REALIZATION OF SUSTAINABLE COMPETITIVE ADVANTAGE THROUGH PRODUCT DIFFERENTIATION IN COMMERCIAL BANKS IN KENYA: A CASE STUDY OF FIRST COMMUNITY BANK

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DECLARATION

This research project is my original work and has not been submitted in any other university.

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

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DEDICATION

This project is dedicated to my family especially my parents, my beloved wife Bishara and my daughter Zakiya for their love, care, support and encouragement to pursue and finish my studies.
ABSTRACT

A firm is said to have a sustained competitive advantage when it is implementing a value creating strategy not simultaneously being implemented by any current or potential competitors and when these other firms are unable to duplicate the benefits of this strategy. To succeed in building a sustainable competitive advantage, a firm must try to provide what buyers will perceive as superior value. This entails either a good quality product that is worth paying for even if a premium has been charged or a fairly priced product capable of satisfying the buyers needs. The main objective of the study was to establish the extent to which product differentiation enhances sustainable competitive advantage in commercial banks in Kenya. Case study research design was adopted in this study. Data collection was from primary and secondary sources. Data was analysed using thematic and content analysis. Analysis of the findings shows that differentiation strategies are greatly used by commercial banks in Kenya to remain competitive. This can be attributed to the changes in business focus from being cost leaders to being customer focused. The greatly used strategies are broad differentiation involving maintaining strong relationship with customers, identifying needs of customers, and improved customer service, offering professional services to customers among others. Many of these strategies focus on the customer because it is the key for any business success especially for First Community Bank. The next greatly used strategies were those of narrow differentiation involving improved customer service, identifying needs of customers, reputation on quality and service, and offering professional service to customer. From the findings, it was established that a differentiation strategy is based upon persuading customers that a product is superior in some way to that offered by competitors. The respondents were requested to indicate the challenges facing First Community Bank during implementation of product differentiation strategies. From the findings, lack of sufficient resources, regulations from CBK and lack of skills and knowledge on how to develop product that suits the market were the main challenges to effective implementation of product differentiation. The First Community Bank should adopt differentiation strategies that address needs of specific market segments. To achieve this, clients’ needs must be identified by way of continuously seeking customer feedback and promptly addressing them. So as to adequately address customers need the clients should be involved in product development. Research has shown that customer preferences keep changing, which translates into a guiding principle that products must keep changing so as to ensure sustained customer satisfaction. The study investigated the extent to which banks achieve sustainable competitive advantage through product differentiation focusing on First Community Bank. The study recommends that a further study should be carried out to establish ways through which banks could enhance product differentiation so as to improve customer satisfaction and enhance positive perception on banks. A further study should be carried out to establish the effects of product differentiation on financial performance of commercial banks.
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CHAPTER ONE
INTRODUCTION

1.1 Background of the Study

Every industry including banking has an underlying structure or a set of fundamental economic and technical characteristics which give rise to competitive forces. A firm can clearly improve or erode its position within an industry through its choice of strategy. Competitive strategy, then, not only responds to the environment but also attempts to shape the environment in its favour (Porter, 1985). As competitive conditions grow ever more turbulent, the importance of developing and sustaining competitive advantage appears to be increasing exponentially. Competition in the retail sector has been increasing for years, the importance of developing an effective competitive strategy appears to be increasing constantly (Harris and Ogbonna, 2001). One central measure of organizational effectiveness is continuously engaging in differentiation of organizational products. Efficiency, actualization of customer-centric products and services, and limitation of the fixed costs of doing business can also help to achieve a sustainable competitive advantage within the marketplace.

Zack (1999) argues that commercial banks view product differentiation as their most valuable and strategic resource, while Porter, (1985) agrees by pointing out that in an economy, where the only certainty is uncertainty, the only sure source of lasting competitive advantage is differentiation. Many markets are quite saturated with numerous firms endeavouring toward like core competencies hence organizations are forced to dissect their business processes for the purpose of determining what product to develop and offer to the market and attain a sustainable competitive advantage.
According to Porter (1985), competitive strategy can be understood as the activities a company undertakes to gain a sustainable competitive advantage in a particular industry. Porter (1985) assumes that there are essentially three generic types of competitive strategy (based on two basic types of competitive advantage): cost leadership, differentiation and focus on certain target segments (which itself is either anchored through low-cost or differentiation).

Companies following a differentiation strategy strive to create and market unique products for varied customer groups. They aim to create a superior fulfillment of customer needs in one or several product attributes in order to develop customer satisfaction and loyalty, which can often in turn be used to charge a premium price for products.

In differentiation strategy, the business concentrates achieving superior performance in an important customer benefit area valued by a large part of the market. Thus the firm seeking quality leadership, for example must make product with the best components, put them together expertly, inspect them carefully, effectively communicate their quality (Kotler, 2009). Differentiation strategies are based on offering buyers something unique or different that makes the firm’s product or service distinct from that of rivals. The important assumption behind differentiation strategies is that customers are ready to pay premium price for a product that is distinct in some important way, like better service and superior quality and special appeal (Kotler, 2009).
Differentiation arises and competition increasingly occurs on the bases of product augmentation which also leads the marketer to look at the user’s total consumption system, the way the users performs the tasks of getting and using products and related services. This study therefore seeks to establish the realization of sustainable competitive advantage through product differentiation in commercial banks in Kenya with specific reference to First Community Bank.

