study.

4.2 Profile of respondent firms

4.2.1 Physical location of the audit linns

Ilie respondents were asked to indicate the physical location of their organizations. The researcher lud intentions of establishing how widespread the service of audit firms was in Nairobi, and find out whether the physical location of each audit firm had any influence on the responses related to the study.

All the sixteen audit firms that responded are located in Nairobi. Personal interviews conducted with some of the respondents revealed that a few of the audit firms located in Nairobi also had branches in other parts of the country. Whereas the head offices of majority of audit firms in Kenya are strategically located in Nairobi, they offered services to clients countrywide through branch offices.

•1.2.2 Period of operation of the Audit firms

Ihe respondents were asked to indicate how long they had been in operation by ticking as appropriate against given time segments. The longer an audit firm was in operation, the more experience it had in responding to environmental changes and the more objective the responses were expected to he Relatively new firms were thus not expccted to have faced many challenges emanating from changes m the business environment and their responses would affect the study findings. Tahlc 4.1 presents a summary of the responses.

fable 4.1: Period of operation of Audit firms

Period of operation	frequency
less iliiin 1 year	-
1 to 5 years	-
6 to 10 years	6
11 to 15 years	5
16 years and above	5
Total	16

Source: Primary data

Out of the sixteen audit firms that responded, six of them (38%) had been in operation for a period ranging between 6 and 10 years, live of them O 1%) had existed lor a period of between 11 and /.5 years while five of them f3l°o) had been in operation for 16 years and over. The standard deviation was I .475. Study findings show that audit firms have been operating in Kenya for a long time and all have been affected in one way or another by- changes in the business environment. The responses were thus considered objective.

4.2.3 ProductsAcrvices offered bv the Audit firms

The respondents were asked to list the products/services the audit firms offered to clients, findings from the desk study indicated that audit firms worldwide offered products/services to clients, which could be categorized into three, namely audit, accountancy, consulting. I he rcscarchcr sought to establish whether audit lirms in Kenya offered similar products/services to clients or had some unique ones, findings of the study revealed that the audit llrms in Kenya offered products/services which could he categorized into three as corroborated by evidence from the desk study. Generally audit firms worldwide offer their clients services/products which may he categorized into three as. established from the findings. Indications are that audit firms in Kenya offer the same range of services as offered by others worldwide and were likely to lace similar challenges when faced by changes in the business environment

4.2.4 Number or full time employees in the uudit firms

I he respondents were asked to indicate the number of full time employees in their organizations The researcher related the number of employees to the size of the firm in that the bigger the number of employees, the bigger the si/e of the firm. The size of the audit lirms too would determine the number of clients served and to some extern give an indication of the si/e of business. Table 4.2 below gives a summary of the responses.

Table 4.2 Number of full time employees

Period of operation	frequency
Less than 5	1
5 to 10	2
10 to 15	5
15 to 20	1
25 and above	5
Total	16

Source: Primary data

Oul of the sixteen audit firms that responded, it is only one which had less than 5 full lime employees, two had between 5 and 10 employees, five had between 10 and 15 employees, three audit lirms had between 15 and 20 employees while live audit firms had 25 employees and above. Hie standard deviation was 0.894. The audit firms under study were relatively medium sized establishments, not only serving many clients, but also creating employment for many people.

4J Kcs|>onses of Audit Firms (o changes in the business environment

I he first objective of the study was to establish the responses of audit llrms to changes in the business environment and the researcher posed four questions to respondents. Firstly, the researcher sought responses on the extent to which environmental factors had alTcctcd Operations of the audit fimis. The type of changes and extent to which the changes affected operations of the audit firms would determine responses to changes in the business environment. The extent to which the various changes impacted on operations of the audit firms was expected to vary from firm to firm and appropriate responses would as such he different. I able 4.3 presents a summary of the findings.

