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"EFFECT OF STRATEGIC MANAGEMENT POSTURE ON THE PERFORMANCE OF COMMERCIAL BANKS IN NAIROBI, KENYA"

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Abstract

This study sought to establish the effect of strategic management posture on the performance of the commercial banks in Nairobi Kenya. The objective of the study to determine how product differentiation affects the performance of commercial banks. This study was guided by Ansoff's Model of Strategic Posture. The study adopted a descriptive survey design and a sample of 369 employees from each bank branches in Nairobi was selected using stratified random sampling. The questionnaires were the main tool for collecting data. Reliability of the tool instruments was tested by use of Cronbach's Alpha coefficient and validity by use of content validity. The data was analysed by use of both descriptive and inferential statistics. The findings revealed that there was a strong positive relationship between Product differentiation and financial performance ($r=0.769$, $p< 0.01$) and significantly accounted for 58.9% of variance in financial performance of commercial banks in Nairobi. The study recommended that right-based approach should be used to create value for strategic management posture adopted by the commercial banks.

Key Words: Product differentiation, financial performance, strategic management posture

1. Introduction

Commercial banks play a vital role in the economic resource allocation of countries (Oloo, 2011). They channel funds from depositors to investors continuously. For them to do so, they need to generate necessary income to cover operational cost, be profitable and need to maximize their shareholders wealth. Beyond the intermediation function, the financial performance of banks has critical implications for economic growth of countries (Nyamongo&Temesgen, 2013). Good financial performance rewards the shareholders for their investment. This, in turn, encourages additional investment and brings about economic growth. On the other hand, poor banking performance can lead to banking failure and crisis which have negative repercussions on the economic growth. This has attracted the interests of researchers to examine bank performance in relation to these challenges and changes.

Banking has entered a new era (Canadian Banks, 2013). In this new norm, banks around the world face massive regulatory reform, constant change and ever-present uncertainty. They find themselves charting a path forward through an environment of limited economic growth and shifting consumer behaviours, demands and demographics (Central Bank, 2010; Nyamongo&Temesgen, 2013). Conflicting expectations for shareholders, consumers, regulators (often across various jurisdictions) and central banks add additional layers of complexity to the decision making process (CBK, 2010;Nyamongo&Temesgen, 2013). The Canadian Banking Industry is held in high regard by its global counterparts, due to its stability during the recent financial crisis (Canadian Banks, 2013).Canada's banks, which earned worldwide admiration for their performance during and after the 2008 financial crisis, are however immune to these forces. Banks globally are under pressure to simultaneously improve the customer experience, meet compounding regulatory requirements and reduce operating costs (Nyamongo&Temesgen, 2013; Adegoroye&Moruf, 2012).

Currently there are 43 banks and 1 Mortgage finance institution in Kenya (CBK, 2010). Out of the 44 banks, 31 are locally owned and 13 are foreign owned and 3 out of the locally owned have significant shareholding from the government and state corporations. There are two fully Islamic banks-Gulf African Bank and First Community Bank-which opened their doors in early 2009 and now have nearly 1 percent of gross banking assets (CBK, 2010). In addition to the two Islamic banks other banks have also been able to offer banking services through special accounts created to meet the needs of the Islamic banker. The banks have come together under the Kenya Bankers Association (KBA), which serves as a lobby for the banks' interests and also addresses issues affecting member institutions (CBK, 2010).

The Kenyan banking industry is facing many challenges including cut-throat competition among each other and CBK strict regulations especially on minimum cash deposits, the induplum rule dictating maximum interest rates on amounts borrowed, as well as floor rates. Other challenges include serving more educated and discerning customers, technological innovations, globalization, and encroachment into banking services by mobile phone providers in money transfer and utility bill payment services (Kithinji&Waweru, 2007). Banks therefore have a huge task of employing effective strategies to remain in profitable operations. The Kenyan banking sector has registered a continued growth in performance over the last eight years, with the banking sector collectively registering impressive performance (Nyamongo&Temesgen, 2013).

Despite the good overall financial performance of banks in Kenya, there are a couple of banks declaring losses (Oloo, 2011). Moreover, the current banking failures in the developed countries and the bailouts therefore motivate this study to establish effect of strategic management posture on the financial performance of banks in Kenya. Thus, to take precautionary and mitigating measures, there is dire need to understand the strategic management postures and its effect on the performance of commercial banks in Kenya.

