AN INVESTIGATION INTO INTERNAL GROWTH STRATEGIES EFFECT ON FINANCIAL PERFORMANCE OF COMMERCIAL BANKS, (A CASE STUDY OF EQUITY BANK IN NAIROBI)

SABINA MUTIA

A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENT FOR THE AWARD OF A DEGREE IN MASTER OF BUSINESS ADMINISTRATION (MBA) SCHOOL OF BUSINESS KENYATTA UNIVERSITY

APRIL, 2013
DECLARATION

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

Signature ___________________________ Date: ______________________

Sabina Mutia

D53/CTY/PT/20772/2010

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

Signature ___________________________ Date: ______________________

Mr. Robert D. Nzulwa

Department of Business Administration

School of Business

For and on behalf of Kenyatta University

Signature ___________________________ Date: ______________________

Dr. Muathe S.M.A

Chairman,

Business Administration Department

School of Business, Kenyatta University
DEDICATION

To my dear sons Alvin and Trevor, you are the greatest gift on earth, without you, I would not have come this far. God bless you. A special dedication also to my late parents, William Ivali Mutia and Margaret Kavuo Ivali, how I wish both of you were alive to see my great success and celebrate it.
ACKNOWLEDGEMENT

My sincere thanks go to the almighty God for giving me sound health and mind. To my dear brothers and sisters for their support and encouragement, they always said ‘it is possible”. My deep appreciation goes to my Supervisor Mr Robert D. Nzulwa for his selfless academic support and guidance throughout the writing of this research proposal. Many thanks to my MBA class at Kenyatta University for their encouragement when things were tough. God bless you all.
ABSTRACT

Growth strategies involve a significant increase in performance objectives (usually sales or market share). Many organizations pursue one or more types of growth strategies. This paper aimed to investigate the effect of internal growth strategies on financial performance. The objectives of the study was to determine whether Information Technology, Customer satisfaction, Employee reward scheme and Retained earnings impact on financial performance of commercial banks. This study employed a descriptive research designs. The research was conducted using primary and secondary data that is both qualitative and quantitative. Questionnaires were used to collect secondary data. Purposive/Judgemental sampling technique was used to select the respondents. The respondents included the Branch Managers, Operations Manager and the Marketing Manager of each Branch, this gave tangible information about the overall effect of internal growth strategies on the financial performance. In order to test liability and validity for questionnaires, a pilot study was conducted. Descriptive statistical method was applied to measure and determine the relationship that exists among the collected data. Field study was done later and the data analyzed and discussed to come up with a conclusion which enabled the researcher to give recommendation to the concerned parties. The study found that the organization invests in information technology. Range of services accessed, number of referrals and customer feedback affected the financial performance of the bank to a very great extent. The organization used retained earnings for expansion to a very great extent. Moreover, person-contingent rewards affected the financial performance of the bank to a moderate extent. The study concludes that the bank had invested in information technology. Information technology has caused tremendous growth in banking industry. The organization also used retained earnings to pay debt to a moderate extent. The study concludes that monetary (bonus, trips paid for by the company, gifts from a rewards catalog, or services such as cell phone or paid cable) and job-contingent rewards affected the financial performance of the bank to a great extent. The study recommends banks to invest in information technology. Information technology causes tremendous growth in banking industry. The study recommends the banks to involve customers or customer representatives before investing on any internal growth strategies.
# TABLE OF CONTENTS

LIST OF TABLES .......................................................................................................................... 6

LIST OF FIGURES ........................................................................................................................ 6

ABBREVIATIONS .......................................................................................................................... 6

CHAPTER ONE .............................................................................................................................. 6

INTRODUCTION ............................................................................................................................ 6

1.1 Background of the Study ......................................................................................................... 6

1.1.1 Background of Banking Industry in Kenya ........................................................................ 6

1.1.2 Equity Bank ....................................................................................................................... 6

1.1.3 Types of strategies by Equity Bank .................................................................................. 6

1.2 Statement of the Problem ....................................................................................................... 6

1.3 Objectives of the Study .......................................................................................................... 6

1.3.1 General Objectives ........................................................................................................... 6

1.3.2 Specific Objectives ........................................................................................................... 6

1.4 Research Questions .............................................................................................................. 6

1.5 Significance of the Study .................................................................................................... 6

1.6 Purpose of the Study ........................................................................................................... 6

1.7 Scope of the Study .............................................................................................................. 6

1.8 Limitation of the Study ....................................................................................................... 6

CHAPTER TWO ............................................................................................................................ 6

LITERATURE REVIEW .............................................................................................................. 6

2.1 Introduction........................................................................................................................... 6
<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.2</td>
<td>Concept of Strategy</td>
<td>7</td>
</tr>
<tr>
<td>2.3</td>
<td>Growth strategies</td>
<td>7</td>
</tr>
<tr>
<td>2.3.1</td>
<td>Diversification</td>
<td>7</td>
</tr>
<tr>
<td>2.3.2</td>
<td>Product Development</td>
<td>7</td>
</tr>
<tr>
<td>2.3.3</td>
<td>Market Penetration</td>
<td>7</td>
</tr>
<tr>
<td>2.3.4</td>
<td>Market Development</td>
<td>7</td>
</tr>
<tr>
<td>2.4</td>
<td>Internal Growth Strategies</td>
<td>7</td>
</tr>
<tr>
<td>2.4.1</td>
<td>Organic growth</td>
<td>7</td>
</tr>
<tr>
<td>2.4.2</td>
<td>Inorganic growth</td>
<td>7</td>
</tr>
<tr>
<td>2.5</td>
<td>Factors influencing financial performance</td>
<td>7</td>
</tr>
<tr>
<td>2.6</td>
<td>Internal growth strategies and performance</td>
<td>7</td>
</tr>
<tr>
<td>2.7</td>
<td>Equity bank strategies</td>
<td>7</td>
</tr>
<tr>
<td>2.7.1</td>
<td>Diversification strategies</td>
<td>7</td>
</tr>
<tr>
<td>2.7.2</td>
<td>Business acquisition strategies</td>
<td>7</td>
</tr>
<tr>
<td>2.7.3</td>
<td>Value Chain Strategies</td>
<td>7</td>
</tr>
<tr>
<td>2.7.4</td>
<td>Financing Strategies</td>
<td>7</td>
</tr>
<tr>
<td>2.7.5</td>
<td>Marketing Strategies</td>
<td>7</td>
</tr>
<tr>
<td>2.7.6</td>
<td>Customer Care and Operation Strategies</td>
<td>7</td>
</tr>
<tr>
<td>2.7.7</td>
<td>Human Resource Strategies</td>
<td>7</td>
</tr>
<tr>
<td>2.8</td>
<td>Internal Growth Strategies in Equity Bank</td>
<td>7</td>
</tr>
<tr>
<td>2.8.1</td>
<td>Information technology</td>
<td>7</td>
</tr>
<tr>
<td>2.8.2</td>
<td>Customer satisfaction</td>
<td>7</td>
</tr>
</tbody>
</table>
2.8.3 Retained earnings ................................................................. 8
2.8.4 Employee Reward scheme ................................................... 8
2.9 Empirical Review ................................................................. 8
2.10 Research Gaps ................................................................... 8
2.11 Conceptual Framework ....................................................... 8
2.11.1 Information Technology .................................................... 8
2.11.2 Customer Satisfaction ....................................................... 8
2.11.3 Retained Earnings ........................................................... 8
2.11.4 Reward Scheme ............................................................. 8
2.11.5 Financial Performance .................................................... 8

CHAPTER THREE ........................................................................... 8

RESEARCH METHODOLOGY ........................................................ 8

3.1 Introduction ........................................................................... 8
3.2 Research design .................................................................... 8
3.3 Location of the study ............................................................ 8
3.4 Target Population ............................................................... 8
3.5 Sampling Procedure ............................................................ 8
3.6 Sample size ........................................................................... 8
3.7 Research Instruments .......................................................... 8
3.8 Pilot study ............................................................................. 8
3.9 Validity of the Research Instruments .................................... 8
3.10 Reliability of the Research instrument ................................. 8
3.12 Data Collection Procedure ........................................................................................................9