1.1.1 Sustainable Competitive Advantage

The concept of sustainable competitive advantage appeared in 1984, when Day (1984), suggested certain types of strategies to “sustain the competitive advantage”. The term sustainable competitive advantage was later proposed by Porter (1985), when he discussed the basic types of competitive strategies firms can follow for example, low cost, differentiation, and focus to achieve sustainable competitive advantage. To succeed in building a sustainable competitive advantage, a firm must try to provide what buyers will perceive as superior value. This entails either a good quality product that is worth paying for even if a premium has been charged or a fairly priced product capable of satisfying the buyers needs. Barney (1995) argues that a competitive strategy comprises of both offensive and defensive moves. An offensive move is an action taken when an organization tries to exploit and strengthen its competitive position for instance being ahead of a competitor in pricing, promotion, product features and distribution channels. On the other hand, a defensive move is any action that gives a firm a competitive advantage such as patents or exclusive contracts with suppliers.
A firm is said to have a sustained competitive advantage when it is implementing a value creating strategy not simultaneously being implemented by any current or potential competitors and when these other firms are unable to duplicate the benefits of this strategy. (Barney, 1991). Sustainable Competitive Advantage is the prolonged benefit of implementing some unique value-creating strategy not simultaneously being implemented by any current or potential competitors along with the inability to duplicate the benefits of this strategy (Barney, 1995).

According to Barney (2007), a firm has a competitive advantage when it is able to create more economic value than its rival firms. Economic value is explained as the difference between the perceived benefits gained by a customer who purchases a firm’s products and services and the full economic cost of these products and services. Thus, the size of a firm’s competitive advantage is the difference between the economic value a firm is able to create and economic value its rivals are able to create. A company has competitive advantage whenever it has an edge over its rivals in securing customers and defending against competitive forces. Sustainable competitive advantage is born out of core competencies that yield long term benefits to the company. According to Porter (1988), in formulating sustainable competitive advantage involves the consideration of four key factors i.e. strengths, weaknesses, threats and opportunities that determine the limits of what a company can successfully accomplish. The company’s strength and weaknesses are its profile of assets and skills relative to competitors, including financial resources, technological postures and brand identification.
1.1.2 Commercial Banks in Kenya

The Banking industry in Kenya is governed by the Companies Act, the Banking Act, the Central Bank of Kenya Act and the various prudential guidelines issued by the Central Bank of Kenya (CBK). The banking sector was liberalised in 1995 and exchange controls lifted. As at 31st March 2011 the banking sector comprised 45 institutions, 44 of which were commercial banks and 1 mortgage finance company. Commercial banks and mortgage finance companies are licensed and regulated under the Banking Act, Cap 488 and Prudential Regulations issued there under. The commercial banks role in an economy is paramount because they execute monetary policies and provide means of facilitating payment for goods and services in the domestic and international trade. Banking is now an essential part of the economic system. Modern trade and commerce would almost be impossible without the availability of suitable banking services.

First of all, banking promotes savings. All manner of people, from the ordinary labourers and workers to the rich land owners and businessmen, can keep their money safely in banks and saving centers.

Secondly, banking promotes investments. Banks easily invest the money they get in industry, agriculture and trade. They either invest it directly or advance loans to other investors. The banking sector in Kenya is a very lucrative but offer homogenous products and services. Marketing initiatives to differentiate and create a lasting competitive advantage has increased over the years with the aim of attracting and retain new and existing customers. Communication efforts have been fruitful in brand
building and product/service awareness but this has not offered a long term solution for banks that aim at long term growth and stakeholder loyalty. The need for creation of a lasting competitive advantage has recently led to revisions of both long term and short term goals.

1.1.3 First Community Bank

First Community Bank is the first Bank approved by the Central Bank of Kenya (CBK) under Cap 488 of the Banking Act to operate as a full-fledged Sharia Compliant banking institution. The bank received its formal approval from the Central Bank of Kenya on 29th May 2007 thereby opening the door for Sharia compliant banking not only in Kenya but indeed in the entire East and Central African region. All branches are located strategically in different towns within the country. Currently it has 18 branches which are: Moyale, Mandera, Wajir, Hebaswein, Garissa, Malindi, Msalani, Kisumu, Nakuru, two in Mombasa and seven in Nairobi. Certainly, the benefits to the clients from this aggressive branch expansion program were an overwhelming value in terms of service delivery and overall networking perspectives.

The bank is owned by a diverse base of community businessmen and professionals from Kenya and Tanzania. The bank commenced official operations on 1st June 2008. As a committed Kenyan bank, FCB’s motive is to take its alternative form of banking to as many places as possible within the country. Regionally, they have put into place mid-term plans to establish operations in other East African financial centers where they believe there is sufficient demand for Sharia Compliant financial services. As a Pioneer of Sharia Compliant banking institution, with addition to its core banking
business, it is also in the final stages of bringing to Kenya a number of other innovative Sharia Compliant products. These include; Islamic Insurance (Takaful), Islamic Bonds (Sukuk) and Sharia Compliant Mutual Funds and Shares trading. All their products and services are offered on fully Sharia Compliant basis as approved by the Sharia Advisory Board which comprises of prominent Islamic scholars both from inside and outside Kenya.

1.2 Research Problem

The need to remain competitive has been a key preserve of most banks. As a service industry, launching and enhancing new products and services is a clear way of retaining and attracting new customers. To excel in this act, banks must keep pace with the technological offering as well as respond to the needs of its customers. With the current globalized world, coupled with a knowledgeable population, it is very difficult to keep pace with the changes in the industry as customers are able to get to know what is happening across the globe within a split of a second without a struggle.

The banking industry, in the recent past, has faced increasing competition and tremendous challenges due to industry globalization, privatization of government owned banks, adversely changing econ-political patterns and narrowing profit margins this has prompted the industry players to take competition to a higher level thus competing on the basis of corporate values. The government and customers alike in the value chain are constantly evaluating the role of commercial banks in the country.
The challenge is for commercial banks to meet these pressures by identifying and exploiting sources of competitive advantage. The challenge is that, lack of effective competitive strategies by the bank in the past few years has led to dwindling market share, lost of customers and its negative impact on the banks’ profitability. Empirical evidence suggests that the link between product differentiation and sustainable competitive advantage is an understudied area. Koigi (2002) researched on implementation of a strategic alliance an experience of Kenya Post Office Savings bank and Citibank. Chesang (2002) touched on the implications of merger restructuring and financial performance of commercial banks in Kenya. Kiptugen (2003) identified strategic responses by Kenya Commercial Bank to a changing competitive environment.

1.3 Research Objective

To establish the extent to which product differentiation enhances sustainable competitive advantage in commercial banks in Kenya.