1.1 Statement of the Problem

For economic sustainability of the country, it must have a strong banking sector since commercial banks play a vital role in the economic resource allocation of countries. They channel funds from depositors to investors continuously. For them to do so, they need to generate necessary income to cover their operational cost they incur in the due course and generate profit. However there have been tremendous and rapid changes within and outside the environment their greatly affecting their operations and performance. These changes have created a lot of interest into various strategies employed by different banks in Kenya on their performance. Many studies have shown a positive relationship between various strategies and performance (Huselid 2007; Armstrong & Baron, 2009; Katou, 2008; Ahmad & Schroeder, 2003; Bae&Lawler, 2000; Batt, 2002; Guthrie, 2001; Gardner & Moynihan, 2003).

Despite these findings most studies have been characterized by lack of a solid theoretical foundation explaining the mechanisms causing the observed enhanced performance. Available studies do not adequately investigate exactly how a good strategy employed by a firm leads to improved performance. Researchers have termed some strategies employed by banks lack of clarity regarding ‘what exactly leads to what’ (Purcell, 2004; Gerhart, 2005 &Katou, 2008).

Without a clearly delineated theoretical model of strategic posture and its effect on performance, scholars cannot adequately validate the efficacy of such and provide useful suggestions to practitioners. There is, therefore, a great need for additional evidence to support the strategic posture and performance relationship from different sectors and contexts. It is from this background that this study seeks to investigate how strategic management posture affects the performance of commercial banks in Kenya.

1.2 Research Objectives

$H_0$1:There is no significant relationship between product differentiation and the performance of commercial banks in Nairobi Kenya.

1.3 Theoretical Framework

The study anchored on Ansoff's theory of strategic posture. In his matrix, he developed a tool that would provide executives, the senior management teams and marketers to devise strategies that would help them in the future growth and development. Strategic posture can be viewed as a firm's placement along a continuum ranging from low to high risk. Ansoff determined that there is an existing product-market strategy that exists as a joint statement that relates to a product line. The same corresponds to a mission set in which the products in the market are supposed to fulfill. According to him, there are four strategic posture alternatives that companies can adapt to evenly operate as a successful venture in the market. In 1957, Ansoff provided a posture that would be used in strategic planning and positioning in the market by a company (Ansoff, Declerck, &Hayes, 1984). Ansoff established four strategic features that would be used by firms in planning and understanding the market as well as planning for a favourable future.

According to Ansoff, there is a corresponding relationship between products and the growth of the markets. Products can be considered new or existing in the market and in the same sense, the market may be considered new or existing. The posture has four strategic alternatives. These are the penetration of the market, the development of the products, the development of the market and the overall product and market diversification. Under local circumstances, the market penetration can also be linked to the networking of the branches of the respective company. The product development can also be considered as having the capability to differentiate the products in the market (Ansoff, Declerck, & Hayes, 1984). Diversification in the context of the banking sector as required in this research will consider the innovations in the technological sector which is sound enough in improving the quality of the products. Ansoff, Declerck and Hayes (1984) determined that the penetration in the market through use of the existing branches with reference to the available products and services is important in increasing the market share by use of the current scenario and segment. Therefore, consideration of the branch networking considers more of the goods and services provided at the branches.

1.4 Conceptual Framework

In this research, independent variable was product differentiation while dependent variable was performance of commercial banks. It was hypothesised that product differentiation as independent variables could have a positive and direct associations on the dependent variables, the performance of commercial banks. The direction of the arrows shows the interrelationships between these variables.

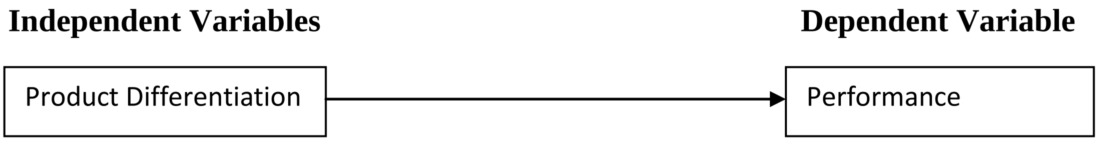

Figure 1.Conceptual Framework Showing Interaction of Key Variables of the Study

Source: Researcher (2016)

2. Literature Review

2.1 Product Differentiation and Performance of Commercial Banks

Differentiation strategy is where the firm positions itself to provide a unique product or service and even charges a premium for creating the uniqueness. The strategy is useful where the target market has unique tastes and preferences and the firm has the ability to fully meet their requirements (Porter, 2008). In doing so, the firm gains brand loyalty which effectively locks out competition. Porter asserts that the firm can only gain this attribute of being unique if it is actually unique at doing something or just perceived as such by customers.

