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Growth Strategies and Performance of Commercial Banks in Nairobi County, Kenya

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Abstract

Changing trends globally and customers' expectations are forcing banks to search for new ways of income generation. Growth strategies often play a vital role in a business's management as it allows a company to choose a direction of action and determine how to achieve its goals. The general objective of the study was to determine the effect of growth strategies on performance of commercial banks in Nairobi County, Kenya. The specific objective was to examine effect of diversification strategy on performance of Commercial banks in Nairobi County, Kenya. The study was anchored on porters' theory of competitive advantage and modern portfolio theory. This study adopted a descriptive research design. The target population was 794 bank staff from 39 commercial banks in Nairobi County. Stratified random sampling was used to sample 238 bank staff. The study used primary data which was collected using questionnaires. A pilot study was conducted with 24 respondents representing 10% of the sample. The research used content validity. Cronbach's Alpha Coefficient method was used to measure questionnaire reliability. Ethics of confidentiality, anonymity, no harm to the respondents', and voluntarily participation was adhered to strictly when collecting data. Quantitative data was analyzed using descriptive and inferential statistics and tabulated. The findings showed that diversification enables the bank to leverage its resources effectively and that diversification enhances risk minimization in the banks' investments. It was also found that diversification influences good decision making on profitable investments. In addition, the study established that risk mitigation strategies are reinforced through diversification. The study concludes that diversification strategy has a positive and significant effect on the performance of commercial banks in Nairobi County, Kenya. This study recommends that the banks should adopt diversification in their operations through use of technological advancements and other aspects such as innovation and benchmarking strategies to realize full benefits of diversification. Further, the management of commercial banks in Nairobi County

should formulate and implement effective strategies to enhance regional, national and new customer segments development.

Key words: *Growth Strategies, Diversification Strategy, Organizational Performance*

1.1 Introduction

Changing trends globally and customers' expectations are forcing banks to search for new ways of income generation. Growth strategies refer to the methods that a firm uses in order to achieve its goals for expansion (Calloway, 2018). Blackburn, Hart, and Wainwright (2013) explained that growth strategies offer a framework to help organization managers to devise strategies for future growth. Growth strategies are aimed at winning larger market share, even at the expense of short term earnings through diversification, product development, market penetration and market development. Growth means both quantitative and qualitative development in businesses. Quantitative growth means an increase in current output, sales revenue, product range, extent of resources. Qualitative growth is about developing the quality of business elements. In the banking industry, competitive advantage creates an edge above competitors in winning over customers. Commercial banks therefore consistently assess their business and operating environment which enables the banks to adopt growth strategies that ensure they perform excellently in the industry (Amidu & Wolfe, 2013).

Global Perspective of Growth Strategies

According to Strickland and Thompson (2015), growing a business will entail developing and implementing strategies that add value to the company, attract and satisfy the consumers, allow the company to compete effectively with other industry rivals, conduct operations while improving the company's financial as well as market performance. Pepsi Co in the United States has implemented market penetration as its primary intensive growth strategy. The strategy supports business growth through increased sales to attain a bigger market share. The company uses aggressive marketing in attracting more customers. The company's strategic objective linked to their intensive growth strategy is to minimize costs and prices to attract more consumers despite market saturation (Calloway, 2018). Ardyan (2018) found out that the majority of organizations in the United States used market penetration strategies in order to gain a base in the markets they wished to control. He further points out that market penetration can take various forms. Each form is dependent on the kind of marketing strategy that the firm will choose to adopt into their grand plan of market penetration.