Table 4.3: Extent to which environmental factors affected operations of audit firms

Environmental factor	Mean score	Standard deviation
An unstable political climate	0.447	0.894
Regulation through restrictions from ICPAK. Government and other regulatory bodies.	0.823	1.646
Liberalization of the financial scctor interest rates determined by market forces-	0.57	1.140
Reduction in government/donor funding of the operations of the enlity	0.411	0.822
Increased/decreased rale of infiation	*0 V5X*	1.916
legislative changes	0.372	0.743

Abrupt and rapid changes in Information Communication Technology OCT)	0.891	1.781
Competition from the big audit firms for the your market	0.671	1 .342
N 16		

Source: Primary Data,

Out of the sixteen respondents, at least twelve of them were affected by an unstable political climate Whereas three of the respondents were neutral, one respondent had not been affected at all. The analysis gave a standard deviation of 0.742 and a mean score of 0.17 I. Whereas six respondents were at least affected by ICPAK/Government regulations, one respondent was neutral while nine of them indicated that their operations had not been affected at all I his resulted to a standard deviation of 1.646 and a mean score of 0 82.1. further interviews revealed that most of the audit firms complied with ICPAK/Government regulations and were prepared for whatever regulatory changes envisaged. I ihcrali/ation of the financial sector leading to interest rates being determined by the market forces affected operations of fourteen out of the sixteen audit firms that responded One firm indicated that its operations had not been affected at all by the factor, while another one remained neutral on the issue. The responses gave a standard deviation 1.140 and a mean score of 0.57. Reductions in government funding affected operations of at least ten out of the sixteen audit firms that responded. While two audit firms remained neutral on the issue, four of them indicated that they had not been alTccted by the factor at all. I he responses gave a standard deviation of 0.822 and a mean scorc of 0.411 I he increased rate of inflation affected the operations of all the audit firms that took part in the study. The responses gave a standard deviation of 1.916 and a mean score of *0 95N* I egislative changes affected operations of at least eleven audit firms. While one of the respondents remained neutral, four of them indicated that the factor had not affected their operations at all. Ihe responses gave a standard deviation of 0.743 and a mean score of 0 172 Abrupt changes in Information Communication Technology OCT) affected operations of at least fifteen audit firms while the other one remained neutral on the issue. The responses gave a standard deviation of I .781 and a moan score of 0.89|. Competition from the bigger audit firms affected operations of at least fourteen out of the sixteen audit firms that responded While one of the respondents remained neutral, the other one indicated that it had not been affected at all by competition. The responses gave a standard deviation of 1.342 and a mean score of 0.671. I he findings of the study' indicate that apart from IC'I'AK/fiovernment regulations which the audit firms always anticipate and are adequately prepared to cope with, the other factors in the dynamic business environment had affected operations of the audit firms and all that is required is to put mechanisms in place to manage the changes for unless they manage change, change w ill manage them.

Some of the occurrences in the environment that had impacted negatively on the operations of the audit firms include inflation, and hence an environment that is not conducive to business: having to comply to the ever changing ICPAK/Government regulations: the liberalized financial sector where interest rates are determined by market forces, the ever reducing government funding leading to their seeking alternative sources of funds. Some of which are expensive: the high cost of investing in ICT, which changes rapidly and abruptly: competition from the major audit firms and illegal operators. I he business objectives of an organization are continually threatened by risks. To respond to these risks, management develops strategies that enable the organization to meet its objectives. Strategics determine which business processes are necessary to meet management's objectives and which processes require controls to mitigate business risk. No organization is immune to risk. Moreover, each organization's business risks change constantly. Hie nature and consequences of business risks facing organizations are becoming more complex and substantial The speed of change, higher *customer* expectations, increased competition, rapid changes in technology, and countless other factors affect organizations in ways that managers are often unprepared to handle If management fails to identify a significant risk oi docs not adequately consider business risks, the organization is unlikely to have in place control activities to manage those risks. Alternatively, if management does not consider environmental changes carefully, its existing control activities may no longer be adequate or appropriate. However, if an organization has a strong risk-management process, including an effective control environment, management can be reasonably sure that it has identified the significant business risks and responded to them appropriately.