1.4 Value of the Study

This study will provide direction and solutions to managers and board of directors of First Community Bank and other commercial and Sharia compliant banks in Kenya with information on the realization of sustainable competitive advantage through product differentiation in commercial banks in Kenya.

The result of the study will be important to the scholars, academicians and researchers in investigating the influence of context, validating previous research, facilitating theory building and contributing to the exiting body of knowledge in the area of differentiation strategies and competitive advantage. The study can also be a source of reference material for future reference to those academicians who undertake the same topic in their studies.

This study will also be important to Central Bank of Kenya’s regulator who are currently facing certain challenges in implementing Sharia system in Kenya banking regulation by coming up with banking policies which will incorporate both Islamic and non Islamic Sharia system. The findings therefore will inform policy.
CHAPTER TWO
LITERATURE REVIEW

2.1 Introduction
This chapter presents a theoretical review that demonstrates the association between product differentiation and competitive advantage through formulation of strategies that influence and are influenced by opportunities to gain long term differentiation.

2.2 Theoretical Review
2.2.1 Resource Based View
Resource based approach to sustainable competitive advantage focuses on the internal analysis of a firm. The approach entails an audit of tangible assets of a company which may be physical, human and financial resources. The audit also entails intangible assets such as brands and patents. Patents and proprietary knowledge serve to restrict entry into an industry. Ideas and knowledge that provide competitive advantages are treated as private property when patented, preventing others from using the knowledge and thus creating a barrier to entry.

Internal analysis aims to identify strengths and weaknesses in a firm. It helps to identify what is achievable and what issues to address. A firm's strengths are its resources and capabilities that can be used as a basis for developing a competitive advantage. Strengths can be either tangible or intangible. These are what you are well-versed in or what you have expertise in, the traits and qualities your employees possess (individually and as a team) and the distinct features that give your
organization its consistency. Strengths are the beneficial aspects of the organization or the capabilities of an organization, which includes human competencies, process capabilities, financial resources, products and services, customer goodwill and brand loyalty. Examples of organizational strengths are huge financial resources, broad product line, no debt, committed employees, patents, strong brand names, good reputation among customers, cost advantages from proprietary know-how, exclusive access to high grade natural resources, and favorable access to distribution networks.

Weaknesses are the qualities that prevent us from accomplishing our mission and achieving our full potential. The absence of certain strengths may be viewed as a weakness. These weaknesses deteriorate influences on the organizational success and growth. Weaknesses are the factors which do not meet the standards we feel they should meet. Weaknesses in an organization may be depreciating machinery, insufficient research and development facilities, narrow product range, poor decision-making, etc. Weaknesses are controllable. They must be minimized and eliminated.

For instance - to overcome obsolete machinery, new machinery can be purchased. Other examples of organizational weaknesses are huge debts, high employee turnover, complex decision making process, narrow product range, large wastage of raw materials, lack of patent protection, a weak brand name, poor reputation among customers, high cost structure, lack of access to the best natural resources, lack of access to key distribution channels, etc. In some cases, a weakness may be the flip side of a strength. Take the case in which a firm has a large amount of manufacturing capacity. While this capacity may be considered a strength that competitors do not
share, it also may be a considered a weakness if the large investment in manufacturing capacity prevents the firm from reacting quickly to changes in the strategic environment. Internal analysis should also encompass and fit into the vision, mission, aims and objectives of a firm. It should also help in identifying a series of strategic options the company can consider and form informed choices.

2.2.2 Michael Porter’s generic strategies

Porter (2000) argued that superior performance can be achieved in a competitive industry through the pursuit of a generic strategy, which he defines as the development of an overall cost leadership, differentiation, or focus approach to industry competition. If a firm does not pursue one of these strategy types, it will be stuck-in-the-middle and will experience lower performance when compared to firms that pursue a generic strategy. Competitive strategy consists of all those moves and approaches that a firm has and is taking to attract buyers, withstand competitive pressure and improve its market position. A company has competitive advantage whenever it has an edge over its rivals in securing customers and defending against competitive forces (Thompson and Strickland, 2010). Sustainable competitive advantage is born out of core competencies that yield long term benefit to the company. Sources of competitive advantage include high quality products, superior customer service and achieving lower costs than its rivals. To succeed in building a sustainable competitive advantage, a firm must try to provide what buyers will perceive as superior value. This entails either a good quality product at a low price or a better quality product that is worth paying more for (Porter, 2008).
When using differentiation strategy, a company focuses its efforts on providing a unique product or service (Bauer and Colgan, 2001). Since, the product or service is unique this strategy provides high customer loyalty (Hlavacka et al., 2001). Product differentiation fulfills a customer need and involves tailoring the product or service to the customer. This allows organizations to charge a premium price to capture market share. The differentiation strategy is effectively implemented when the business provides unique or superior value to the customer through product quality, features, or after-sale support. Firms following a differentiation strategy can charge a higher price for their products based on the product characteristics, the delivery system, the quality of service, or the distribution channels. The differentiation strategy appeals to a sophisticated or knowledgeable consumer interested in a unique or quality product and willing to pay a higher price.

The key step in devising a differentiation strategy is to determine what makes a company different from a competitor's (Reilly, 2002). When using differentiation, firms must be prepared to add a premium to the cost (Hyatt, 2001). This is not to suggest costs and prices are not considered; only it is not the main focus. However, since customers perceive the product or service as unique, they are loyal to the company and willing to pay the higher price for its products (Hlavacka et al., 2001). The value added by the uniqueness of the product may allow the firm to charge a premium price for it. Because of the product's unique attributes, if suppliers increase their prices the firm may be able to pass along the costs to its customers who cannot find substitute products easily (Johnson and Scholes, 2009).
Firms that succeed in a differentiation strategy often have the following internal strengths: access to leading scientific research; highly skilled and creative product development team; strong sales team with the ability to successfully communicate the perceived strengths of the product; and corporate reputation for quality and innovation.