Delbufalo, Poggesi and Borra (2016) noted that the reason that advised the corporate's in Australia and other eastern pacific countries to conduct the diversification was the need to reach newer markets before the competitors and the need to raise extra revenues. In their study, they noted that markets in china are very competitive and had a negative effect on the revenues that were being generated. Ernst and Young Group (2014) reported that due to the shrinking in profit margins during year, many firms especially in the insurance firms choose to seek for proper strategies to grow. They did this by developing products that primarily aimed customer needs structuring to fit individual buyers

Regional Perspective of Growth Strategies

According to Anyanwu and Agwor (2015), growth strategies often play a vital role in a business's management as it allows a company to choose a direction of action and determine how to achieve

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its goals. Growth strategies allow companies to access new markets; expand geographically, complementary skills, and core competencies relatively fast. In doing so, they increase their shareholders' or investors' value. Some Nigerian banks merged in2005and in subsequent periods when they faced the threat of merging or liquidation. However, most of the banks that merged involuntarily entered another problem cycle between 2009 and 2012. Actually, most of their equities were zero or even negative. This situation adversely affected their financial performance (Abolarinwa & Asogwa, 2020).

Okechukwu (2019) opines that merger and acquisition provide the faster ways to achieve growth or capitalize the firms accumulated assets in order to attain strategic positioning. In making its entry decision, a profit- oriented firm would always compare the desirably of entry by internal means and entry by acquisition and then choose the means consistent with its corporate objectives of sustaining organization growth. Tufa (2018) identified that marketing problems in micro and small enterprises in Ethiopia results from lack of awareness on how to compete in the market, limited business management and salesmanship ability, limited capacity to promotional activities, and lack of market-related knowledge.

In Tanzania, Mmanyi (2020) found that small banks have adopted several growth strategies to extend their coverage in various regions of the country, and increase their market share. The banks developed the markets driven customer products and services at a lower costs or differentiation strategy to survive in the highly competitive market. The small banks also merged or inquired others to increase their assets and a wider market share. According to the study, various banks have employed growth strategies resulting to network expansion, increase market share, infrastructure, and human capital development. The banks have also developed the markets driven customer products and services at a lower cost or differentiation strategy to survive the competition forces in the market.

Local Perspective of Growth Strategies

Wanjiru and George (2015) noted that both internal and external growth strategies can be used simultaneously and that each has its own advantage and disadvantage. The opportunity to build synergies as well as market power is a benefit of an external development strategy. External growth strategies will devalue a company if managers re-invest the company's resources or free cash flows in ineffective projects that benefit them personally. The major advantages of growth include providing a more corporate control in an organization, encouraging internal free enterprise and protecting firms' culture for diverse motives.

Muchele (2019) found that market penetration, market development, product development, diversification had a positive correlation with organizational performance. Maithya (2021) discovered a significant positive association between diversification strategy, product development strategy, market penetration strategy, market development strategy and performance of telecommunication firms in Kenya. Ojwaka (2018) found that market development, market penetration, product development and diversification strategies had a positive significant relationship with organizational performance of commercial printing firms in Nairobi. In Kenya, commercial banks have employed various growth strategies premised on the need to enhance financial performance in dynamic banking industry.

Organization Performance

According to Hinson (2016), organizational performance refers to the actual output or the results of the organization as measured against the intended outputs and the outputs. Bonaglia and Goldstein (2016) explained organization as the organization's effectiveness and how it achieves its objectives and strategies. It is also how organizations employ various strategies towards ensuring that it has a good market share within the industry. Organization performance encompasses three basic elements in the organization. The elements include the market performance, financial performance and the shareholder return. Good organization performance means that the various strategies adopted are working in the right way for the company. Performance measurement for commercial banks can be done by calculating ratios such as Return on Assets (ROA) and Return on Equity (ROE). Return on Assets evaluates the efficiency of an investment as is calculated as net income divided by total asset while return on equity is the amount of net income returned as a percentage of shareholders equity. The higher the return on equity ratios, the higher the financial performance of commercial banks while the higher the ROA values, commercial banks appear to be more effective in resource utilization (Richard, 2019).

Banking Sector in Kenya

The banking sector is regulated by the Central Bank of Kenya Act (CBK). The 2019 CBK Annual Supervisory report gives the latest published structure and status of the commercial banks in Kenya. As at 31st December 2019 the sector had a total of 40 commercially oriented banks of which 39 were commercial while one is a mortgage finance company. The banking sector was liberalized in 1995 and exchange controls lifted. The CBK, which falls under the Minister for Finance docket, is responsible for formulating and implementing monetary policy and fostering the liquidity, solvency and proper functioning of the financial system. Players in this sector have experienced increased competition over the last few years resulting from increased innovations among the players and new entrants into the market.