The second issue to be addressed was the responses the audit Arms employed to copc with changes in the business environment The various audit firms were cxpcctcd to be unique on their own in terms of planning preparedness in responding to changes in the business environment. Since the extent to which the changes impacted on each audit firm was not the same, the researcher sought to find out how each of the respondent firms were responding. I able 4.4 below presents a summary of the findings.

lable 4.4: Responses of Audit firms lo changes in the business environment

Environmental Factors und Firms Responses	Mean score	Standard deviation
Political-Legal./actors		
We tr>- not operating in areas that have unstable political environments. F..g ethnic clashes prone areas	0.371	0.742
We regard the existence of the large firms as a compliment to our objectives and not as competitors	0.667	1.334
We comply with any I('PAR regulations or any new Government statutory regulation with ease	0.570	1 .140
Economic factors		
When market interest rates rise, we increase our charge out rates to clients	0.447	0.894
When faced with a reduction in funding, we employ cost cutting measures	0.371	0.742
Socio-iiiltnral factors		
We do not participate in CSR activities due to increased costs of doing business	0.7 16	1.432
We lay off staff when inflation bites	1.176	2.352
We employ various cost cutting methods when faced by increased costs	0.460	0.938
Technological factors		
Wc continuously invest in new equipment and upgrade our systems in order to cope with the technological change	0.447	0.894
We continuously build capacity of our stall to ensure that the organization is able let adapt to any changes in the environment	0.542	1 .083
Competition		
We invest in marketing activities, which include advertising, personal selling, publicity and new product development so as lo remain competitive.	0.570	1.140

We continuously look for new markets to expand our reach to remain competitive	0.326	0.652
We educate our clicnls on the importance of dealing with audit firms that operate legally so that they avoid being exploited by illegal operators.	0.411	0.822
We network and collaborate with other Audi! firms to enjoy synergy instead of looking at them as enemies when there is competition N * 16	0.417	0 834

Source: Primary Da la.

When presented with the statement we do not operate in areas affected by an unstable political environment, twelve out of the sixteen respondents were in agreement, and three of the remaining lour disagreed while one remained non-committal. I he responses gave a standard deviation ofO.742 and a mean score of 0 371.

Out or the sixteen respondents fourteen of them regarded the existence of large firms and other similar initiatives as being complementary to their operations and not as competition. One audit linn viewed it as competition while one remained neutral. The responses gave a standard deviation of 1.334 and a mean score of 0.667.

Ihe statement 'We comply with any new ICPAK/Govcrnmcnt statutory regulation with ease' drew some mixed reactions with fourteen of the- respondents being in agreement, one of them disagreeing and one of litem remaining non-committal. The fact thai the IC'I'AK is ihe major regulator of organizations is well known amongst practitioners in the audit industry and as such, they arc adequately prepared to comply with changes emanating from IC'I'AK/Govern menI regulations.

Out of the sixteen respondents eleven of them agreed with the statement 'When market interest rates rise, we increase our charge out rates to clients', three of them disagreed while two of them were non-committal. According to Fred (1991), economic factors have a direct impact on the potential attractiveness of various strategies for example; if interest rates rise then funds needed for diversification may be too costly or unavailable, I red further asserts that as interest rate rise, discretionary income declines and the demand for discretionary goods falls. As stated earlier, demand-driven audit services arc provided at prices clients are willing to pay for continued access to these services and hence in responding to changes in interest rates, the audit firms are in support of commercialization.

Out of the sixteen respondents, fifteen of the respondents agreed with the statement ' The increased rate of clients' inflation has led us to develop new products, none of the respondents disagreed whereas one remained noncommittal.

Thirteen of the respondents agreed with the statement we continuously invest in new equipment and upgrade our systems in order to cope with the technological changes', two disagreed while one remained neutral. Technology-based issues underlie nearly every important decision that strategists make and as I insky (1998) argues, technological advancements can create new improved products, change the relative competitive list positions in an industry and render the existing products and services obsolete. The findings indicate that a sizeable number of audit lirms in Kenya have taken the issue of continuous investment in technology seriously.

Twelve of the respondents agreed with the statement 'We continuously build capacity of our stall' to ensure that the organization is able to adapt to any changes in the environment' while four disagreed. The higher the level of training, the more adaptive one becomes to new ways of doing things. Notwithstanding the budgetary constraints k ing laced by many audit firm* as a result of reduction in donor funding, there is need to continuously build staff capacity to enable them adapt to the changing technologies. To the statement we invest in marketing activities, which include advertising, personal selling, publicity and new product development so as to remain competitive' fourteen agreed, one disagreed while one remained neutral. Whereas eleven of the respondents agreed with the statement 'We continuously look for new markets to expand our reach to remain competitive', four disagreed while one remained non-committal. Through research, competitors are identified and their strengths and weaknesses determined with a view to developing effective strategies that can give the audit firms a competitive edge.