2.3 Competitive Advantage

One of the major environmental influences in a business arise from competition. Increased competition threatens the attractiveness of an industry by reducing the profitability of players (Porter, 1990). Firms respond to this by being proactive in their strategy formulation and implementation with the overall aim of gaining a competitive advantage. Competition denotes the existence of firms that try to sell identical products or services to the same group of customers.

Competitive advantage, also called business specific advantage, refers to some propriety characteristics of a business, which cannot be imitated by competitors without substantial cost and risk. Barney (1991) indicates that the creation of competitive advantage occurs through the implementation of strategies that add value and create benefits for one company when another company fails to do so. For any company to remain relevant they need to achieve a sustained competitive advantage. Sustained competitive advantage is the prolonged benefit of implementing some unique value creating strategy not simultaneously being implemented by any current or potential competitor, along with the inability to duplicate the benefits of this strategy (Hoffman, 2000). Competitive advantage enables businesses to survive against its competition over a long period of time.
Day (1984) and Porter (1987) see competitive advantage as the objective of strategy, arguing that superior performance will automatically result in competitive advantage. Reed and DeFillippi (1990) suggest that competitive advantage can be derived from numerous sources and that strategy manipulates the sources of advantage under the firm’s control in order to generate competitive advantage. According to Porter (1985) in his work analyzing the competitive forces in industry suggested four “generic” business strategies that can be adopted in order to gain competitive advantage. The four strategies relate to the scope of business activities; narrow versus broad and the extent to which business seeks to differentiate itself.

2.4 Sustainable Competitive Advantage

A number of studies have explored the conditions under which a business” competitive advantage is sustainable (Barney 1991; Coyne 1985). Barney lists four (4) essential requirements for a resource or skill to be a source of sustainable competitive advantage. According to Barney, for resources or skills to constitute a source of sustainable competitive advantage they must possess the following characteristics; they must be valuable, they must be rare among a firm’s current and potential competitors, they must be imperfectly imitable and finally, there must not be any strategically equivalent substitutes for the resource or skill.

Writing on “Sustainable Competitive Advantage in Service Industries, a Conceptual Model and Research Propositions” Bharadwaj, Varadarajan and Fahy (1993) posited that the attainment of sustainable competitive advantage is not an end in itself, but a means to an end –namely superior long term financial performance. A company is not
in business to achieve a sustainable competitive advantage over its competitors but to create wealth for its shareholders. Actions which contribute to sustainable competitive advantage but detract from creating shareholder wealth can be a good strategy in the competitive sense, but bad strategy for the company. It is also worth noting that certain sources of competitive advantage may be more enduring than others.

For a strategy to be sustainable, it must be different to imitate. Companies must be flexible to respond to competition and market changes. Companies must nurture a few competences to stay ahead of rivals and achieve a sustainable competitive advantage. With globalisation, markets are opening up and regulations easing up. This has led to some barriers of competition falling and making competitive advantage temporary and difficult to sustain. According to Barney (2007), a firm has a competitive advantage when it is able to create more economic value than its rival firms. Economic value is explained as the difference between the perceived benefits gained by a customer who purchases a firm’s products and services and the full economic cost of these products and services. Thus, the size of a firm’s competitive advantage is the difference between the economic value a firm is able to create and economic value its rivals are able to create.

Shapiro (1989) links competitive strategy and competitive advantage using the game theory. Shapiro argues that an organisation can influence the competitive behaviour of other organisation in the industry. This can be done through manipulation and sending different signals to the organisation’s competitors. Shapiro further explains how a firm can influence the actions of rival firms and thus the market environment. The key
idea is that by manipulating the market environment through influencing the actions and behaviour of its rivals, a firm may be able to increase its profits. Superiority of the firm depends largely on its ability to out-wit and how it out-maneuvers its rivals. This will greatly depend on what one firm thinks a rival will do in a particular situation and swiftly reacting to this. This view recognizes the role of strategic signaling as an important mechanism for influencing or intimidating rivals as a means of achieving a sustainable competitive advantage.

Thompson et al., (2006) stipulates that core competences and competitive capabilities are important avenue for securing a competitive edge over rivals in situations where it is relatively easy for rivals to copy smart strategies. Competitors can easily copy a firm’s successful strategies and therefore making it difficult for a firm to out-smart the competition with superior strategies. For a firm to achieve a sustainable competitive advantage, the firm must out-execute its strategies. This can involve building competitive capabilities and core competences that are difficult for rivals to duplicate.

According to Wernerfelt (1984), strategy of a firm is a function of the complement of the resources that the firm holds. Wernerfelt suggested that competitive advantage is created when resources that are owned exclusively by the firm are applied to developing unique competencies. The resulting advantage can then be sustained due to lack of substitution and imitation by the firm’s competitors. Wernerfelt resource based view on competitive advantage is based on the view that firms are heterogeneous and that the firm’s competitive advantage can be attributed to ownership of valuable resources that its competitors does not own. The unique and
valuable resources enable the firm to perform its activities better than its competitors. Competitive strategies are also based on these resources and how a firm deploys them. The resources a firm holds therefore determine how well that firm perform its activities and how a firm will be positioned to succeed if it has the best and most appropriate stock of resources relevant for its business and strategy.

2.5 Differentiation

Differentiation strategy enables a firm to provide goods and services that competitors are not yet offering or are not able to copy. Uniqueness in brand, technology, and products is also a key aspect (Porter 1985). In Kenya, Equity bank was able to penetrate into the market due to its differentiated customer service and targeting middle and low class group. Banks before were considered to be for the rich and mostly employed people. The banks services were considered the best when it entered the market and thus the bank has up to date created an image in the market as the big bank that gives quality service to its customers. The only thing that made it different from other banks is its differentiated customer service which up to date its competitive advantage.

In the differentiation strategy, an organization seeks to be unique in its industry in certain areas. It therefore focuses on one or more attributes that buyers in the industry perceive as important and position itself uniquely to meet those needs. Differentiation can be based on the product itself, the delivery system or its marketing approach. The organization must be truly unique at something in order to be perceived as different. One way of achieving competitive advantage is through competence based
approaches in which an organization tries to build differentiation as its core competence, which if peculiar to the organization will be difficult for competitors to imitate (Johnson and Scholes, 2002). These strategies have a long term benefit to the business especially so if they are not easily duplicated.