A few of the local banks have grown strongly to gain a significant share of their domestic banking market. Some of the larger local banks have also established subsidiaries in other African countries. But most of the local banks are small with only a few branches. Very few have shareholder capital of more than $5 million. They are predominantly urban-based. Their lending is mainly short-term and directed to local businesses, mainly small- and medium scale, and especially traders: most do not have the capital base to lend to larger corporate clients. The industry has faced several issues such as changes in regulatory framework, declining interests margins due to customer pressure for non-traditional services and introduction of non-traditional players who now offer financial services products (Mwarey, 2018).

1.2 Statement of the Problem

Businesses in the real world are faced by a challenge to either grow their products or close down due to the state of competition in many sectors. The shareholders also demand value for their investments. There has been increased competition in the banking sector over the last few years mainly due to new entrants in the financial sector like the micro finance and mobile phone companies that provide financial services to the unbanked and under banked population particularly in the rural areas. The banks have made efforts to remain competitive through adoption of growth strategies mainly by opening up new branches, introduction of news services and operating regionally (Kungu, Desta, & Ngui, 2019). The strategies are aimed at growing

banks' market shares, expand on asset base, increase in annual profits, minimize costs, and outdoing its competitors (Maudos, 2017).

The banking profitability of the banking sector in Kenya fell drastically in 2020. Profit before tax was 140 billion in 2020 but it fell to Kshs. 107.3 billion in 2020, reflecting the lowest since 2012 (CBK, 2021). Return on assets has decreased from 4.7% in 2013 to 3.86% in 2015 to 3.33% in 2017 whereas return on equity has decreased from 29.2% in 2013 to 24.4% in 2015 to 20.68% in 2017(Bank Supervision Annual Report). High competition in the banking sector has resulted to collapse and receivership of some banks which were unable to adopt growth strategies that would enable them to remain competitive. For instance, Chase Bank experienced liquidity troubles, a case that led to its placement under receivership. The CBK put two other banks, Dubai Bank of Kenya and Imperial Bank Kenya into receivership (Quarts Africa, 2016). This state of affairs shows the practice problem concerning the financial performance of commercial banks in Kenya.

There is some empirical evidence suggesting that a firm's performance depends on whether the firm adopts internal or external growth strategies. Mwangi (2019) study on product development and organizational performance in five star hotels found that there exists a significant relationship between product development and organizational performance. Nyawira (2016) on the relationship between marketing strategies and performance of large hotels in Nairobi County established that marketing strategies application had a positive impact of performance of hotels. Muchele (2019) study on effect of growth strategies on the performance of food manufacturing firms in Nairobi County, Kenya found a positive effect of growth strategies on organizational performance. These studies were conducted in other sectors unlike the current study that was carried out in the banking sector. There are limited studies in the banking sector in Kenya. This study sought to fill the research gap by carrying out a study in the banking sector in Nairobi County, Kenya.

1.3 Objectives of the Study

To examine effect of diversification strategy on performance of commercial banks in Nairobi County, Kenya

2.1 Literature Review

2.2 Theoretical Framework

2.3 Modern Portfolio Theory

Modern Portfolio Theory (MPT) was proposed by Harry Markowitz (1959). The theory encourages careful choice of investments to include in a portfolio. An investor can successfully reduce risks while increasing the anticipated return of a portfolio. According to Markowitz, the risk of a portfolio is the portfolio's covariance, and every investor should aim to build a portfolio of low-covariance investments. Several scholars have assessed the relationship between financial performance and diversification and their theoretical basis and reference was Modern Portfolio Theory. Sharpe further developed the concept in the MPT in 1963. He formulated the factor model used to determine how a security performs relative to the general market index. Ross also instituted an asset pricing model in 1976 that has gotten wide application in valuing assets when considering multiple risks.