3.13 Data Analysis and Presentation ..................................................................................................9

CHAPTER FOUR ...............................................................................................................................9

RESULTS FINDINGS ..........................................................................................................................9

4.1.2 Reliability Analysis ....................................................................................................................9

4.2 Demographic Information .............................................................................................................9

4.3 Information Technology .................................................................................................................9

4.4 Customer Satisfaction .....................................................................................................................9

4.5 Retained Income ...........................................................................................................................9

4.6 Employee Reward Scheme ..........................................................................................................9

CHAPTER FIVE .........................................................................................................................................9

5.1.1 Information Technology .............................................................................................................9

5.1.2 Customer Satisfaction ...............................................................................................................9

5.1.3 Retained Income .......................................................................................................................9

5.1.4 Employee Reward Scheme .......................................................................................................9

REFERENCES .........................................................................................................................................9

APPENDICES ........................................................................................................................................9

Appendix I: Introductory Letter to the Respondents .........................................................................9

Appendix II: Questionnaire ................................................................................................................9

Appendix III: Equity Bank Branches in Nairobi ................................................................................9
LIST OF TABLES

Table 3.1: Target population........................................................................................................28

Table 3.2: Strata Table ..................................................................................................................29

Table 4.1: Reliability Coefficients ...............................................................................................32

Table 4.2: Extent that information technologies affected the financial performance of the bank........................................................................................................................................................................35

Table 4.3: Extent that customer satisfaction aspects affected the financial performance of the bank........................................................................................................................................................................39

Table 4.4: Extent that the organization use retained earnings in the areas..........................41

Table 4.5: Extent that employee reward system aspects affected the financial performance of the bank........................................................................................................................................................................43

Table 4.6: Correlation Matrix ........................................................................................................44
LIST OF FIGURES

Figure 2. 1: Diagram showing the conceptual framework (source: own) ........................................... 24

Figure 4. 1: Designation of the respondents .................................................................................... 33

Figure 4. 2: Period the respondents had worked with the organization ........................................... 33

Figure 4. 3: Highest academic qualification of the respondents ....................................................... 34

Figure 4. 4: If the organization invests in new information technology ........................................... 35

Figure 4. 5: Frequency of change over in information technology ..................................................... 36

Figure 4. 6: Comparison of the financial performance of the bank after any change .................... 37

Figure 4. 7: If the respondents would recommend the bank to be investing in information technology .......................................................................................................................... 37

Figure 4. 8: Extent that customer satisfaction affected the financial performance of the bank ................................................................................................................................. 38

Figure 4. 9: Consumer behavior after any change in internal growth strategies experienced ........ 39

Figure 4. 10: How internal growth strategy impact on shareholder’s equity ................................... 40

Figure 4. 11: If the organization had an employee reward system ................................................... 42

Figure 4. 12: Behavior of employees to any internal growth strategy ........................................... 42
**ABBREVIATIONS**

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>ATM</td>
<td>Automated Teller Machine</td>
</tr>
<tr>
<td>BCG</td>
<td>Boston Consultation Group</td>
</tr>
<tr>
<td>CBK</td>
<td>Central Bank of Kenya</td>
</tr>
<tr>
<td>CBN</td>
<td>the Central Bank of Nigeria</td>
</tr>
<tr>
<td>EBS</td>
<td>Equity Building Society</td>
</tr>
<tr>
<td>IDB</td>
<td>Industrial Development Bank</td>
</tr>
<tr>
<td>IT</td>
<td>Information Technology</td>
</tr>
<tr>
<td>KCB</td>
<td>Kenya Commercial Bank</td>
</tr>
<tr>
<td>M&amp;A s</td>
<td>mergers and acquisitions</td>
</tr>
<tr>
<td>NBFIs</td>
<td>non-bank financial institutions) in Kenya</td>
</tr>
<tr>
<td>NCBD</td>
<td>Nairobi Central Business District</td>
</tr>
<tr>
<td>NPO</td>
<td>Non-Performing Loans</td>
</tr>
<tr>
<td>OCE</td>
<td>Organization Commitment of Employee</td>
</tr>
</tbody>
</table>
CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The emergence of banks owned by the local private sector began in the mid-1970s. Financial markets in Africa in the period since independence have been dominated by foreign and government-owned commercial banks. But deficiencies in financial intermediation provided an opportunity for local private investors to enter financial markets, especially in those countries where the domestic private sector was relatively well developed, such as Kenya and Nigeria. Between the late 1970s and the mid-1980s, 13 local banks were set up in Nigeria (mostly with established foreign banks as minority partners), and 4 banks and 25 non-bank financial institutions (NBFIs) in Kenya. A few local banks were also set up in Zambia, and banks and finance houses in Uganda, in the mid to late 1980s (Kariuki 1993).

The expansion of the local banks and NBFIs was temporarily retarded in Kenya by a series of bank failures in the mid-1980s, but rapid growth resumed later in the decade. A few of the local banks have grown strongly to gain a significant share of their domestic banking market. (Milligan 2006)

The growth of local banks was mainly due to a combination of low entry requirements and the perception that banking provides opportunities for profit not available in many other sections of the economy. Over the last few years, the Banking sector in Kenya has continued to grow in assets, deposits, profitability and products offering. 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 (Zeithaml and Bitner, 1996).

Although banks are confronted with quite similar challenges and changes, the responses vary considerably (Carrier, 1999). This points to variations in the strategic orientation, which stem from divergent organizational structures of individual banks and different characteristics of national markets. The corporate governance and capitalization of banks play an important role in the selection of an appropriate banking strategy. Country specific factors comprise customer preferences, the degree of competition and (in) formal legal frameworks, among other things.
Growth strategies involve a significant increase in performance objectives (usually sales or market share) beyond past levels of performance. Many organizations pursue one or more types of growth strategies (Pearce and Robinson (1997). One of the primary reasons is the view held by many investors and executives that "bigger is better." Growth in sales is often used as a measure of performance. Even if profits remain stable or decline, an increase in sales satisfies many people. The assumption is often made that if sales increase, profits will eventually follow.

Rewards for managers are usually greater when a firm is pursuing a growth strategy. Managers are often paid a commission based on sales. The higher the sales level, the larger the compensation received. Recognition and power also accrue to managers of growing companies. They are more frequently invited to speak to professional groups and are more often interviewed and written about by the press than are managers of companies with greater rates of return but slower rates of growth. Thus, growth companies also become better known and may be better able, to attract quality managers (Pearce and Robinson, 1997).

In finance literature the growth strategies followed by companies can be broadly classified into organic and inorganic growth strategies.

Organic or internal growth strategies have to do with the internal business environment and include such key aspects as new product development, diversification into new business lines or expansion plans. Internal growth is the most common among different organizations aspiring for business growth. It is a gradual growth process spread over a few years (Bruner, 2004).

In general, internal growth strategies would involve such key business aspects as Designing and developing new products/services, building on existing products/services for new opportunities increase sales of products/services through better market reach, expanding existing product lines and service offerings, reaching out for new markets and expansion into foreign markets.

Internal growth is the preferred means of business growth for many organizations that plan a steady growth. It is easy to start with focus and expand steadily organically, as there is better control exercised by organizations this way, in terms of planning the required resources to be in place to support the growth.
1.1.1 Background of Banking Industry in Kenya

The concept of modern banking can be traced back to the 17th century England, where goldsmiths accepted gold deposits for safe keeping in their secure safes. Deposits of Gold received receipts from goldsmiths certifying that the deposits were made. Upon presentation of the receipts to the goldsmiths, they were obliged to deliver the stipulated amount of gold to the owner of receipt. Since the gold was redeemable on demand, the goldsmiths had to ensure that the gold was always available whenever a receipt was demanded (John, 2004).

The emergence of banks owned by the local private sector began in the mid-1970s, Bain (2003) despite the lack of academic evidence on the relationship between growth strategies and firm performance, the professional literature seems to provide some ‘mixed’ answers that relates to the study’s research questions (Xia, 2006).

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 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. As at December 2008 there were forty six banking and non-bank institutions, fifteen microfinance institutions and one hundred and nine foreign exchange bureaus. The banks have come together under the Kenya Bankers Association (KBA), which serves as a lobby for the banking sector’s interest’s. The KBA serves a forum to address issues affecting members. Over the last few years, the Banking sector in Kenya has continued to grow in assets, deposits, profitability and products offering.