Differentiation builds competitive advantage by making customers more loyal, less price sensitive and less willing to consider other product alternatives. According to Rao, (2011), the firm pursuing a high differentiation strategy along some key product’s attribute or buyer need, can earmark its own strategic group within the industry in such a scenario, destructive price war can be avoided. Product quality helps the firm build its own reputation and demand that often gets translated into higher market share as well differentiation arises and competition increasingly occurs on the bases of product augmentation which also leads the marketer to look at the user’s total consumption system, the way the users performs the tasks of getting and using products and related services. Each augmented adds cost, however and augmented benefits soon become expected benefits and necessary points of panty. For example today's hotel guests expect cable, satellite television with a remote control and high speed internet access or two phone lines, this means competitors must search for these other features and benefits (Jaquier, 2010).

As competition intensifies, design offers a potential way to differentiate and position a company’s products and services. Increasingly fast paced markets, price and technology are not enough. Design is the factor that will often give a company its competitive edge. Design is the totality of features that affect how a product looks,
feels and functions in terms of customer requirements. Design is particularly important in making and marketing retail services, apparel, packaged goods and durable equipment. The designer must figure out how much to invest in form, feature development, performance, durability, reliability, reparability and style (Jaquier, 2010).

According to Kotler, (2009), Sellers may face abundance of differentiation possibilities including form, features, customization, performance quality, conformance quality, durability, reliability, reparability and style and when a physical product cannot easily be differentiated, the key to competition success may lie in adding valued services and improving their quality. The main service differentiation is ordering, ease delivery, installation, customer training, customer consulting, maintenance and repair.
CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Introduction
The main objective of the study was to establish the realization of sustainable competitive advantage through product differentiation in commercial banks in Kenya. This chapter outlines the approach that was used in carrying out the study. It discusses the research design, data collection and data analysis.

3.2 Research Design
Case study research design was adopted in this study. Case study involves collection of in depth information for understanding of situations or phenomenon, holistically and in context. According to Kombo and Tromp (2006) a case study design is a way of organising educational data and looking at the object to be studied as a whole, and should be used when one is intending to analyse an issue in detail. The case study design was therefore appropriate as the objective of the study was to have a detailed analysis of differentiation strategies that First Community Bank has implemented in order to achieve a sustainable competitive advantage in Kenya.

3.3 Data Collection
Data collection refers to gathering of information to serve or prove some facts (Kombo and Tromp, 2006). Data collection was from primary and secondary sources. The researcher collected primary data using a structured interview guide (closed ended), unstructured (open ended) questions and by observation. Ten line managers from the various functions of the bank were targeted as the interview respondents.
The researcher conducted the interviews and the direct observation in person. Secondary data was collected from already existing materials such as company’s website, company’s reports and announcements and other external sources such as the media.

According to Cooper and Schindler (2003) interview guide helps obtain in depth information as the researcher can adapt the questions as necessary, clarifies doubts and ensures that the responses are well understood through paraphrasing or repeating as required. Interviews and direct observation were the main methods of collecting data. Necessary care and due diligence was put in place which ensured the validity and reliability of the data collection.

3.4 Data Analysis

Data analysis refers to examining what has been collected in a survey or experiment and making deductions and inferences. It involves scrutinizing the acquired information and making inferences (Kombo and Tromp 2006). Data was analysed using thematic and content analysis. The data analysis involved the initial steps of editing and cleaning up data collected from interviews and observation. The refined data was then analysed by use of thematic and content analysis. This involved analysing major concepts, contents or themes relevant to the research objective and interpreting them to draw conclusions and recommendations.
CHAPTER FOUR
DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction
This chapter presents data analysis, interpretations and discussions. Information in this chapter is divided into two sections. The first section details the analysis of general information of the respondents while the second section deals with analysis of data on the objective based on descriptive statistics.

4.2 Response Rate
The sample of the study comprised of 10 respondents which comprised of five general managers and heads of department in charge of human resources, research & development, ICT, marketing and finance/auditing. The researcher interviewed the respondents using an interview guide. Some of the respondents could not be accessed due to work commitment while others were on leave. Out of the sample of 10 employees of the bank, the researcher managed to interview 7 giving a response rate of 70%.

According to Mugenda and Mugenda (2003) a 50% response rate is adequate, 60% good and above 70% rated very good. This also concurs with Kothari (2004) assertion that a response rate of 50% is adequate, while a response rate greater than 70% is very good. This implies that based on this assertions; the response rate in this case of 70% is very good.
4.3 General Information

In order to achieve the main purpose of this study, the researcher found it useful to find out the general information of the respondents. The general information of the respondents included employee position in the bank, level of education, work experience and the department.

4.3.1 Designation

The respondents were asked to indicate their position in the bank where the study established that 3(42.84%) were top managers while the other 4 respondents were heads of department in charge of human resources, research & development, ICT, marketing and finance/auditing. This represented 14.29% of the respondents each. Table 4.1 shows the findings of the study.

Table 4.1: Employees Position in the Bank

<table>
<thead>
<tr>
<th>Respondents</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Managers</td>
<td>3</td>
<td>42.84</td>
</tr>
<tr>
<td>Human resources</td>
<td>1</td>
<td>14.29</td>
</tr>
<tr>
<td>Research &amp; development</td>
<td>1</td>
<td>14.29</td>
</tr>
<tr>
<td>Information Communication Technology</td>
<td>1</td>
<td>14.29</td>
</tr>
<tr>
<td>Marketing</td>
<td>1</td>
<td>14.29</td>
</tr>
<tr>
<td>Finance &amp; auditing</td>
<td>0</td>
<td>0.00</td>
</tr>
<tr>
<td>Total</td>
<td>7</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: Researcher 2015
4.3.2 Level of Education

The study sought to find out the respondents level of education. From the findings, majority 6(86%) of the respondents had attained postgraduate qualification while 1(14.29%) had attained first university degree. It was also established that in addition, the respondents had attended many other short courses both in-house and outside the job training. Figure 4.1 displays the study findings.