Kotler (1998) elaborated on a concept of product differentiation as the downward falling demand curve of an individual product. He suggested that the demand is also dependent on the style of the product and selling activities in addition to pricing. He noticed the importance of non-price competition: reducing price competition is the primary aim of differentiating a product. 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 a distinct in some important way, like better service and superior quality and special appeal (Kotler, 2009).

Research done by Shayo (2009) gave an idea on the contribution of strategy to survival of firms. Product differentiation strategy is considered as a key factor for attaining sustainable competitive advantage for telecommunication industry in Tanzania'. The Researcher of this work has referred Shayo's findings in reference to the topic since sustainability can be brought due to increase in the sales level.

According to Shayo, (2009) differentiation strategy has played a big part in evolution of telecom business in Tanzania. It also helps in developing an emotional bond between customers and products of Zain Tanzania due to the pressure of competition among mobile telephone companies; also it provides insulation against competitive rivalry because of brand loyalty from customers and resulting lower sensitivity to price. As the technology in communication industry is changing day after day, Zain need product differentiation in order to have a better coverage than others, to have the right price to the products, quality of service, by becoming the best quality provider in the market and lastly to build an emotional bond between the customers and the products.

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.

Jaquier, (2010) views that anything a company can do to create value for buyers represents a potential basis for differentiation. Differentiation arises and competition increasingly occurs on the bases of product argumentation 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.

Saloner, Shepard and Podolny (2001) have clarified that most forms of competitive advantage mean either that a firm can produce some service or product that its customers value more than those produced by competitors or that it can produce its service or product at lower cost than its competitors. They also suggest that the firm must also be able to capture the value it creates in order to prosper. The firm must have a sustainable competitive advantage in order to create and capture value.

Kim and Mauborgne (2005) has developed the Blue Ocean Strategy which illustrates that an organisation can generate the high growth and profits by creating new demand in an uncontested market space- "Blue Ocean", than by competing for known customers in an existing industry. Red oceans are all the industries exist today, the known market space. Industry boundaries are defined and the competitive rules known to everyone. Companies try to outperform their rivals to obtain a greater share of product or service. Competition increases in crowded market space, which reduces profits and growth. Blue oceans, refer to all the industries not in existence today, the unknown market space. Demand is created and plenty of opportunity for growth that is both profitable and rapid. Competition is irrelevant because the rules are yet to be set. Blue ocean is b an analogy to depict the wider, deeper potential of market space that is not yet explored. A blue ocean is created when a company achieves value innovation that creates value simultaneously for both the buyer and the company.

Grant (2010) also argues that what really matters is an understanding of customers on what and how they behave, because most customers choose a product/service that reflects their social goals and values to realize community with others or one□s own identity. These social and psychological factors may not be captured by the statistical techniques. On the other side, the firm's ability to offer differentiation is also important to achieve differentiation advantage. Many well-differentiated firms usually spend more from product research and development (R&D), technology, hiring skilled people, marketing, distribution, and customer services. He concludes on several principal stages that use the value chain to identify opportunities for differentiation advantages for firm. The first stage is that the firm should construct a value chain for the firm as well as customers. Then along the value chain, the firm can identify the drivers of uniqueness in each activity in order to assess the firm□s potential for differentiating its products/services. Among the drives of uniqueness identified, firms should select the most promising differentiation variables for the firm.

Kinyuira (2014) revealed that product differentiation strategy had a significant positive effect with the performance of Savings and Credit Cooperatives (Saccos) in Murang'a County. Similarly, Nanjekho (2014) concluded that conclude that product differentiation has significant effect on performance of animal feed manufacturing firms in Central, Rift valley and Western Kenya. Kamau (2013) found there is significant relationship between product differentiation and performance of supermarkets in Nakuru town central business district. This is because product differentiation strategy has a positive correlation with sales performance.

3. Methodology

The design adopted in this study was descriptive survey design. The total population targeted was 2,732 employees from 44 commercial bank that operating in Nairobi Kenya. The sampled 369 respondents including eight (8) CEO's, eight (8) Operations Managers, eight (8) Human Resource Managers were purposively selected due to the small number and the importance of the managerial cadre in this study while 117 Supervisors, 192 Tellers and 36 Administrative Clerks were selected through simple random sampling technique. Structured questionnaires were used to collect primary data. Validity was determined by content validity while reliability was determined through Cronbach alpha with a measure of 0.732. Pearson Correlation analysis and linear regression enabled the researcher establish the extent to which the product differentiation strategy affected the performance of commercial banks.

4. Findings

4.1 Descriptive Statistics: Product differentiation

To measure product differentiation strategy, a set of nine statements were formulated. The respondents were asked to indicate the extent of agreement with each of the product differentiation strategy statements. The pertinent results are presented in Table 1.