The growth has been mainly underpinned by; An industry wide branch network expansion strategy both in Kenya and in the East African community region .automation of a large number of services and a move towards emphasis on the complex customer needs rather than traditional ‘off-the-shelf’ banking products. 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.

Indeed, consulting firms advising companies seem to emphasize one growth strategy over the other because of their differential impact on firm performance. For example, some institutions are encouraging companies to perform mergers and acquisitions (M&A s),
arguing that the more external growth they do, the more their financial and economic performance will increase. Even if it recognizes the merit of both growth strategies, BCG (Boston Consulting Group) also emphasizes in external growth report from 2004 that the highly acquisitive companies of their U.S. sample have the highest mean total shareholder returns, and that the most successful acquisitive growers outperformed the most successful organic growers, allowing them to gain market share more rapidly than their counterparts. According to BCG, for experienced acquirers like Pfizer, Cisco and Newell, M&A expertise developed through successive acquisitions has become a competitive advantage in its own right. On the other hand, others such as General Electric’s consultancy department have recently praised the advantages of internal growth and encourage companies to pursue it because of the lower costs, the better return of investment and the incentives that it gives to pursue innovation.

Financial markets in Africa in the period since independence have been dominated by foreign and government-owned commercial banks. But deficiencies in financial intermediation provided an opportunity for local private investors to enter financial markets, especially in those countries where the domestic private sector was relatively well developed, such as Kenya and Nigeria. Between the late 1970s and the mid-1980s, 13 local banks were set up in Nigeria (mostly with established foreign banks as minority partners), and four banks and 25 NBFI s in Kenya. A few local banks were also set up in Zambia, and banks and finance houses in Uganda, in the mid to late 1980s. The expansion of the local banks and NBFI s was temporarily retarded in Kenya by a series of bank failures in the mid-1980s, but rapid growth resumed later in the decade. In Nigeria the growth of local banks accelerated dramatically in the second half of the 1980s, with 70 commercial and merchant banks established between 1986 and 1991 when the Central Bank of Nigeria (CBN) suspended issuing new licenses: almost all of these were wholly owned by local investors. During the 1990s a further nine local banks were established in Zambia.

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 growth of local banks was mainly due to a combination of low entry requirements and the perception that banking provides opportunities for profit not available in many other sections of the economy. In all of the countries where local banks were set up in significant numbers, the regulatory barriers to entry were low. Before they were revised (which in most Anglophone African countries was not until the late 1980s or early 1990s) the banking laws did not impose stringent requirements on applicants for bank licenses in terms of relevant expertise, and did not specify grounds for rejection of applications. Political interference subverted prudential criteria in the granting of license, notably in Nigeria, where retired military officers were directors of many banks (Lewis and Ster, 1997), and in Kenya where many banks had prominent politicians on their boards.

1.1.2 Equity Bank

Equity Bank was founded as Equity Building Society (EBS) in October 1984 and was originally a provider of mortgage financing for the majority of Kenyans who fell into the low income population. The society’s logo, a modest house with a brown roof, was meant to resonate with its target market and their determination to make small but steady gains toward a better life.

Despite its well-intentioned mission, EBS went through significant turmoil during the next decade. The firm’s decline, although exacerbated by a downturn within Kenya’s banking sector, was primarily self-inflicted.

In these early days, EBS operated as an informal family business. The board was comprised of friends of the founders, who “did the latter’s bidding” rather than provide professional oversight. The lack of standardization and controls increased the firm’s lending risk. By 1993, non-performing loans (NPLs) made up 54 percent of its portfolio, accumulated losses totaled KSh8 33 million and the society’s liquidity ratio stood at 5.8 percent well below the 20 percent required by law. Yet, unwilling to give up, the board of directors began an eleventh hour turnaround effort, which dramatically shifted the business strategy and led to the company’s rebirth.

1.1.3 Types of strategies by Equity Bank

Diversification strategies
Diversification refers to expanding business fields either to new markets, new products, or both, while retaining strong core businesses (Yokoyama 2007). Frequent and successful new products introductions are essential for organic growth and competitive differentiation. The numbers of new product introductions have increased dramatically across the globe (Davis 2007). Equity Bank has not also been left behind in this race. It has managed to introduce new innovative services like “Autobank” automatic teller machines and “Cashback services” that have made it more competitive by increasing the revenues generated from its existing customers.

**Business acquisition strategies**

Business acquisition strategy is one of the strategies used by companies to beat competition by accelerating their pace of growth. Firms can strategically benefit from mergers and acquisitions by acquiring new customers and markets, cost reductions through synergies and obtain new products or technologies (SAP 2008).

Equity Bank has responded to competition by rapidly growing its business through a series of acquisitions. Acquisitions include the purchase of the retail business arm of Industrial Development Bank (IDB) in 2005, 20% of Housing Finance from CDC group in July 2007, 100% acquisition of Uganda Micro Finance Ltd for KES 1.66 Billion in April 2008. In June 2008 Equity Bank increased its stake in Housing Finance to 24.9% through a rights issue. Kenyan economy has only 22,000 mortgages compared to its population of 40 Million people.

**Financing Strategies**

Equity Bank has responded to financial strength of its competition by inviting extra shareholders/investors at its various growth stages. In the initial periods the bank had relied on its founding shareholders, their friends and people from Kangema but it later opened up to outsiders, by the time its listing in 2006, Africa a foreign fund already owned 4%. This strategy has given it funds that have helped it to grow faster than the more closely owned competitor’s like Family Bank.

**Marketing Strategies**

Equity Bank has adopted several marketing strategies to respond to the competition in the banking industry. Equity Bank has embarked on several tactics to build an effective
marketing strategy to tackle its competition in the banking industry. These tactics include customer acquisition, distribution, pricing, advertising, branding, relationship management, innovation customer satisfaction, and social marketing strategies.

**Customer Care and Operation Strategies**

Equity Bank business model is built around customer focus. Its business tag line is “A listening, caring, business partner. The bank has endeavored to create a culture to reinforce this strategy. Equity Bank has adapted an open-door marketing strategy where its Chief Executive and Marketing Managers are very easily accessible to its customers.

**1.2 Statement of the Problem**

Organic (Internal) growth is the rate of business expansion through increasing output and sales (growth achieved by internal investments of the firm) as opposed to mergers, acquisitions and take overs which involve an outside firm (Samara,2007). Organic growth is a straight forward mechanism for achieving business growth. Unlike other businesses ‘banks’ article of trade is ‘Brand and Trust’ (Emefide, 2008) Therefore to achieve organic growth banks need to have a formal strategy that is anchored on Customer retention, Customer services, Employee satisfaction, Dynamic branch Management and Leveraging a Multi brand portfolio to create attractive value propositions for each market Segment (Highbeam, 2008).

Equity Bank has witnessed high performance in the areas of branch network, sales and profits. At the same time the bank has been applying internal growth strategies affecting the areas of Information Technology, Customer Satisfaction Management, Retained Earnings and Empowerment of Employee through reward Scheme.

It is however not clear whether this performance is as a result of the growth strategies it has applied. Empirical research that would have explained this relationship has not done much to show the relationship between growth strategies and performance. Much attention has been given to studying External growth strategies. Several studies done in the banking sector in Kenya have focused on competitive advantage, strategic choices etc. For instance, Warugu (2001) in his research, found out that focus and product differentiation are some of the major strategies that the banks have employed in their quest to outdo each other. Similarly Kiptugen (2003) looked at the strategic responses to a changing competitive environment in the banking Industry, he established that proactive rather than reactive strategies such as research
on changing customer needs and preferences forms the basis of its strategic planning. Mbwayo (2005) focused on the strategies applied by commercial banks in Kenya in anti money laundering compliance programs.

This study intended to explore the various Internal growth Strategies employed by Equity Bank and their effect on Financial performance.

1.3 Objectives of the Study
1.3.1 General Objectives
To establish the effect of Internal growth strategies of financial performance of Commercial Banks.