Source: Researcher 2015

Figure 4.1: Respondents Level of Education

The findings of the study concurs with Ngulube and Tafor (2006) who observed that each commercial bank has its own management organization structure with a matching head count budget to support the business and the persons assigned various duties should possess requisite professional and academic qualifications. From the findings, majority of the respondents had attained academic qualification commensurate with their job designation.
4.3.3 Respondents Work Experience

The study found it necessary to find out the respondents years in service as employees of First Community Bank. Based on the findings, majority (57%) of the respondents had over 10 years experience while 29% had between 5-10 years. It was also revealed that 14% of the respondents had an experience not exceeding 5 years.

Source: Researcher 2015

Figure 4.2: Respondents Work Experience

In a study on the relationship corporate strategy and human capital, (Maria, 2011) found that strategy implementation depends highly on the skills of the human resource handling them. She indicated that the skills can be acquired through experience. From the findings therefore majority of the respondents were experienced and hence can be highly informative on issues that relate to application of differentiation strategies to create a sustainable competitive advantage. Given that majority of the respondents had substantial work experience, it is therefore expected that the application of differentiation strategies would be a success.

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4.4 Product Differentiation Strategies adopted by First Community Bank

From the findings, the study revealed that First Community Bank deliberately give assorted products and focus on the low end market so as to stay ahead of the competition. The finding concur with to Kotler and Kevin (2006), who stated that differentiation seeks to make a product more attractive by contrasting its unique qualities with other competing products. Grant, (1991) indicated that since choosing among multiple options is always based on implicit and explicit differences, the First Community Bank must differentiate financial products and delivery means in order to give the customer a reason to choose their products or service as they focus on creating unique value-adding quality service and purposefully using product differentiation factors. Armstrong and Kotler (1999) points that differentiation in banks can occur by manipulating many characteristics, including features, performance, style, design consistency, durability, reliability, or reparability and that differentiation allows a commercial bank to target specific populations in the market.

Analysis of the findings shows that differentiation strategies are greatly used by commercial banks in Kenya to remain competitive. This can be attributed to the changes in business focus from being cost leaders to being customer focused. The greatly used strategies are broad differentiation involving maintaining strong relationship with customers, identifying needs of customers, and improved customer service, offering professional services to customers among others.
Many of these strategies focus on the customer because it is the key for any business success especially for First Community Bank. The next greatly used strategies were those of narrow differentiation involving improved customer service, identifying needs of customers, reputation on quality and service, and offering professional service to customer. Contrary to expectations, these findings were generally similar with Gathoga (2001) who found that the most popularly applied strategy among commercial banks in Kenya was differentiation broad focus. Multinational banks were the pioneers in the Kenyan market and perhaps have had great influence on strategy in the banking industry.

The respondents further stated that banks also remain competitive by having aggressive campaigns of their products, branding their products by offering unique products that differentiate them from others, for example, a bank can have premier products for high income earners, products for low income earners and products for women and specific accounts for men. Finally, it was evident that the First Community Bank worked towards constantly developing new products for their customers in order to create variety.

4.5 Product Differentiation Strategies and Sustainable Competitive Advantage

A firm is said to possess competitive advantage over its rivals when it sustains profits that exceed the average for its industry. The goal of business strategy is to achieve a sustainable competitive advantage. A firm gains this advantage by adopting competitive strategies in its business units. Porter (1980), proposed that there are three sources of competitive advantage, namely, cost leadership, differentiation and focus.
In the banking industry, increased competition threatens the attractiveness of the industry and reduces the profitability of the players in the sector. It exerts pressure on banks to be proactive and to formulate successful strategies that facilitate proactive response to anticipated and actual changes in the competitive environment (Johnson & Scholes, 2002). Banks therefore focus on gaining competitive advantage to enable them respond to, and compete effectively in the market. By identifying their core competences, banks are able to concentrate on areas that give them a lead over competitors, and provide a competitive advantage (Pearce & Robinson, 2005).

According to Johnson and Scholes (2008), core competences are more robust and difficult to imitate because they relate to the management of linkages within the organizations value chain and to linkages into the supply and distribution chains. On the opinion, on whether the adoption of product differentiation as competitive strategies of any value to the first community bank, all 100% of the respondents indicated that the adoption of product differentiation as competitive strategies of value to the firm. This implies that commercial bank must constantly engage product differentiation and focus on proven differentiation strategies to corner specific segments of the market in their industry, using existing competitors' strategies as a starting point to identify fresh opportunities and gain and sustain competitive advantage. The Commercial banks should be uniquely positioned to deliver on each of its attributes basing its strength on leadership, expertise, technology, customer focus, service, support and convenience to avail variety of high quality products at a low price, that are featured and beneficial to the customers.
Differentiation strategy involves developing a product or service that offers unique attributes that are valued by the customers in that the customer perceives them to be better than or different from those of competitors. Needs and demands of the customer must be accurately defined and value must be delivered. The firm might differentiate itself in terms of product form, brand image, product features, breadth of product line, technology, customer service and pricing or distribution channels. This strategy is appropriate where the target customer is not price sensitive, market is competitive, customers have specific needs and the firm has unique resources and capabilities which enable it satisfy this needs in ways that are difficult to copy (Porter, 1985). In a highly competitive market, the shortest route to differentiation is through brand image, product features and customer service. This is evident in the banking industry, where banks are providing more or less identical products for nearly the same price. Unless a bank can extend its product quality beyond the core service with additional and potential service features and value, it is unlikely to gain customer satisfaction (Changet al., 1997).