Table 1: Product Differentiation

Differentiation	**SD**	**D**	**N**	**A**	**SA**	**Mean**	**STD**
My bank extensively differentiate its product	7 (2.42%)	16 (5.54%)	51 (17.65%)	180 (62.28%)	35 (12.11%)	3.76	0.83
My bank offer different Pricing as a mechanism to differentiate product	8 (2.77%)	31 (10.73%)	74 (25.61%)	167 (57.79%)	9 (3.11%)	3.48	0.83
My bank uses customers tastes and preferences to differentiate product	4 (1.38%)	15 (5.19%)	31 (10.73%)	195 (67.47%)	44 (15.22%)	3.90	0.76
My bank uses current market Conditions to differentiate product	13 (4.5%)	35 (12.11%)	58 (20.07%)	153 (52.94%)	30 (10.38%)	3.53	0.99
My bank products are unique from competitors	6 (2.08%)	25 (8.65%)	57 (19.72%)	181 (62.63%)	20 (6.92%)	3.64	0.82
My bank aims at differentiating to have a better coverage than competitors	7 (2.42%)	11 (3.81%)	26 (9%)	153 (52.94%)	92 (31.83%)	4.08	0.88
My bank aims at differentiating to have right price to the products	15 (5.19%)	31 (10.73%)	41 (14.19%)	167 (57.79%)	35 (12.11%)	3.61	1.00
My bank aims at differentiating is to ensure quality of services	7 (2.42%)	12 (4.15%)	59 (20.42%)	176 (60.9%)	35 (12.11%)	3.76	0.81
My bank aims at differentiating to bond customers and the products	3 (1.04%)	15 (5.19%)	39 (13.49%)	177 (61.25%)	55 (19.03%)	3.92	0.79
Average score						**3.74**	**0.86**

Source: Researcher (2016)

From Table 1, the researcher noted that 180 (62.28%) and 35(12.11%) of the respondents agreed and strongly agreed respectively that their bank extensively differentiate its product from the competitors with a mean of 4 (agree) and S.E of 0.05 with a standard deviation of 0.83. Further, the results revealed that 176 (60.9%) of the respondents confirmed that they use pricing differentiation to different their products from their competitors. However, with a mean of 3 (Neutral) with a S.E of 0.05 and standard deviation of 0.76, 74 (25.61%) of them were neutral as pricing is sometimes determined by CBK to cushion the Kenya Shillings. Customers tastes and preferences was used as differentiation strategy as shown by 195 (67.47%) and 44 (15.22%) of the respondents who agreed and strongly agree respectively. The mean was 3.90; S.E was 0.04 with a standard deviation of 0.76.

Further, 153(52.94%) and 30(10.38%) of the respondents agreed and strongly agree respectively that their bank used current market condition as product differentiation strategy with a mean of 4 (agree), S.E of 0.06 and standard deviation of 0.99. The results also revealed that bank employed differentiation strategy by making their products unique from their competitors as shown by 181(62.63%) and 20 (6.92%) of the respondents who agreed and strongly agreed. The mean score was 4 (agree), S.E of 0.05 and standard deviation of 0.82.

Different banks employ differentiation strategy for various aims so as to gain competitive advantage in the market. The findings revealed that 153(52.94%) and 92(31.83%) of the respondents agreed and strongly agree respectively that the aim for differentiating is to have a better coverage than competitors with a mean of 4 (agree), S.E of 0.05 and standard deviation of 0.88. Further, 167(57.79%) and 35(12.11%) of the respondents agreed and strongly agreed respectively that the aim for differentiating is to have right price to the products relative to their competitors. Also, the results indicated that 176(60.9%) and 35(12.11%) of the respondents agreed and strongly agreed that their aim of differentiation strategy is to ensure quality of services. With a mean of 4 (agree) and a S.E of 0.05 with standard deviation of 0.81. Lastly, differentiation strategy was used by the respondent's banks to bond customer and their product. This loyalty of the product was shown by 177(61.25%) and 55(19.03%) of the respondents who agreed and strongly agree respectively with a mean of 4 (agree), S.E of 0.5 and standard deviation of 0.79.

The overall mean of product differentiation strategy as shown in Table 4.4 was 4 (Agree) with a standard error of 0.05 and standard deviation of 0.86. The findings revealed that the unique products offered by the banks were saving and credit products which was tailored according to specific market segment. The banks majorly concentrated on form of the products, features of the product, customization, performance quality, conformance quality, durability, reliability and value addition to so as to achieve and sustain differentiation to become the above average performer in banking industry if its price premium exceeds the extra cost incurred in being unique.