1.3.2 Specific Objectives
i. To determine how information technology affect financial performance of Equity bank.
ii. To assess how customer satisfaction affect financial performance of Equity bank.
iii. To examine how retained earnings affect financial performance of Equity bank.
iv. To investigate how employee reward scheme affect financial performance of Equity Bank.

1.4 Research Questions
i. How does Information Technology impact the financial performance of Equity bank?
ii. How does Customer Satisfaction affect financial performance of Equity bank?
iii How do retained earnings affect financial performance of Equity bank?
iv. How does employee reward scheme affect financial performance of equity bank?

1.5 Significance of the Study
The commercial banks would benefit from the effective strategies that would be investigated by the study thus enabling them to increase their performance. The customers on the other hand would receive satisfactory services as their needs would be met exceeding their expectations (Kotler, 1999). Above all, the government in its efforts to alleviate poverty by ensuring a viable economy would be able to come up with better legal and operational framework that would support the banks in order to remain competitive and avoid failure.


1.6 Purpose of the Study

This study investigated the effect of organic growth or internal growth as strategic growth options in the banking sector. Equity Bank has pursued organic growth and was used as a case study. The study aimed to investigate how the internal growth strategies impact on financial performance in the banking sector.

1.7 Scope of the Study

The study covered Equity bank ltd. Equity bank is a local bank which has shown a significant growth both internally and externally. Kenya like any other country is populated with an approximate population of 33 million people therefore there is need for banks to grow with the same rate to avoid shortages.

1.8 Limitation of the Study

Lack of commitment, cooperation and willingness from respondents was a challenge during data collection in the field.
CHAPTER TWO
LITERATURE REVIEW

2.1 Introduction

This chapter critically analyzed literature review organic growth and how it influences financial performance of banks by focusing on literature on history of growth of banks, internal growth; its benefits and limitations, factors influencing financial performance Empirical review, and conceptual framework.

2.2 Concept of Strategy

The top management of an organization is concerned with the selection of a course of action from among different alternatives to meet the organizational objectives. The process by which objectives are formulated and achieved is known as strategic management and strategy acts as the means to achieve the objective. Strategy is the grand design or an overall ‘plan’ which an organization chooses in order to move or react towards the set of objectives by using its resources. Strategies most often devote a general programme of action and an implied deployed of emphasis and resources to attain comprehensive objectives. An organization is considered efficient and operationally effective if it is characterized by coordination between objectives and strategies. There has to be integration of the parts into a complete structure. Strategy helps the organization to meet its uncertain situations with due diligence. Without a strategy, the organization is like a ship without a rudder. It is like a tramp, which has no particular destination to go to. Without an appropriate strategy effectively implemented, the future is always dark and hence, more are the chances of business failure (Emmanuel, 2008).

In management, the concept of strategy is taken in broader terms. According to Glueck, “Strategy is the unified, comprehensive and integrated plan that relates the strategic advantage of the firm to the challenges of the environment and is designed to ensure that basic objectives of the enterprise are achieved through proper implementation process”.

2.3 Growth strategies

A company’s strategy consists of the business approaches and initiatives it undertakes to attract customers and fulfill their expectations, to withstand competitive pressures and to strengthen its market position. These strategies provide opportunities for the organization to
respond to the various challenges within its operating environment. Firms also develop strategies to enable them seize strategic initiatives and maintain a competitive edge in the market (Porter, 1985). The competitive aim is to do a significantly better job to its customers. The success of every organization is determined by its responsiveness to the customer needs. The adopted growth option (internal vs. external growth or a mix of the two strategies) might have a direct impact on the strategy of the company and its performance, as well as on the development of our economies in general.

While Porter (1996) viewed strategy as the process of creating a unique and valuable position with means of a set of activities in a way that creates synergistic pursuit of the objectives of a firm, Mintzberg (1990) suggests that the term strategy is used to mean a plan, a ploy, a pattern, a position or a perspective the 5 Ps. Mintzberg defines strategy in terms of a process. Since strategy has almost inevitably been conceived in terms of what the leaders of an organization plan to do in the future, strategy formation has, not surprisingly, tended to be treated as an analytic process for establishing long-range goals and action plans for an organization, that is, as one of formulation followed by implementation.

Strategy can be viewed as building defenses against the competitive forces, or as finding positions in the industry which forces are weakest, Pearce & Robinson (1997). Porter (1980) also noted that strategy is all about competitions and trying to gain competitive advantage. Batemand (1990) suggested that strategy is a pattern of actions and resource allocations designed to achieve the goals of the organization. The strategy that an organization implements is an attempt to match the skills and resources of the organization to the opportunities found in the External Environment. Jauch (1988) argued that decisions and actions taken will lead to the development of an effective strategy which will help to achieve organizational objectives.

According to Dalton and Dalton (2006) Company growth can be achieved in a number of ways. The two most important ones are external growth, which is realized through mergers and acquisitions (M&As), and internal growth, which is usually defined as a company’s growth rate excluding any scale increases from M&As. Both types of growth strategies are regularly used simultaneously by companies. However, according to Delmar et al. (2003), the analysis and comparison of these two generic growth strategies has been neglected to a large extent in the academic literature. This is somehow surprising because these two types of growth are likely to require different managerial skills and organizational structures, as well
as to have a different impact on firm performance (Penrose, 1959; Delmar et al., 2003; Dalton and Dalton, 2006; McKelvie et al., 2006).

Assuming that there are a number of providers, customers will choose which offering to accept on their perception of value-for-money. The competitive aim is to do a significantly better job of providing what customers are looking for, thereby enabling the company to earn a competitive advantage and outsmart rivals in the market place. The core of a company’s marketing strategy consists of its internal initiatives to deliver satisfaction to customers but also includes offensive and defensive moves to counter the maneuvering of rivals, actions to shift resources around to improve the firm’s long term competitive capabilities and market position, and tactical efforts to respond to prevailing market conditions (Gale, 1992).

Service marketing concepts and strategies have developed in response to the tremendous growth of service industries resulting in their increased importance to world economies (Zeithaml and Bitner, 1996). This is in relation to employment, gross domestic product and business opportunities. As technological advancement has equalized most production processes, one of the few remaining strategies that can set one company apart from others is customer service. Chandler (1962) stated that strategy determines the basic long-term goals of an enterprise, and the adoption of courses of action (strategy as plan of action) and the allocation of resources necessary for carrying out these goals (strategy as re-source allocation). The four broad growth strategies are:

2.3.1 Diversification

This is investing in or acquiring products/services/businesses outside an organization's core competencies or industries. Diversification strategies are used to expand an organization's operations by adding markets, products, services or stages of production to the existing business. The purpose of this strategy is to allow the organization to enter lines of business that are different from current operations. (Nosal, 2004)

Typically, this strategy is utilized only after all other growth strategies within current markets have been exhausted as diversification can be very risky. The first three growth strategies can normally be pursued with existing core competencies. However, diversification requires organizations to acquire new skills, technologies and facilities.
There are two major types of diversification: concentric and conglomerate. Concentric diversification means the new venture is strategically related to the existing lines of business, while conglomerate diversification occurs when there is no strategic fit or relationship between the new and old lines of businesses. (Jetter, 2005)

2.3.2 Product Development

Product development strategy is defined as developing new products/services or modifying existing products/services so they appear new, and offering those products/services to current or new markets. While this may sound easy, in reality very difficult with success dependent on quality customer and competitor intelligence. This strategy involves working with existing products/services in existing markets, although new customers may also be attracted. Product modification seeks to add new features to extend the current offering. Modification possibilities are potentially endless, but some basic options include modifying color or size, offering more for a higher price, adding new ingredients or processes, offering new options or bundling existing products/services together. (Nielsen, 2006).

2.3.3 Market Penetration

Market penetration is the name given to a growth strategy where an organization focuses on selling existing products to existing markets. Growing an organization by penetrating its market more thoroughly is typically the first growth strategy most organizations pursue. Market penetration is the least risky growth strategy as the organization's experience with its existing markets increases the odds of success. Common market penetration strategies include offering sales/coupons for products or services, increasing an organization's sales force, increasing distribution and promotion of products or services and increasing marketing and advertising expenditures. However, implementing any one of these new marketing strategies may require considerable investments of both time and money, and may not be translated into profits for a reasonable time period (Maria Bike, 2008).