Ten of the respondents agreed with the statement NVe educate our clients on the importance of dealing with audit firms that operate legally so that they avoid being exploited by illegal operators', five disagreed while one were neutral. In the recent past, there has been an influx of illegal operators posing as genuine audit firms, through which unsuspecting clients lost money. Majority of the audit firms have taken an initiative to educate their clients on the need to identify themselves with audit firms operating within the legal framework. I his has complemented the ICI'AK/Govemment's efforts in curbing the menace.

Responding to the statement 'We network and collaborate with other audit firms to enjoy synergy instead of looking at them as enemies when there is competition*, the responses indicate that fourteen were in agreement while only one remained neutral and one disagreed When faced with a common problem, the audit firms have their own forums in which they deliberate on the issues of concern. For instance, m the recent past, the practitioners have been meeting to deliberate and have a common stand on the pending Accountants bill. In addition, through their own established networks, the audit firms arc able to share information pertaining to clientele in various parts of the country. The responses indicate that various audit firms have mechanisms in place of responding to the changes. Plough personal interviews levealcd that these mechanisms are not documented anywhere, these were implemented on adhoc basis. To each of the challenges facing the audit firms, the respondents at least had some way of responding. The mechanisms stated are, however, not institutionalized and capturcd in their policy documents.
The third and fourth issues to be addressed were the challenges faced by audit firms in serving clients that result from changes in the business environment (political-legal, economic, socio-cultural, and technological and competition) and the coping mechanisms employed The respondents were asked to list and explain the challenges their respective organizations laced that resulted from changes in the business environment and the mechanisms they used to cope with the challenges. The researcher conducted personal

intonlewx wilh selected respondents to gel more information as the responses received through the questionnaire were not detailed. The findings were:

Challenges caused by I'olitical-Legal factors; night out of sixteen respondents indicated that their operations had been alTectcd by unstable political environment and thai they were not keen on continuing with the operations their clients migrate due to insecurity llic stafftoo is prone to risk of losing property and lives. All the sixteen audit firms that responded indicated that they changes in ICPAK/Govcrnmcnt regulations posed a challenge to their operations and that tension had been heightened by the impending Accountants Mill I he audit firms however, anticipated changes in Government regulations and are always ready for them. They have little problems in complying with the changes.

Challenges caused by Economic factors Liberalization of the financial sector • interest rates being determined market forces indicate a factor that posed a challenge to all the sixteen audit firms as by their responses. The audit firms responded to the increases in rates by increasing their pricing rates. The continued reduction of funding over the years conplcd with increasing demand lor services/products of audit firms by the clients is a challenge thirteen audit firms indicated that affected their operations

Challenges caused by Socio-Cultural factors; I he findings indicate that all the sixteen audit firms that responded had been affected by increased rate of inflation and had cut down their scale of operations in corporate responsibility activities.

Challenges caused by technological factors: I he high cost of investing in technology, coupled with the abrupt and rapid changes in Information Communication Technology (ICI) is a factor that posed challenges to all the sixteen audit firms. They indicated that during budgeting, adequate provisions arc made for technological changes and resultant investment. I'he audit firms have continued to invest in new equipment and upgrade existing systems, especially loans tracking and communication systems.

Chalhtnges caused hy Cbmpttiriw factors: Thirteen audit firms indicated that the major audit firms have developed products similar to (hose of middle level and small size audit firms and are targeting a market, previously a preserve of Ihe mediumfemall sized audit firms. The audit firms invest in such marketing activities as advertising, personal selling, publicity and new product development not only to remain competitive, but also enhance customer loyalty and expand outreach. The audit firms, in addition, indicated that there had been an increase in unfair competition from firms operating illegally (not registered as audit firms) and exploiting the ignorant clients. Besides using networking and collaboration meant to lock out illegal operators, the audit firms also use training sessions with clients to educate them on the need to deal with reputable and legally recognized audit firms.