From the findings, it was established that a differentiation strategy is based upon persuading customers that a product is superior in some way to that offered by competitors. Differentiation strategy emphasizes on creating value through uniqueness, as opposed to lowest cost (Hlavacka et al., 2001). Uniqueness can be achieved through service innovations, superior service, creative advertising and branding among others. The key to success is that customers must be willing to pay more for the uniqueness of a service than the firm paid to create it. Firms adopting a differentiation strategy can charge a higher price for their products. Differentiation
strategy appeals to a sophisticated or knowledgeable consumer interested in a unique and quality product. According to Ovidiu et al (2009), differentiation strategy is one of Porter’s strategies used in the service industry for the purpose of enhancing customer satisfaction. It is believed that differentiation strategy can be the result of a strong strategic campaign designed to strengthen the unique characteristics of the products/services within the mind of the consumers. The brand name is a strong differentiation element within such a strategy. Offering unique and a broad range of new services to customers and refining existing services delights customer since they have a variety to choose from (Abratt & Dion, 2006).

4.6 Benefits of Differentiation Strategy

According to Porter, differentiation may generate superior performance for the reason that it provides insulation against competitive rivalry because of brand loyalty by customers and resulting lower sensitivity to price. It also increases margins, which avoids the need for a low-cost position. The resulting customer satisfaction and the need for a competitor to overcome uniqueness provide entry barriers. Differentiation yields higher margins with which to deal with supplier power, and it clearly mitigates buyer power, since buyers lack comparable alternatives and are there by reducing price sensitivity.

Finally, the firm that has differentiated itself to achieve customer satisfaction should be better positioned vis-à-vis substitutes of its competitors (Porter, 1988). Besides reducing the five threats of entry, rivalry, substitutes, suppliers and buyers, differentiation creates value by enabling a firm to charge a premium price that is
greater than the extra cost incurred by differentiation. A firm should concentrate on the improvement of service quality and customer involvement in order to satisfy their customers which would ultimately help the firm to retain its customers and improve performance (Russell-Bennett et al., 2007).

4.7 Challenges During Implementation of Product Differentiation

The respondents were requested to indicate the challenges facing First Community Bank during implementation of product differentiation strategies. From the findings, lack of sufficient resources, regulations from CBK and lack of skills and knowledge on how to develop product that suits the market were the main challenges to effective implementation of product differentiation. The respondents also indicated that product differentiation implementation process was faced by competition from well-established banks such Barclays banks, Cooperative Bank and Kenya Commercial bank. The inability to source staff competitively, access new market opportunities and competitive pricing was also lacking affecting implementation of product differentiation strategies.

Implementation of differentiation strategy requires particular consideration to the organizational structure, management controls, compensation policies and implementing cost leadership strategies. As mentioned previously, organizational arrangements and implementation tools should not only fit but also reinforce the strategy. Porter (1980) suggests that strong marketing ability, product engineering, creativity, strong capability in market research, corporate reputation, quality or technological leadership, unique combination of skills drawn from other businesses
and strong cooperation from channels are commonly required skills and resources for implementing differentiation. Common organizational requirements include strong coordination among functions in research and development, product development, and marketing, subjective measurement and incentives instead of quantitative measures and amenities to attract highly skilled and creative labour.
CHAPTER FIVE
SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter summarizes the study and makes conclusion based on the findings. The recommendations of the study, limitations of the study and recommendation for further research are also presented.

5.2 Summary of the Findings

From the findings, the study established that that the commercial banks build upon the value of an existing strategy and as it promotes, reinforce, augmenting real or perceived product performance and communicating product use information. This in turn generate customer excitement and greater product awareness, enhance consumer satisfaction, loyalty, and product usage, drive cross-selling opportunities, enable premium pricing and help reduce the overall marketing expenditures. This concurred with Seng and Lin, (2004) who found that commercial bank has persistently striven to create mechanisms for differentiating itself and developing competitive products to improve their financial service delivery, improve customer satisfaction and create and sustain competitive advantage for the bank.

From the findings, the study established that bank adopted co-brands and promotional merchant discounts, flexible payment options and loyalty programs and charging low fee and charges as a strategy to remain competitive in the market. From the findings, the study established that that bank adopts co-brands and promotional merchant
discounts, flexible payment options, loyalty programs, charging low fee and charges and allocating of high limits as a strategy to remain competitive in the market. From the findings, majority of the respondents indicated that the bank had achieved commodity products with high production volumes, offering of customized services with low volumes of many differentiated services and high volumes of few standardized products.

From the findings, the study established that First Community Bank must constantly engage product differentiation and focus on proven differentiation strategies to corner specific segments of the market in their industry, using existing competitors' strategies as a starting point to identify fresh opportunities. The firm should be uniquely positioned to deliver on each of its attributes basing its strength on leadership, expertise, technology, customer focus, service, support and convenience to avail variety of high quality products at a low price, that are featured and beneficial to the customers. From the findings the study established that commercial banks in Kenya need to adopt a number of best practices when trying to create differentiation through credit card which include focusing on strengths, developing a strong marketing campaign, a unique logo and brand, and a unique image in order to have sustainable competitive advantage. This concurred with Thompson and Strickland (2001), who stated that Commercial banks need to gain their competitive advantage by linking the processes in their operations which gives them strength in delivery of products or services, based on capabilities coming from the entire value chain.
On the respondent’s comments on the impact of product differentiation in achieving sustainable competitive advantage, the study established that that any firm have opportunities for differentiating its offering to customers, although the range of differentiation opportunities depends on the characteristics of the product, economically valuable bases of product differentiation can enable a firm to increase its revenues, neutralize threats and exploit opportunities. The respondents further stated that when firms sell differentiated products, they gain some ability to adjust their prices whereby a firm can sell its output at very high prices and produce relatively smaller amounts of output, or it can sell its output at very low prices and produce relatively greater amounts of output.