MPT underpins that basis for considering the impact of diversification on performance of banks in Kenya. This is supported by scholars like Chen and Yu (2011) and Olajide (2012) who reported

that diversification leads to exploitation of economies of scale. Furthermore, diversification results to increased profits, stability of income streams, sales growth, sustainability and improving performance of the company's shares in the market. However, the theory assumes that investments in different portfolios ensure corporate sustainability. Although this is a criticism of the theory, it was still applicable in the current study since product diversification ensures that the bank offers various services and products which enhances sustainability in a competitive environment particularly in the era of emerging technology.

2.4 Empirical Studies

Diversification strategy is an important component of the strategic management of an organization. Sharma and Anand (2018) state that diversification is a risk strategy that organizations employ through having a different range of products in its portfolio. They further explain that diversification aims at increasing the market share by the organization and consequently increasing profitability in the organization. Burkirwa (2017) indicates that diversification can also be seen as a strategy of penetrating into the new market segments by the organization. In diversification, organizations try to explore new market segments in order to reap maximum benefits and increase on its market base. In today's ever changing and turbulent business environment, diversification has become a catalyst for achieving competitive advantage and performance in the banking sector because banks operate in a highly competitive environment (Alli, Hashmi, & Mehmood, 2016). Banks are now moving towards diversification of their revenues to reduce risk of their portfolios and to increase the profitability. Diversification can enhance the profitability by reducing overall risk involved in banking operations (Ismail, 2015). Nwakoby and Ihediwa (2018) opined that companies whose products are threatened by environmental uncertainty or by declining phase of their life cycle curve will prefer to engage in diversification to overcome the risks. A firms may also engage in expanding its product line and activities to different sectors where environmental uncertainty is reduced and, profitability is higher.

Ismail (2015) studied effect of income-diversification in the banking sector in Pakistan. The study adopted a longitudinal survey design. Secondary data was collecting from financial reports of 14 banks. The study reviewed seven years financial reports collected from the banks websites. According to the study findings, diversification of income generating activities whether interest or non-interest based enhances the profitability through reducing general risks involved in the bank operations. Results also showed significant positive relationship between income diversification and bank performance.

Onur and Ihsan (2016) sought to determine whether there exists significant differences between diversification and performance in three countries; Turkey, Italy and Netherlands. Data was collected from firms' financial reports. Findings showed no significant correlation between diversification and firm performance in Italy and Netherlands but there was a weak correlation between diversification and firm performance in Turkey. Ranka, Vladimir and Dragan (2017) aimed at determining the relationship between diversification and performance of insurance companies in Serbia. Data was collected from company financial reports for a period of ten years. Results showed that there was a significant positive relationship between risk-adjusted returns measured both by return on assets and return on equity and line-of-business diversification and performance.

Nwakoby and Ihediwa (2018) examined effect of firm diversification on financial performance of Nigerian firms. The study adopted Ex-Post Facto research design. The study used secondary data collected form firms financial reports from a period of ten years. The study concluded that banks' financial performance was affected positively by diversification. Rono (2016) conducted a study on effect of growth strategies on performance on the cement industry in Kenya. The study adopted a descriptive research design. The sample was 150 sampled using stratified sampling from a target of 1472 staff. Data was collected using questionnaires. The results showed that product diversification enables firms to develop a new product that serves a different market that what it was serving which enables a firm's growth and competitive advantage in future.

Makhoha, Namusonge and Sakwa (2016) examined portfolio diversification on financial performance of banks in Kenya. The study employed mixed research design. The study sample was 133 bank managers selected using random sampling. Data was collected using questionnaires and interview guides. Results showed that portfolio diversification had a positive significant effect on bank performance. Manyuru, Wachira and Amata (2017) investigated the impact of corporate diversification on value of firms listed at the Nairobi Stock exchange. Secondary data was collected from the firms' website. Findings showed that industrial diversification enhanced firm value in agricultural sector only and geographical diversification is not significantly related to firm value.

2.5 Conceptual Framework

The study was guided by the following conceptual framework.