4.J.I Strategic responses

Pearce and Robinson (I W) argue that strategic responses are a set of decisions and actions that result in the formulation and implementation of plans designed to achieve a firm's objectives Strategic responses arc part of competitive strategies that organizations develop in defining their goals and policies. I hey are reactions lo what is happening on the environment of the organization. Strategic responses are concerned with the long-term strategy of an organization involving high investments and embracing the organization as a whole, f indings of the study indicate that the respondent firms had embraced various strategic responses to changes in the business environment. In responding to competition from other financial institutions, ihe audit finns invested in new products development and seeking to expand the market outreach through various marketing strategics. The firms practice market development, product development and market penetration strategies.

According to Ansoff *(1965),* I he development of new markets for the product may be a good strategy if the firm's core competencies are related more to the specific product than to its experience with a specific market segment. Because the firm is expanding into a new market, a market development strategy typically has more risk than a market penetration strategy. A product development strategy may he 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 strengths by developing a new product targeted to its existing customers. Competition takes place in several sites: between technological regimes, between different design configurations, and between several options of design common to great number of firms (loxhall and l awn, 1992). Dominance may generate irreversibilities and constraints. As technologies evolve, future developments are confined to certain lanes of technological development Firms remain trapped within a particular paradigm and. consequently, new technological discontinuities, in general, will come from outside, from another industry or from a new stream of knowledge (Utterback, 1994), Different users will almost necessarily adopt a good" technology, one that presents advantages with respect to other existing or competing technologies. The superior technology diffuses through the market in a natural way and imposes itself over other concurrent technologies (Vmck, 1995).

The respondents regard other pa line re as complementing their efforts as opposed to being competitors. The audit lirms are currently holding consultative meetings with a view to arriving at a common approach on how to respond to the pending Accountants Hill. Hie networking and collaboration elTorts are meant to ensure that the Audit lirms enjoy synergy. In their study. Miles and Snow (1985) argue that the rapid changes in the current business environment induce organizations to develop networks that are made of contractual arrangements such as strategic alliances. Ihese new organizational forms would allow organizations facing a demanding environment to focus on their core competencies while maintaining innovation capabilities and flexibility. Strategic behaviors based on alliances can also be interpreted as an evidence of institutional isomorphism (Did Maggie and Powell 1983) as suggested by Meyer et al. (1990) in the case of American hospitals where alliances are shown to be a way to reduce the increasing environmental uncertainty. The audit lirms have tended to take a futuristic approach by seeking to embrace a commercialization approach to enhance sustainahility and growth.

4.3.2 Operational responses

Operational responses target specific functional areas of the organization. Ihcsc do not require a huge amount of resources to implement and they arc on a short-term basis (usually less than one >ear). According to Pearce and Robinson (1999). operational controls provide post action evaluation and control over short periods usually from one month Ui one year. The audit firms responded to the rapid and ahiupt changes in ICI through investment in new equipments and upgrading of existing systems. In addition, the audit firms continuously invested in staff capacity building to cope with the changes. Technological progress is seen as occurring according to specific trajectories: by working on a particular technological regime, the lirm develops a unique design configuration that is the practical result of the application of the knowledge possessed (Dosi, 19X2: Nelson & Winter, 19X2).

the audit firms shift from areas characterized by conllicts such as post election violence as they impact negatively on their day-to-day operations I he audit firms, having been in the business lor long, arc able to predict impending regulatory measures, and consequently, have the ability to respond promptly to the changes, which would otherwise impact negatively on their operations.

ITic audit firms, in response to changes in interest rates, which negatively alTect their profitability, pass on the additional costs to the clients. In addition, clients were sensitized on the need to transact with legally registered Audit firms.