2.3.4 Market Development

this strategy, an organization seeks to sell its existing products into new markets. In other words, you grow by leveraging your product or service knowledge to reach new customers. A more common scenario is one in which a small business owner attempts to develop a new market for their existing products and services. The new market can be geographical (e.g. foreign export) or an untapped segment of a domestic market. It's even possible to develop a
new market for existing products by adjusting the product's packaging or expanding the product's distribution channels. In any event, a market development growth strategy requires a working knowledge of existing markets and the ability to gaps in the market place that can be exploited to your advantage (Gaibler, 2009).

2.4 Internal Growth Strategies

This is the rate of business expansion through increasing output and sales (growth achieved by internal investments of the firm) as opposed to mergers, acquisitions and take-overs which involves an outside firm (Samara, 2007). Organic growth is a straightforward mechanism for achieving business growth. The essential feature of organic growth is the reinvestment of the previous years’ profit in the existing business, together with finance provided by shareholders. Unlike other businesses, banks’ article of trade is brand and trust (Emefiele, 2008; Emmanuel, 2008), therefore to achieve organic growth, banks need to have a formal strategy that is anchored on: customer retention; customer service; employee satisfaction; dynamic branch management; leveraging a multi-brand portfolio to create attractive value propositions for each market segment; and customer profitability (Atkearney, 2005; Business Wire, 2008; Daruvala and Yulinsky, 2001; Emmanuel, 2008; Highbeam, 2008; Milligan, 2006).

2.4.1 Organic growth

This is the process of business expansion due to increasing overall customer base, increased output per customer or representative, new sales, or any combination of the above, as opposed to mergers and acquisitions, which are examples of inorganic growth. Organic growth is growth that comes from a company's existing businesses, as opposed to growth that comes from buying new businesses.

2.4.1.1 Benefits of organic growth

Organic growth provides more corporate control, encourages internal entrepreneurship, and protects organizational cultures and core values (Denrell, Fang and Winter, 2003; Emefielie, 2008). It also provides managers with a better understanding of their own firm and assets, and internal investment is likely to be better planned and efficient. Organic growth result in the creation of sustainable competitive advantages since the firm’s value-creating process and positions are less likely to be duplicated or imitated by other firms (Barney, 1998). It is a cheaper growth strategy compared to Mergers and Acquisitions.
2.4.1.2 Limitations of organic growth

Organic growth is a slower way of growth compared to M&A since it requires the development of new resources (setting up the whole business, hiring and recruiting human capital, investing in machineries) internally, which is susceptible to Penrose Effect (Dierickx and Cool 1989; Thompson and Wright, 2005). The logic of the Penrose Effect is that firm-level managers have firm-specific experiences internal to the firm and that in successive time periods the firm may not likely be able to adjust timely its managerial resources to the desired level due to dynamic adjustment costs. Since the more experienced managers need to explain to the new managers’ firm specific details, if one were to continually add new managers at a rapid rate, eventually current operation effectiveness is expected to decline.

Effects of merger and acquisitions on banks performance Considerable amount of studies have been carried out to test whether M&A result in successful improvement of banks’ profitability and efficiency. A wide range of performance indicators has been applied in these studies, ranging from simple Balance Sheet and Profit and Loss ratios to more advanced statistical efficiency measures. Some of these studies find little or no evidence of M&A-enabled productivity gains (Berger and Humphrey, 1992; Lang & Welzel, 1999; Rafferty, 2000). However, results from other studies showed that M&A does result in improved profitability (Akhavien, et al, 1997; Cuesta and Orea, 2002; Focarelli, et al, 2002; Houston, et al, 2001).

2.4.2 Inorganic growth

This is the rate of growth of business sales expansion etc. by increasing output and business reach by acquiring new businesses by way of mergers, acquisitions and take-overs. This kind of growth also takes place due to government directives, leading to enhancement of business in some identified priority sector/area. The inorganic growth rate also factors in the impact of foreign exchange movements or performance of other economies.

As opposed to the organic growth, this kind of growth is affected to a great extent by exogeneous factors. It is also a faster way for companies to grow compared with organic growth (where the main focus is productivity enhancement and cost reduction).

2.4.2.1 Benefits of inorganic growth

There accruing benefits of inorganic growth are gaining access to technology that the business does not currently have in place. For example, an electronics firm may choose to
merge or acquire a competitor that has a reputation for innovative product development. As a result of the union, the business benefits from whatever new products are developed and eventually marketed to consumers. (Smith 2006)

Another benefit of inorganic growth is that the approach often serves to increase the client base by combining the customer lists of the existing company with the acquired company. In some cases, this means that the business has a presence in consumer markets that was not possible in the past. Broadening the client base in this manner is typically considered a quick and relatively easy way to increase market share without putting a great deal of time and resources into an expanded sales and marketing effort (Dalton 2006).

2.5 Factors influencing financial performance

Finance has been identified as the most important factor determining the survival and growth of organization. Access to finance allows organization to undertake productive investments to expand their businesses and to acquire the latest technologies, thus ensuring their competitiveness and that of the nation as a whole. Poorly functioning financial systems can seriously undermine the microeconomic fundamentals of a country, resulting in lower growth in income and employment (Griliches, 1998). Landes (1998) argues that despite their dominant numbers and importance in job creation, organizations traditionally have faced difficulties in obtaining formal credit or equity.

2.6 Internal growth strategies and performance

The interest and focus on organic growth in a meaningful way is a recent phenomenon, which grew out of the financial scandals of the late 1990s and early years of the following decade. What the public learned from these scandals was that (1) there are different types of earnings; (2) companies can create earnings in different ways; (3) earnings can be created by accounting recognition, accounting policies, accounting adjustments, accounting elections, and valuations; (4) earnings can be created by financially engineered transactions, pension fund gains, related party transactions, currency gains, cookie jar reserves, classification of investment transactions, channel stuffing, etc.; (5) earnings management is more widespread than many thought (Hess 2006).

In the BCG group report (2004) it is stated that be it a company is fueled organically, through acquisitions, or by a mixture of both, growth is growth, and any kind of growth has the potential to create shareholder.
2.7 Equity bank strategies

Equity Bank was founded as Equity Building Society (EBS) in October 1984 and was originally a provider of mortgage financing for the majority of Kenyans who fell into the low income population. The society’s logo, a modest house with a brown roof, was meant to resonate with its target market and their determination to make small but steady gains toward a better life. Despite its well-intentioned mission, EBS went through significant turmoil during the next decade. The firm’s decline, although exacerbated by a downturn within Kenya’s banking sector, was primarily self-inflicted.

In these early days, EBS operated as an informal family business. The board was comprised of friends of the founders, who “did the latter’s bidding” rather than provide professional oversight. The lack of standardization and controls increased the firm’s lending risk. By 1993, non-performing loans (NPLs) made up 54 percent of its portfolio, accumulated losses totaled KSh833 million and the society’s liquidity ratio stood at 5.8 percent well below the 20 percent required by law. Yet, unwilling to give up, the board of directors began an eleventh hour turnaround effort, which dramatically shifted the business strategy and led to the company’s rebirth.

The strategies being used by Equity Bank to respond to the competition in the Kenyan banking industry include diversification and improvement its value chain. According to Mintzberg, 1994 strategy making is not an isolated process limited to strategy planning meeting. To the contrary it is interwoven with all it takes to manage an organization.

2.7.1 Diversification strategies

Diversification refers to expanding business fields either to new markets, new products, or both, while retaining strong core businesses (Yokoyama 2007). Diversification has not been limited to the banking industry, retail chains have also successfully diversified to banking. In Kenya mobile phone companies have also diversified into money transfer services.

Frequent and successful new products introductions are essential for organic growth and competitive differentiation. The numbers of new product introductions have increased dramatically across the globe (Davis 2007). Equity Bank has not also been left behind in this race. It has managed to introduce new innovative services like “Autobank” automatic teller machines and “Cashback services” that have made it more competitive by increasing the revenues generated from its existing customers.
2.7.2 Business acquisition strategies

Business acquisition strategy is one of the strategies used by companies to beat competition by accelerating their pace of growth. Firms can strategically benefit from mergers and acquisitions by acquiring new customers and markets, cost reductions through synergies and obtain new products or technologies (SAP 2008).