Independent Variables **Dependent Variable**

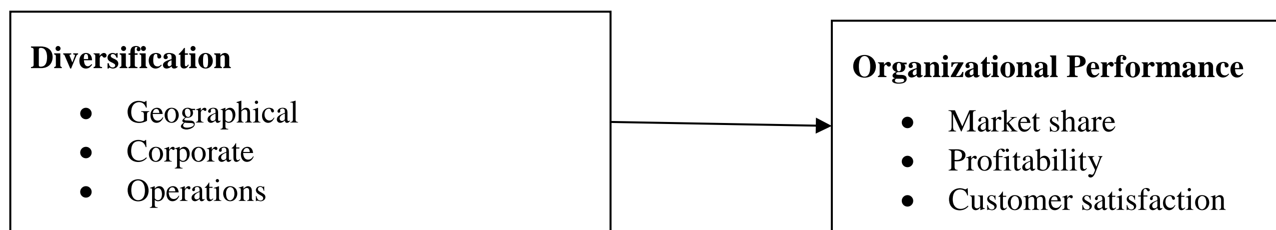

Figure 1: Conceptual Framework

Source: Adopted from literature review

The conceptual framework demonstrated that through diversification of geographical, corporate and operations, the banks will be able to increase their market share, profitability and enhance customer satisfaction.

3.1 Research Methodology

This study adopted a descriptive research design. This research design was chosen by the researcher since it is more specific, correct and describes events in a strategic way (Zurmuehlin, 2013). This research was conducted in the 39 commercial banks in Nairobi. The banks have a total of 794 pensionable and permanent staff that formed the study unit of observation. The study's population was made up of 794 pensionable and permanent staff in the commercial banks. Stratified random sampling was used to obtain the study sample size which was determined. The

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staff were stratified into three classifications; local public commercial banks, local private commercial banks, and foreign commercial banks. Mugenda and Mugenda (2008) asserted that 10 to 30 % of population is enough thus the researcher sampled 30% of the target to obtain a sample of 238 respondents.

This study used primary secondary data which was acquired using a questionnaire with both open and close ended questions. This study tested both content and face validity. In addition, Cronbach's Alpha Coefficient method was used to measure questionnaire reliability. The researcher applied for an authorization letter from the school of entrepreneurship, and strategic management, Jomo Kenyatta University of Science and Technology and a research permit from National Commission of Science, Technology and Innovation (NACOSTI). The researcher then visited the banks to notify the management of the study and request for an appointment to administer questionnaires to the study respondents.

The study used the Scientific Package for Social Sciences (SPSS) version 26 for inferential statistics, which included Karl Pearson Correlation and regression analysis. Regression analysis was conducted to understand how a unit change in the independent variable (diversification) would predict a change in the dependent variable (performance of commercial banks).

4.1 Results and discussion of findings

The following are the findings on how diversification strategy affects performance of commercial banks in Nairobi County. The respondents were requested to indicate their level of agreement on various statements relating to diversification strategy and performance of commercial banks in Nairobi County, Kenya. A 5 point Likert scale was used where 1 symbolized strongly disagree, 2 symbolized disagree, 3 symbolized neutral, 4 symbolized agree and 5 symbolized strongly agree.

Table 1: Diversification Strategy and Performance of Commercial Banks

Statements	Mean	Std. Deviation
Conducts an honest assessment of risks involved in undertaking of new products in new markets	3.955	0.967
Diversification enables the bank to leverage its resources effectively.	3.944	0.878
Diversification enhances risk minimization in the banks' investments.	3.894	0.989
Diversification influences good decision making on profitable investments.	3.851	0.816
Risk mitigation strategies are reinforced through diversification	3.817	0.975
Diversification enhances new product and service features to enhance customer loyalty.	3.806	0.874
Diversification enhances new service and product development in the bank	3.720	0.920
Aggregate	**3.844**	**0.898**

Findings in Table 1 show that respondents agreed that their organization conducts an honest assessment of risks involved in undertaking of new products in new markets. This is shown by a mean of 3.955 (std. dv = 0.967). In addition, the participants agreed that diversification enables the bank to leverage its resources effectively. This statement is supported by a mean of 3.944 (std.