4.4 Factors Influencing Responses by Micro Finance Institutions

The respondents were asked to indicate the extent to which listed factors influenced the strategic responses their respective audit firms adopted to cope with changes in the business environment. The various strategies adopted by the different firms aie influenced by the respective long and short term objectives set. The focus of the various linns, which include growth and productivity objectives: locus on customer changing needs; and the need to identify new opportunities, markets and products to remain competitive, among others I he extent to which each of the factors inllucuccd responses of the Audit firms thus differed from one firm to another. The fencings of the study arc summarized in tahle 4.5 below

Table 4.5: factors that influence responses by Audit firms to changes in the business environment.

factor	Mean score	Standard deviation
Strategic planning and management objective of continuous reviews	0.837	1.673
forced by changes to adapt or change strategy	0.447	0.894
Industry experience	0.447	0.894
Need to identify new opportunities, markets and products to remain competitive	0.891	1.781
Growth and profitability objectives	*0 542*	1.084
Focus on customer changing financial needs	0.570	1.140
AH *16*		

Source: Primary Data.

fourteen of the respondents held that strategic planning and management objective of continuous reviews influenced their strategic responses to changes in the business environment, one was not influenced by the factor whereas one was neutrel. This is mostly done at the functional level of strategy, which is carried out hy managers of the various functions areas It involves development of annual objectives and short-term strategies in areas such as operations, marketing, finance and accounting.

fhirtcen of the respondents were forced by changes to adapt to or change strategy. This factor did not influence two of the respondents whereas one was neutral. As noted by Senior < 1997). there are various catalysts for organizational change such as restructuring, which may include the purchase of new ICI equipment or systems, business process intensification/extensions, staff right sizing, redesign of job groups and redundancies. In the recent piist. the scenario has been that some audit firms, in response to competition from major firms, have themselves transformed into associations to remain competitive.

Industry experience influenced twelve of the respondents whereas three were not influenced hy the factor; one was non-committal on the issue. A sizeable proportion of the audit firms studied had been in existence for a long period of time. The lessons learnt through many years of experience have equipped the firm managers with the necessary skills to detect foreseeable changes from certain symptoms and develop appropriate responses.

The need to identify new opportunities, markets and products to remain competitive is a factor that influenced fourteen of the respondents while two remained neutral on the issue According to Ansoff and McDonncI (1900), strategic responses may take many forms depending on the organization's capability and the environment in which it operates. Well-developed and targeted responses are formidable weapons for the firm in acquiring and sustaining a competitive edge. Fhe strategic responses, according to Kiptugen (2003), include restructuring, marketing, information technology and culture change etc. The stiff competition in the financial services sector has seen an increase in innovations amongst audit firms in Kenya, which include development of new market driven products and expansion of outreach to target new markets with a view to remaining competitive.

Growth and piofitability objectives are a factor that influenced fourteen of the respondents, one was neutral while one was not influenced hy the factor. I'earce and Robinson (1999) assert that strategic responses are a set of decisions that result in the formulation and implementation of plans designed to achieve a firm's objective. Growth and profitability are key objectives of any organization ami audit firms are not an exception, hence key influencers of strategic responses to changes in the business environment.

Focus on customer changing financial needs is a factor that influenced fourteen of the audit firms, one was neutral while one was not influenced by the factor. The Chartered Institute of Marketing. UK defines marketing as a management philosophy which encompasses the identification, anticipation and satisfaction of customer needs and wants at a profit*. In addition, the marketing concept emphasizes the fact that 'Customer is the King' and all activities of the firm should focus on the customer. I he products/services of audit firms must be tailored to suit the changing financial needs of the clients.

The study findings also indicate that the responses employed by the various audit firms in response to changes in the business environment were influenced by various factors. Key amongst the influencing factors is the strategic planning and management objective of continuous reviews, foreseen changes are catercd for in the various organizations' strategic plans, which are reviewed periodically. Other factors influencing responses to changes in the business environment include the following: - being compelled by the changes to adapt to or change existing strategies; industry experience, having been in operation for long enough to understand the dynamics of the business environment; the need to identify new opportunities, markets and products so as to remain competitive; growth and profitability objectives; and focus on customer changing financial needs.

CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary* of Findings

Understanding the impact of environmental changes on the organizations could help practitioners in the field ensure that the audit firms develop rational strategies to effectively respond. Identifying and evaluating environmental opportunities and threats enables organizations to develop a clear mission, to design strategies to achieve long-term objectives, and to develop policies to achieve annual objectives. I bis study sought to gain a better understanding of the responses of audit firms to the challenges emanating from the turbulent business environment and more so the regulatory environment that influence the strategic and operational plans of audit firms in Kenya; the factors that intluencc these responses, which are critical to their outreach and sustainability. The study populations were the audit firms that are registered members of the ICPAK, whose number stood at 561 as per the ICPAK report 2007/2008. Hie respondents in each of the audit lirms were either the ('hief l-xecutive Officer or a senior member of the firm.