Mergers and acquisitions are the most popular form of growth strategy according to a survey by Boston Chapter of the association for corporate growth conducted in New England USA. Other proponents of this strategy are Welch & Welch (2005) and Gaughan (1999). Growth aspects include market penetration, market development, product penetration and diversification (Ansoff 1965).

Equity Bank has responded to competition by rapidly growing its business through a series of acquisitions. Acquisitions include the purchase of the retail business arm of Industrial Development Bank (IDB) in 2005, 20% of Housing Finance from CDC group in July 2007, 100% acquisition of Uganda Micro Finance Ltd for KES 1.66 Billion in April 2008. In June 2008 Equity Bank increased its stake in Housing Finance to 24.9% through a rights issue. Kenyan economy has only 22,000 mortgages compared to its population of 40 Million people.

2.7.3 Value Chain Strategies

The term ‘Value Chain’ was used by Michael Porter in his book "Competitive Advantage: Creating and Sustaining superior Performance" (1985). The value chain analysis describes the activities the organization performs and links them to the organizations competitive position. Porter argues that the ability to perform particular activities and to manage the linkages between these activities is a source of competitive advantage. Porter distinguishes between primary activities and support activities.

Primary activities are directly concerned with the creation or delivery of a product or service. They can be grouped into five main areas: inbound logistics, operations, outbound logistics, marketing and sales, and service. Each of these primary activities is linked to support activities which help to improve their effectiveness or efficiency. There are four main areas of support activities: procurement, technology development (including R&D), human resource management, and infrastructure (systems for planning, finance, quality, information management.
2.7.4 Financing Strategies

Equity Bank has responded to financial strength of its competition by inviting extra shareholders/investors at its various growth stages. In the initial periods the bank had relied on its founding shareholders, their friends and people from Kangema but it later opened up to outsiders, by the time its listing in 2006, Africa a foreign fund already owned 4%. This strategy has given it funds that have helped it to grow faster than the more closely owned competitor’s like Family Bank.

2.7.5 Marketing Strategies

Equity Bank has adopted several marketing strategies to respond to the competition in the banking industry. Equity Bank has embarked on several tactics to build an effective marketing strategy to tackle its competition in the banking industry. These tactics include customer acquisition, distribution, pricing, advertising, branding, relationship management, innovation customer satisfaction, and social marketing strategies.

Equity bank has responded to competition in the banking industry by creating a strategy to acquire more customers from the unbanked population in the affected towns like Murang’a and Limuru and from rivals to increase its market share. In the 1990's Kenya' economy was performing very poorly due to then prevailing global recession. This situation forced several international banks to restructure their local operations. ABN Amro Bank opted to move out and sold its local operation while Standard Chartered and Barclays had massive layoffs and branch closures.

Equity uses a radically different model compared to competition to evaluate its distribution channels. Christopher (1994) defines the channel of distribution as the means whereby products are physically transferred through the system and through which acquisition takes place.

2.7.6 Customer Care and Operation Strategies

Equity Bank business model is built around customer focus. Its business tag line is “A listening, caring, business partner. The bank has endeavored to create a culture to reinforce this strategy. Equity Bank has adapted an open-door marketing strategy where its Chief Executive and Marketing Managers are very easily accessible to its customers. Equity Bank has also created a fulfilling working environment by developing an organizational architect
that empowers its staff even at branch level. This strategy not only generates job satisfaction but also generates customer satisfaction due to the swift decision-making. Firms have now realized that long-term growth and survival is dependent on a good relationship with customers.

2.7.7 Human Resource Strategies

Ammo (2003) emphasizes that “human resource is the most important factor for success in any organization. Lee and Miller, 1999, also notes that one of the key resources needed to execute an organization strategy is its human capital. Therefore, a dedicated and talented workforce may serve as a valuable, scarce, non-imitable resource that can help firms execute an appropriate positioning strategy. In their study of Korean businesses how an organization’s commitment to its employees’ well-being (OCE) can aid in the profitable execution of its positioning strategies. Lee and Miller (1999) found that OCE, by itself, sometimes has a weakly positive association with return on assets (ROA). But far more important, we found that ROA is strongly and positively influenced by the interaction between OCE and the dedicated pursuit of Porter’s (1980) strategies for achieving competitive advantage: these are cost leadership, marketing differentiation and innovative differentiation.

Equity Bank SWOT analysis reveals that, one of its weaknesses as lack of an “experienced” workforce compared to its competition being a relatively young bank. The management of Equity Bank has addressed these gaps by “poaching” from other banks and making heavy investment in training. However, according to the year 2007 financial report this relatively young bank has strategically accumulated wealth of experience through strategic recruitment of staff and directors.

2.8 Internal Growth Strategies in Equity Bank

2.8.1 Information technology

Technological activities lie at the core of wealth creation in high-technology industries and have been shown to contribute substantially to the financial performance of firms (. Ernst, 2001; Narin et al., 1987, Scherer, 1965; Hall et al, 2005).

The usage of information technology (IT), broadly referring to computers and peripheral equipment, has seen tremendous growth in service industries in the recent past. The most
obvious example is perhaps the banking industry, where through the introduction of IT related products in internet banking, electronic payments, security investments, information exchanges Berger (2003), Banks now can provide more diverse services to customers with less manpower. Seeing this pattern of growth, it seems obvious that IT can bring about equivalent contribution to profits (Brynjolfsson and Hitt 2000) Equity Bank has been operating on high levels of IT.

2.8.2 Customer satisfaction

Customers are the lifeblood of any organization. Without customers, a firm has no revenues, no profits and therefore no market value. This simple fact is not lost on most senior executives In a worldwide survey of 681 senior executives conducted by The Economist during October–December 2002, 65% of the respondents reported customers as their main focus over the next three years compared to only 18% who reported shareholders as their main focus (The Economist 2003). Customers are therefore the lifeblood of any organization. Without customers, a firm has no revenues, no profits and therefore no market value. (Zeithaml, 2006). Equity bank has been pursuing this strategy.

2.8.3 Retained earnings

According to Paramasivan and Subramanian (2009),Retained earnings also known as self finance,inter finance and plugging back profit are another method of internal sources of finance. Actually is not a method of raising finance, but it is called as accumulation of profits by a company for its expansion and diversification activities. At each financial year banks have to compulsorily transfer to reserve such as general reserve, replacement fund, reserve for repairs and renewals, reserve funds and secrete reserves, etc. by a company before declaring dividends for the year.

The percentage of net earnings not paid out as dividends, but retained by the Bank to be reinvested in its core business or to pay debt is referred to as Retained Earnings. It is recorded under shareholders' equity on the balance sheet. Retained earnings are calculated by adding net income to (or subtracting any net losses from) beginning retained earnings and subtracting any dividends paid to shareholders (Christian, 2008). Equity bank has not been left out in this strategy.
2.8.4 Employee Reward scheme

The purpose of the Performance Reward Scheme (PRS) is to motivate employees towards the successful implementation of strategies, and to increase overall organizational motivation and efficiency (Torrington 2002). The PRS is designed to reward superior performance. The same scheme framework applies to all participants and requires meeting pre-set targets, as defined in the performance agreement. The PRS is designed to be flexible and adaptive to the changing needs of the commercial banks. Equity bank has been pursuing this strategy.

2.9 Empirical Review

According to Robert Ruffallo’s (2006) study of the Indian Biotech Phamaceutical Company, the company used organic growth through innovation on Information Technology and focused approach. These two strategies enabled the company reach great heights. The company transformed from a small entity into the largest biopharma company in India.

A study done by Gupter Gayatri’s (2008) on Woolworths growth strategies, the company focused on its customers needs and improved its market share making it the leading food retailer of Australia. The company transformed from being a company that was system driven to a company that others try to emulate. The company used innovation and customer satisfaction to become number one food retailer by early 1990’s in Sidney Australia. The Company survived a scene when it’s unprofitable ventures almost led to bankruptcy. However it’s innovative initiatives that emphasized better shopping experience and reduction of prices to attract customers helped the company to tide over the crises and became a fortune.