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dv = 0.878). As shown by a mean of 3.894 (std. dv = 0.989), the respondents agreed that diversification enhances risk minimization in the banks' investments.

The respondents agreed that diversification influences good decision making on profitable investments. This is supported by a mean of 3.851 (std. dv = 0.816).In addition, the participants agreed that risk mitigation strategies are reinforced through diversification. This statement is supported by a mean of 3.817 (std. dv = 0.975). As shown by a mean of 3.806 (std. dv = 0.874), the respondents agreed that diversification enhances new product and service features to enhance customer loyalty. The respondents agreed that diversification enhances new service and product development in the bank. This statement is supported by a mean of 3.720 (std. dv = 0.920).

4.2 Coefficient Correlation Analysis

The coefficient correlation matrix for the diversification and performance of banks variables is shown in Table 2 below.

Table 2: Correlation Matrix of the Diversification Variable and Performance of Banks

		Diversification
Performance of Banks	Pearson Correlation	.805(**)
	Sig. (2-tailed)	.003
	N	238

** Correlation is significant at the 0.01 level (2-tailed).

The correlation matrix Table 2 revealed that there was a very strong relationship between diversification strategy and performance of commercial banks in Nairobi County, Kenya (r = 0.805, p value =0.003). The relationship was significant since the p value 0.003 was less than 0.05 (significant level). The findings are in line with the findings of Ismail (2015) who revealed that there is a very strong relationship between diversification strategy and organization performance.

4.3 Regression Analysis

Table 3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.911[a]	.830	.833	.09756

The model summary in Table 3 was used to explain the variation in the dependent variable that could be explained by the independent variables. The r-squared for the relationship between the independent variables and the dependent variable was 0.830. This implied that 83.0% of the variation in the dependent variable (performance of commercial banks in Nairobi County, Kenya) could be explained by independent variables (diversification strategy).

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Table 4: Model of Coefficients

Model	Unstandardized Coefficients			Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	0.439	0.083		5.289	0.009
	Diversification strategy	0.274	0.087	0.279	3.149	0.003

a. Dependent Variable: performance of commercial banks

The results also revealed that diversification strategy has a significant effect on performance of commercial banks in Nairobi County, Kenya $\beta 1=0.274$, p value= 0.003). The relationship was considered significant since the p value 0.003 was less than the significant level of 0.05.The findings are in line with the findings of Ismail (2015) who revealed that there is a very strong relationship between diversification strategy and organization performance.

4.4 Summary of Findings

The study found that diversification strategy has a positive and significant effect on performance of commercial banks in Nairobi County, Kenya. The respondents agreed that their organization conducts an honest assessment of risks involved in undertaking of new products in new markets. In addition, the participants agreed that diversification enables the bank to leverage its resources effectively. The respondents agreed that diversification enhances risk minimization in the banks' investments. The respondents agreed that diversification influences good decision making on profitable investments. In addition, the participants agreed that risk mitigation strategies are reinforced through diversification. The respondents agreed that diversification enhances new product and service features to enhance customer loyalty. The respondents agreed that diversification enhances new service and product development in the bank.

5.1 Conclusion

The study also concludes that diversification strategy has a positive and significant effect on the performance of commercial banks in Nairobi County, Kenya. The study found that geographical diversification, corporate diversification and operations diversification influences performance of commercial banks in Nairobi County, Kenya. The banks have also diversified their operations with aim of making more profits. Some of the commercial banks in Kenya offer other services such as bank assurance where they collaborate with insurance firms to offer insurance services. Through, diversification the banks are able to make good decisions on profitable investments. Diversification enables banks to spread their risks hence avoid bankruptcy. Risk assessment helps the banks to assess which investments to make that would not put their profits at risk.

6.1 Recommendations

This study recommends that the management of commercial banks in Nairobi County should put into consideration geographical diversification, corporate diversification and operations diversification. It is also recommended that the banks should adopt diversification in their operations through use of technological advancements and other aspects such as innovation and benchmarking strategies to realize full benefits of diversification. Another recommendation is that the banks should develop a strategic plan so as to outline all the potential ways it can diversify its operations.

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