I indings ol the study indicate changes in regulations as well as other environmental forces have affected the types of products developed, the nature of positioning and market segmentation strategies, the types of services offered, and the choice of business to acquire or sell I be changes have an influence on the staff, clients, and the institutions' portfolio, ami can create numerous pressures on institutions trying to maintain or achieve financial and operational self-sufficiency. If ignored, these changes can ultimately compromise an audit firm's operations, profitability, and long-term viability.

5.2 Conclusion

Organizations and environments are considered not to be completely separated and independent from eacb other but. rather, to belong to the same continuum. This position, which contains a more complex representation of possible interactions between actors inside and outside the organization, introduces the idea of the construction of the environment. Meaningful environments are considered to be outputs of the process of organizing and not inputs to it: the process of organizing implies the creation of the environment (Weick. 1979). Ibis interpretative perspective connects knowledge and conduct, in the sense that the environmental context is made up of cognition, experiences, thoughts and actions (Smircich and Stubbart, I'MM.

Deep understanding of the external environment, clear definition of strategic options, good marketing research, strong investments in research and development, lean production infrastructure, and consistent financial support are some of the prescriptions postulated by the specialized literature. It is fair to say that these precepts, to a higher or lower degree, still hold for some industries.

I nvironmental changes have serious economic effects and arc of great concern for organizations that would wish to he ahead of competition. Environmental forces affect the types of products developed, the nature of positioning and market segmentation strategies, the types of services offered, and the choice of business to acquire or sell. Identifying and evaluating environmental opportunities and threats enables organizations to develop a clear mission, to design strategies to achieve long-term objectives, and to develop policies to achieve annual objectives. Though the audit firms and their clients are particularly susceptible given the limited resources that the poor have to cope with any major financial crisis, they have to put in place mechanisms of coping all together in order to remain competitive.

5.3 I.imitations of the study

Notwithstanding the researcher's determination to undertake the study to completion within the given time frame, various constraints were encountered. For instance, some of the information sought was of a confidential nature, which the respondents either deliberately refused lo divulge or did not have access to.

In addition, though the researcher would have wished to administer the data collection IIM)IS to only managing partners of the v arious audit firms, this was not possible as some of (Item had to delegate lo their juniors as they themselves were either busy or away on official duties It was therefore assumed that the respondent* would be able to give similar information as would have been provided by the Chief Executive Officers themselves.

5.4 Recommendations of the study

5.4.1 Recommendation* Tor policy and practice

Based on findings ol the study, it is expected that the stakeholders, who include audit firms will gain a better understanding of the challenges emanating from changes in the business environment and possible responses to remain competitive. Well-developed and targeted responses arc formidable weapons for the audit firms in acquiring and sustaining a competitive edge.

findings of the study indicate that apart from ICPAK/Governmcnt regulations, which the audit firms always anticipate and are adequately prepared to cope with, the other factors in the dynamic business environment, which include unstable political climate, interest rates being determined by market forces, increased rate of inflation, and competition, among others affect operations of audit firms. All that is required is to put mechanisms in place to manage the changes for unless they manage change, change will manage them.

In uddition. understanding the impact of environmental changes on the organizations could help piactilioncrs in the ticld ensure that the audit firms develop rational strategies lo cffcctivcl) respond I he following are measures are highly recommended:

hmimiuiH'iiltil Manning on a continuous hum: this is the acquisition and use of information about events, trends, and relationships in an organization's external environment, the knowledge ol which would assist management in planning the organization's future course of action I he audit firms ought to scan the environment in order to understand the external forces of change so that they may develop effective responses that secure or improve their position in the future. This will enable them to avoid surprises, identify threats and opportunities, gain competitive advantage, and improve long-term ami short-term planning.