David Conklin’s (2008) study of Richard Ivey School of Business Study of Bionade Soda Company, the company focused on marketing strategies of the highly innovative organic drink in Germany. The bionate Soda was refused by distributors to stock, as it was unknown product. Fortunately, the product caught attention of some media and advertising professionals, who frequented a small bar in Munich Germany, where the bar owner fascinated by the product-added the drink to his menu. With the help of low budget marketing techniques and below the line promotions Bionade Soda made a place for itself in the market. Having faced tough times in the initial years, the sales skyrocketed by 2007 and within a short span of time, its owners turned into millionaires. Following this incredible
success in the German market, the makers of Bionade Soda aspired for international expansion.

2.10 Research Gaps

Brings into the picture the understanding of how important a customer is to a business or enterprise. To bear in mind that customers are the lifeblood of any organization and should be treated with utmost care and diligence. This is seen in the Woolworths study whereby growth strategies that helped it transform from being a follower that was system driven to a company that others emulate.

Helps to understand and analyse the market entry and market penetration strategies in emerging markets. To also understand the competitive strategies that a company should pursue. This is seen in the study of Indain Biotech Pharmaceutical company where the company used innovation technology and a focused approach.

Assists in understanding the use of low-budget marketing techniques to market new products offering and also to understand the concept of viral marketing and below-the-line promotions. This is seen in the study of Bionade soda company where the owner used low budget marketing techniques to capture a big market share. The sales sky rocketed within a short span of time and the owners became millionnaires.

2.11 Conceptual Framework

Conceptual frameworks, according to educational researcher Smyth (2004), are structured from a set of broad ideas and theories that help a researcher to properly identify the problem they are looking at, frame their questions and find suitable literature. Most academic research uses a conceptual framework at the outset because it helps the researcher to clarify his research question and aims.

<table>
<thead>
<tr>
<th>Independent Variables</th>
<th>Dependent Variable</th>
</tr>
</thead>
</table>
2.11.1 Information Technology

The usage of (IT), broadly refers to the usage of computers and peripheral equipment. This has seen tremendous growth in service industries in the recent past. The most obvious example is perhaps the banking industry.

In general, existing studies have concluded two positive effects regarding the relation between IT and banks’ performance e.g it IT reduces bank’s operational costs. Bryjolfsson and Hitt 2006). IT is fundamental to a firm’s survival and growth. Studies (Wallace & Carolle) 2006 indicate that effective and efficient use of IT is a key factor differentiating successful firms from their less successful counterparts. For example IT capabilities were found to be an important differentiator of banks that were doing well in the mid-1980’s as compared to those that were less profitable (Nolan 1994). Widely publicized IT programs in firms such as Equity bank have been associated with superior business performance.

Performance can be measured in terms of sales growth, returns on assets and labour productivity. Heavy use of transactional IT investment is found to be significantly associated with strong firm performance. Organizational learning plays a significant role in determining the outcomes of IT in terms of performance to an organization.

2.11.2 Customer Satisfaction

Customers are the lifeblood of any organization. Without Customers, a firm has no revenues, no profits and therefore no market value. Customer Satisfaction is relatively more dependent on customization- that is the degree to which the firm’s offering is customized to meet...
heterogeneous customer’s needs as opposed to standardization. Satisfaction, for example is expected to lead to repurchase behavior, which translates into increased sales and profits.

Performance measures in this case are Customer satisfaction, Loyalty and Profitability. More satisfied Customers will return (with their friends and buy again in the future. Some organizations use the IPA (Importance Performance Analysis) which is a widely used analytical technique that yields prescriptions for the management of customer satisfaction. Gupta and Zeithaml 2007).

2.11.3 Retained Earnings

According to Paramasivan and Subramanian( 2009), Retained earnings also known as self finance and ‘plowing back’ profit are another method of internal sources of finance. Retained Earnings represent profits a company has not distributed for years preferring to keep them to fund operating activities. These are profits a company has accumulated for many years and it has not paid out as dividends. Retained Earnings can be used to pay debt and future dividends, or can be reinvested into business activities for future growth. Accruals are predicted to improve earnings ability to measure firm’s performance as reflected in stock returns.

Performance is measured by profitability ratios, which measure’s a company’s ability to generate earnings relative to sales, assets and equity. Other performance measures are the comparison of the total amount of profit per share retained by a company over a given period of time against the change in profit per share over that same period of time. (Melscot, 2008).

2.11.4 Reward Scheme

The purpose of the Performance Reward is to motivate employees towards the successful implementation of strategies, and to increase overall organizational motivation and efficiency (Torrington 2002). Motivated employees play a key role in an organization’s success. Two major components of control systems will positively affect employee feelings of empowerment that is performance feedback and performance based reward system. Organizations measure performance to evaluate alternatives for the future action and to reward those who have performed (Thomson s 2004).

Performance is measured against a performance plan i.e a previously established and agreed performance targets. A performance score is calculated according to key performance
indicators. At the end of the year performance will be measured against the set targets and bonus and merit increase will be calculated. Should the target have been met within the required time deadline, 100% of the weighting score is earned (Smits, 2008).

2.11.5 Financial Performance

This refers to the level of performance of a business over a specified period of time, expressed in terms of overall profits and losses during that time. Evaluating the financial performance of a business allows decision-makers to judge the results of business strategies and activities in objective monetary terms. It’s a subjective measure of how well a firm can use assets from its primary mode of business and generate revenues (Kivan Shaw 2006).

There are many different ways to measure Financial Performance, but all measures should be taken in aggregation. Line items such as revenues from operations, operating income or cash flow from operations can be used, as well as total unit sales. The analyst or investor may wish to look deeper into financial statements and seek out margin growth rates or any declining debts. The use of Ratio Analysis for evaluating financial performance is also an important tool. (John Karr 2006).

CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Introduction

This chapter describes the research area, research method, study population, sampling procedure, procedures in the development of research instrument, validity and reliability of the research instruments, data collection procedure and data analysis.

3.2 Research design

According to Noum, (2007), research design is the scheme, outline or plan that is used to generate answers to research problems. This study adapted a descriptive survey research design. The method is chosen since it is more precise and accurate since it involves description of events in a carefully planned way (Babbie, 2004). Furthermore, Berg and Gall (1996) note that descriptive research produced statistical information about aspects of a study that interest policy makers. Descriptive studies were used not only for the purpose of
description but also for the determination of relationships between variables at the time of study.

3.3 Location of the study

The study was carried out in Nairobi province. Equity banks located in Nairobi was studied. Equity bank is a financial service provider headquartered in Nairobi. It is one of the commercial banks by the central bank of Kenya. According to the central bank statistics as at 2010, the bank had the largest number of customer base in Kenya with over 5.7 (57%) million accounts that formed a true representative of the entire population.

3.4 Target Population

There are 106 branches of Equity bank in the country. However this study focused on the branches located in Nairobi County which are 36 in number. Why I have chosen Nairobi is because it’s more representative than any other country. Nairobi County also has more customers as opposed to the other Counties.

Therefore the Population of study comprised all the 36 branches (see appendix v) of Equity bank in Nairobi County.

<table>
<thead>
<tr>
<th>STRATA/ REGION</th>
<th>NO. OF BRANCHES</th>
</tr>
</thead>
<tbody>
<tr>
<td>NCBR</td>
<td>17</td>
</tr>
<tr>
<td>NBI EAST</td>
<td>6</td>
</tr>
<tr>
<td>NRB WEST</td>
<td>3</td>
</tr>
<tr>
<td>NRBI SOUTH</td>
<td>7</td>
</tr>
<tr>
<td>NRBI NORTH</td>
<td>3</td>
</tr>
<tr>
<td>TOTAL</td>
<td>36</td>
</tr>
</tbody>
</table>
Table 3. 1: Target population
Source: Equity Bank Head Office Nairobi (2012)

3.5 Sampling Procedure

The respondents were the Branch Manager, Operations Manager and the Marketing Manager of each branch. The reason of picking this three core employees in each branch is because they are the ones who do the cascading of the main strategies in the branch level. They were therefore involved with the structuring and implementation of strategy at branch level.