4.2 Correlation between product differentiation and financial performance

The Pearson correlation analysis was used to assess the relationship between product differentiation and financial performance. The objective tested second hypothesis of the study which was there is no significant relationship between product differentiation and the performance of commercial banks in Kenya. The results are as shown in are Table 2.

Table 2: Correlation Between Product Differentiation and Financial Performance

		Product differentiation	**Performance**
Product differentiation	Pearson Correlation	1	
	Sig. (2-tailed)		
	N	289	
Performance	Pearson Correlation	.769**	1
	Sig. (2-tailed)	.000	
	N	289	289

**. Correlation is significant at the 0.01 level (2-tailed)
Source: Researcher (2016)

The results in Table 2 revealed that the relationship between product differentiation and performance is strong, positive and statistically significant ($R = .769$, $p < .01$) with 99.0% confidence level. This showed that product differentiation had significant positive effect on the financial performance of commercial bank. Since the significance level is less than 0.05, the study rejected the second hypothesis and revealed that there is significant relationship between product differentiation and the performance of commercial banks in Kenya. This further indicated that an increase in product differentiation as a result of strategic management posture would result to an increase in financial performance of commercial banks in Kenya.

4.3 Regression analysis: Product differentiation

Since correlation analysis indicated that product differentiation had significant strong positive effect on performance, simple linear regression was used to found out the variation in financial performance that is been explained by product differentiation. The results are as shown in Table 3.

Table 3: Regression results of product differentiation and performance

R Square	Adjusted R Square	Df	F	Sig.
0.591	0.589	(1, 288)	414.385	.000b

	Unstandardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	T	Sig.
(Constant)	-2.725	.322		-8.475	.000
Product differentiation	1.748	.086	.769	20.356	.000

Source: Researcher (2016)

The study sought to determine the influence of Product differentiation on performance of commercial banks. From the findings, the coefficient of correlation (R) between the product differentiation and financial performance is 0.769 and the coefficient of determination (R square) is 0.591. This means Product differentiation that 59.1 % of the variations in financial performance can be explained by Product differentiation while 40.9% is explained by other factors. The relationship between Product differentiation and performance is significant since p=0.000 which is less than 0.05. We still reject the second null hypothesis as there exist a significant relationship between product differentiation and the performance of commercial banks in Kenya. The ANOVA results showed that the percentage variation that is been accounted by product differentiation is statistically significant with F (1, 288) =414.385, P<0.05.This implied that there is a significant linear relationship between the predictor variable(414.385) and financial performance of commercial banks in Kenya.

The intercept value for performance is -2.725 this implies that in the absence of product differentiation, the performance of sampled banks will be significantly at -2.725, P<0.05. The unstandardized regression coefficient (β) value of product differentiation was 1.748 with a t-test of 20.356 and significance level of p<0.05. This indicated that a unit change in product differentiation will result to change in financial performance by 1.748. The regression equation to estimate the financial performance was hence stated as:

Performance = -2.725 + 1.748 * Product differentiation

The second research hypothesis posited HO2: There is no significant relationship between product differentiation and the performance of commercial banks in Kenya. From the results, product differentiation had significant positive effect on performance with $P<0.01$ and it significantly accounted 58.9% variance in commercial banks performance in Kenya. Therefore the second null hypothesis is rejected as product differentiation has significant relationship with the performance of commercial banks in Kenya.

These findings are in agreement with previous studies such as Kinyuira (2014) who revealed that product differentiation strategy had a significant positive effect with the performance of Savings and Credit Cooperatives (Saccos) in Murang'a County with $R= .855$, $P<0.05$. Similarly, Nanjekho (2014) concluded that conclude that product differentiation has significant effect on performance of animal feed manufacturing firms in Central, Rift valley and Western Kenya with $R=0.546$, $P<0.01$. Kamau (2013) found there is significant relationship between product differentiation and performance of supermarkets in Nakuru town central business district. This is because product differentiation strategy has a positive correlation with sales performance with $R=0.443$, $P<0.01$.

5. Conclusions and Recommendations

There was significant relationship between product differentiation and performance of sampled commercial banks in Kenya. These banks were found to extensively differentiate their products and services from their competitors. Product uniqueness was done through pricing and quality so individual customer preferences and tastes are met. This was done line with current market condition so as to increase market share and product loyalty.

The study recommends that the commercial banks should strive to ensure product range extension, product improvement and new product introduction to enable the companies to be more productive, to grow faster, to invest more and also to earn more performance. The commercial banks should ensure new products introduction, reduction of costs, improved innovation process and conformance to regulations are used to influence performance of the firms under study. This will help the tap into customers' needs so well that new products generate their own source of marketing momentum.

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