Struh'Kic planning Information derived from environmental scanning should be used to drive the strategic planning process bv the audit firms. I here is research evidence to show that environmental scanning is linked with improved organizational performance. However, the practice of scanning by itsell is insufficient to assure performance scanning must IK- aligned with strategy, and scanning information must be effectively utilized in the strategic planning process Coupled with the availability of information on external change, scanning can induce strategic, generative organizational learning

5.4.2 Kceommended ureas of further research

I he findings ol this study, it IN hoped, will contribute to the existing body of knowledge and form basis for future ivseaivIters I he following areas of further researcher arc thus suggested: whereas the current studv focused on responses from the management of the audit firms, future studies should focus on responses from the clients. I his will shed light on the kind ol responses the clients employ when affected by changes in the business environment findings of the study should IK replicated to other sectors of the economy. All sectors of the economy arc afTecled h\ changes in the business environment. It would thus be important to know how they tespond.

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APPENDIX

Questionnaire

Pus questionnaire li>i\ been designed to collect information from selected staff of small ami mnlium sized audit frnm in Kenni and n meant for academic purftoxe.s onfa-
ll \ designed into two sections /'lease complete eui. li section as instructed l)o not write your name or anv other form of identification on the questionnaire

.III ihe information in ihi\ questionnaire u ill be treatedm confidence

SUCTION A: BACKGROUND INFORMATION

I I'lcase indicate the physical location of your firm

2 Please indicate the period of operation of the firm (I ick as appropriate)

a. Less than I year
b. I-5 years
c. 6-10 years
d 16 years and above

3. Please list the services you offer to the clients

I I low many full time employees docs the organization have (Tick as appropriate)

a I ess than 5
b 5-10
c. 10-20
d. 20-30
c. 30 and above

SECTION II: TIIE BUSINESS ENVIRONMENT

I. lo what extent have the following factors affected the operation of your organization (Tick as appropriate)

No	A	Environmental factor	Rating				
			Not at nil	A little Extent	Moderate Extent	Great Extent	Very Great Extent
U»		*An unstable political climate*					
(hi		*Government A K'PAK regulations*					
(C)		*Other regulatory bodies such as KR.I. /LIB. Ml A en*					
tdt		*Liberalization of the financial sector interest rates determined by market forces*					
(«t		*Movement in government 'donor funding*					
(0		*Abrupt and rapid changes in information technology*					
<f0		*('ompetition from large firms for your target market*					
(hi		*Specif)' any other regulation that has affected your firm*					

In what extent arc the following strategies undertaken hy your firm to counter challenges in the business environment (please tick as appropriate)

No		Ruling				
		\'ot lit	A little	Moderate	Great	Large
		all	extent	extent	extent	extent
B	Political /legal					
a)	lie do not OfH-rate in areas a Heeled hy ethnic clashes					
h,	li e comply with am new regulations intrixtuceil hy U'PAK and other regulatory					
I.	bodies					
		1				
	Keoniimie fuclnrx					
at	He haw adjusted our prices to reflect additional costs incurred In implementing the changes					
h)	li e lunr laid off staff due to increased cosls'as an effort to cut dawn on costs					
	He have diversified our off-rations and no longer de/tend solely on audit for income					
	SOCIO - cultural					
a)	He do longer partici/xite in corporate social responsibility (C 'SR) activities due to increased costs of doing business					

	Tcchnnlogicul changes					
(0	II c *continually invest in new equipment and li/fgrade our systems In cope uith technological changes*					
h)	IIV *continually huild ca/Htcily of our stall r< > ensure that the firm i\ able to adapt to any changes in the environment*					
	Competition					
at	Iff *invent in marketing at tivities, which includes advertising heavy personal selling, publicity, new services development so as lo remain competitive*					
b)	II'f *continuously ook for* wn *markets to •vpand our teach and •emain com/H-tiiiw*					
c)	IIV *educate our clients on the importance ol dealing with audit firms that operate legally so that they avoid being exploited by quacks*					
di	IIV *network and collaborate with other audit firms to enjoy synergy instead ol looking at them as*					

enemies when there is comiHt<u>lltion.</u>

f'lcuse list ant/ explain any other challenges that your organization has faced In serving clients that result from changes in the business environment explain any other strategy used to cope with these challenges _