5.3 Conclusion

In conclusion, from the research study, it can be established that however little the significance product differentiation holds in relation with competitive advantage, the fact remains that there is a positive relationship between the variables. This means that commercial banks must pay greater attention to the products they offer in terms of quality design, innovations and unique features. Finally, the banking sector face domestic and international competition in addition to rapid shifts in customer demands whereby many banks have come to realize that to remain viable, a strategy of product differentiation may be a more viable option than strategies based on efficiency and price (Spencer, Joiner and Salmon 2009). This research study further demonstrates that product differentiation could be used as a tool for achieving competitive advantage and enhancing greater organizational performance.
The study further concludes that findings that differentiation broad focus is greatly applied can be attributed to the shift of business from being cost focus to being customer focus. Most banks have now realized that they are in a service industry whereby customers are key to their successes and the multinational banks are not an exception. Specific Strategies applied in broad differentiation included maintaining strong relationship with customers, improved customer service, identifying needs of prospective customers, offering professional service to customers, diversity of bank culture to accommodate customer needs, and other specific strategies that had great impact on customers. By creating a relationship with a customer it makes the customer feel part of the business, hence encouraging continuity in business. Customers are not only found in the major cities, extending to rural areas increased the chances of remaining competitive.

5.4 Limitations of the Study

The research was limited to First Community Bank. The research was limited to Nairobi headquarters since most of the decisions are made at the headquarters. The current study did not investigate how competitive strategies impact on the performance of the banks. A study in this respect would be quite useful. A major implication of this study is the insight it gives regarding competitive strategies adopted in the Kenyan commercial banking industry.
5.5 Recommendations

First, in response to the dynamic nature of the business environment and the ever changing needs of customers, it is safe to suggest that executive management needs to make sure that they provide adequate satisfaction to their customers. In other words, executive management should pay more attention to customer satisfaction, since their survival in this dynamic environment is highly dependent on their ability to retain a larger customer base compared to their competitors. In addition, executive management should put additional emphasis and pay more attention to product differentiation as it is an important instrument for achieving competitive advantage which leads to greater organizational performance.

Furthermore, product differentiation appears as a critical driver for competitive advantage, which could perform the role of a bridge that links the positive influence of customer satisfaction to organizational performance. Therefore, management ought to focus and invest more on product differentiation as it could be used as a major competitive advantage tool against competitors in the industry and it is capable of guaranteeing the long term survival of the organization. The First Community Bank should adopt differentiation strategies that address needs of specific market segments. To achieve this, clients’ needs must be identified by way of continuously seeking customer feedback and promptly addressing them. So as to adequately address customers need the clients should be involved in product development. Research has shown that customer preferences keep changing, which translates into a guiding principle that products must keep changing so as to ensure sustained customer satisfaction.
It is evident that competitor keep changing their approach in bid to win and keep the clients. In response to this, first community bank must not only scan the environment to identify the strengths and weaknesses of the competitors but also keep improving the quality of their personnel, systems, facilities and the feature of the existing products. Product differentiation equally serves to cushion the banks from competition in the industry. Products with superior features ensure that customer loyalty is guaranteed which ensures a wider customer base. When the foundation of the business is a clientele that keep growing high profits are reported hence strengthening the brand. A sizable market share enables the bank to compete effectively with other financial institutions in the country.

The study recommends that First Community Bank should ensure that there is sufficient resources and technology that is constantly getting enhanced. Technology not only changes and improves the way an organization operates but also provides a channel of communication within the network. First Community Bank, must invest in attaining skilled and knowledgeable staff capable of developing product that meet customer needs and effectively implement and monitor product differentiation strategies. To keep the staff empowered the institution must make deliberate efforts to make staff training a continuous exercise. Effective technology and competent staff improves the customer experience and becomes cost effective since it increases output. Reducing premium cost enables the institutions to remain competitive.
The study also recommends that First Community Bank should improve their information system in order to ensure that frequent communication is made to their customers. Secondly, the study recommended that the government should come up with policies that would ensure that the challenges facing commercial banks in the maintenance of demand are addressed. Thirdly, the study recommends that First Community Bank should come up with pricing strategies that would avoid over or under pricing. This is because the Kenyan market if price elastic and if there is overpricing of services and products the customers would switch to the next cheaper alternatives like Sacco’s and MFIs. Fourthly, the study also recommends that commercial banks adopt advanced technology that would ensure that there are reduced costs and improved service quality.

5.6 Recommendations for Further Research

The study investigated the extent to which banks achieve sustainable competitive advantage through product differentiation focusing on First Community Bank. The study recommends that a further study should be carried out to establish ways through which banks could enhance product differentiation so as to improve customer satisfaction and enhance positive perception on banks. A further study should be carried out to establish the effects of product differentiation on financial performance of commercial banks.
REFERENCES


Durban South Africa.


APPENDICES

Appendix I: Introduction Letter

Ahmed Sheikh
P.O Box: 8084-00610
Nairobi, Kenya.
Dear respondent,

RE: INTRODUCTION LETTER
I am a postgraduate student pursuing Master of Business Administration (MBA) degree at the School of Business, University of Nairobi. As part of the requirement for the award of the degree, I am expected to carry out and submit a research project. I am conducting a study on Realization of Sustainable Competitive Advantage through Product Differentiation in Commercial Banks in Kenya: A Case Study of First Community Bank.
In this respect, I kindly request you to provide objective answers to the following questions that will be crucial information for this study. The information provided will be kept confidential and it will only be used for the intended purpose of the study. Thank you in advance.

Yours faithfully,

AHMED SHEIKH
Appendix II: Interview Guide

PART 1: RESPONDENT’S BACKGROUND REVIEW

1) What is your position in First Community Bank?
2) What’s the highest level of education you have attained?
3) How long have you worked in the banking industry?
4) How long have you worked for First Community Bank?
5) In which department or division do you work?

PART 2: SUSTAINABLE COMPETITIVE ADVANTAGE

6) Does First Community Bank have any formal competitive strategies in place?
7) What are the examples of strategies that First Community Bank has in place?
8) Which opportunities do you expect the bank to exploit in the future to sustain its competitive advantage?
9) Kindly give me an overview of the banking industry in terms of competition and the general business environment.
10) In your own view how has product differentiation been efficient in sustaining competitive advantage?
11) What are the benefits of product Differentiation in first Community Bank?
12) What are the Challenges facing implementation of product differentiation in First Community Bank?