The banks from which data was obtained was selected using Purposive sampling method. Purposive Sampling also known as judgemental Sampling is a type of Non-Probability Sampling Technique. Non-Probability Sampling focuses on Sampling Techniques where the units that are investigated are based on judgement of the researcher. Thus the units are the various geographical segments of the distribution of the branches.

3.6 Sample size

The Sample Size is all the 36 branches of Equity banks. This represents 100% of the total population targeted. In each branch data was collected from three respondents, the branch Manager, Operations Manager and the Marketing Manager.

The following table shows the units and the exact number of respondents from each.

<table>
<thead>
<tr>
<th>STRATA/REGION</th>
<th>NO. OF BRANCHES</th>
<th>NO. OF RESPONDENTS</th>
<th>TOTAL NUMBER</th>
</tr>
</thead>
<tbody>
<tr>
<td>NCBD</td>
<td>17</td>
<td>3</td>
<td>51</td>
</tr>
<tr>
<td>NBI EAST</td>
<td>6</td>
<td>3</td>
<td>18</td>
</tr>
<tr>
<td>NRB WEST</td>
<td>3</td>
<td>3</td>
<td>9</td>
</tr>
<tr>
<td>NRBI SOUTH</td>
<td>7</td>
<td>3</td>
<td>21</td>
</tr>
</tbody>
</table>
Table 3. 2: Strata Table

| NRBI NORTH | 3 | 3 | 9 |
| TOTAL      | 36 | 15 | 108 |

3.7 Research Instruments

To carry out this research, questionnaires were used. The questionnaires were completed by: Branch Manager, Operations Manager and Marketing officer in each bank. According to Best and Khan (1992), a questionnaire is a method of collecting data which enables the researcher to explain the purpose of the study and the meaning of items that may not be clear. Kerlinger (1986) asserts that a questionnaire is an appropriate data collection instrument as it gives the respondent time to give well thought out answers and it is also effective. There was one questionnaire, containing two sections. The first section dealt with background information of the respondents while the second section dealt with the study objectives. A questionnaire was preffered in this study because respondents of the study are literate and quite able to answer questions asked adequately.

3.8 Pilot study

Before the instruments are used for collecting data, a pilot study was conducted. Conveniently the central bank of Kenya Nairobi was chosen because of its convenience and the employees have almost the same experience with that of commercial banks. Through the pilot study, it was possible to determine whether the questionnaires provided the required data for the study. It helped the researcher discover weaknesses and strengths in the research instrument, check the clarity of the items and also elicit comments from the respondents that helped in the improvement of the instruments by resetting the questions that might seem unclear to the respondents.

3.9 Validity of the Research Instruments

Validity refers to a measure of degree to which data collected using a particular instrument presented the content that the test is designed to measure Mugenda, O and Mugenda, A.(2003). The research established content validity by continuously seeking judgment from the supervisors and from already published data while developing and revising the research instrument. It is through this that the instruments used for data collection were validated.
3.10 Reliability of the Research instrument

According to Orodho (2004) reliability is a measure of degree to which a particular measuring procedure gives equivalent results over a number of repeated trials. The reliability of the questionnaires was determined by test-retest reliability method. Two employees of central bank were asked to respond to the questionnaires. After 2 weeks the researcher administered the questionnaire to the same respondents. From these two sets of responses the correlation coefficient was calculated using Pearson Product Moment Correlation Coefficient.

3.11 Data Collection

In this study both primary data and secondary data was collected. Primary data was collected using questionnaires. For the secondary data, the data was collected from published books, journals as well as the bank’s annual reports.

3.12 Data Collection Procedure

Self-administered questionnaire was used in this study to collect quantitative data. The researcher assured the respondents that information collected was for research purpose only and the responses from the respondents was treated anonymously. The researcher obtained an introductory letter from the University to collect data from the companies then personally deliver the questionnaires to the respondents and has them filled in and then collect later: the drop and pick later method.

3.13 Data Analysis and Presentation

The data was analyzed using the SPSS Software. Descriptive Statistics of the mean and standard deviation was used to summarize the data. The effects of the growth strategies were measured using the Pearson’s Correlation Analysis. The formular for Pearson’s Correlation Analysis takes on many forms. A commonly used formular is shown below:

\[ r = \frac{\sum XY - \frac{\sum X \sum Y}{N}}{\sqrt{\left(\frac{\sum X^2}{N} - \left(\frac{\sum X}{N}\right)^2\right)\left(\frac{\sum Y^2}{N} - \left(\frac{\sum Y}{N}\right)^2\right)}} \]
Qualitative data was presented through descriptions, notes and paragraphs.

Quantitative data was presented through numbers, figures, tables graphs and diagrams.
CHAPTER FOUR
RESULTS FINDINGS

4.1 Introduction
The main objective of the study was to investigate the effect of organic growth or internal growth as strategic growth options in the banking sector. Qualitative data was analyzed through quantitative analysis. Graphs, pie charts and tables were used to present the data. The questionnaires were dropped and later picked at a later date to allow the respondents to feel the questionnaires at their own time. Once the respondents answered the questionnaire, data was then coded and analyzed using SPSS.

4.1.1 Response Rate
The study targeted 108 respondents in collecting data with regard to effect of organic growth or internal growth as strategic growth options in the banking sector. From the study, 80 respondents out of the 108 sample respondents filled-in and returned the questionnaires making a response rate of 78.07%. This reasonable response rate was achieved after the researcher made personal calls and physical visits to remind the respondent to fill-in and return the questionnaires.

4.1.2 Reliability Analysis
Prior to the actual study, the researcher carried out a pilot study to pretest the validity and reliability of data collected using the questionnaire. The pilot study allowed for pre-testing of the research instrument.

Table 4.1: Reliability Coefficients

<table>
<thead>
<tr>
<th>Scale</th>
<th>Cronbach's Alpha</th>
<th>Number of Items</th>
</tr>
</thead>
<tbody>
<tr>
<td>Information technology</td>
<td>0.794</td>
<td>7</td>
</tr>
<tr>
<td>Customer satisfaction</td>
<td>0.809</td>
<td>8</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>0.837</td>
<td>4</td>
</tr>
<tr>
<td>Employee reward scheme</td>
<td>0.813</td>
<td>5</td>
</tr>
</tbody>
</table>

The reliability of the questionnaire was evaluated through Cronbach’s Alpha which measures the internal consistency. The Alpha measures internal consistency by establishing if certain item measures the same construct. Cronbach’s Alpha was established for every objective in...
order to determine if each scale (objective) would produce consistent results should the research be done later on. The findings of the pilot study shows that all the four scales were reliable as their reliability values exceeded the prescribed threshold of 0.7 (Mugenda and Mugenda, 2003).

4.2 Demographic Information

**Figure 4.1: Designation of the respondents**

The study sought to find out the designation of the respondents. According to the findings, 59.32% of the respondents were staffs, 18.64% were marketing managers, 11.86% were branch managers, 6.78% were operation managers and 3.39% were inquiry clerks.

**Figure 4.2: Period the respondents had worked with the organization**

It was important for the study to find out the period the respondents had worked with the organization. From the findings, 47.46% of the respondents had worked with the organization for 5-9 years, 42.37% had worked with the organization for 2-4 years, 6.78% had worked with the organization for over 10 years and 3.39% had worked with the organization for less than 1 year.

**Figure 4.3: Highest academic qualification of the respondents**

The study required the respondents to indicate their highest academic qualification. According to the findings, 51% of the respondents had attained tertiary/college education while 49% had reached university.

The study sought to find out other professional training the respondents had. The findings revealed that some had marketing, other economics professional training but majority had no other professional training.

4.3 Information Technology

The usage of (IT), broadly refers to the usage of computers and peripheral equipment. IT is fundamental to a firm’s survival and growth.
The study sought to find out if the organization invests in new information technology. From the findings, 93% of the respondents indicated that the organization invests in new information technology while 7% indicated that the organization did not invest in new information technology. Technological activities lie at the core of wealth creation in high-technology industries and have been shown to contribute substantially to the financial performance of firms (Ernst, 2001; Narin et al., 1987, Scherer, 1965; Hall et al, 2005).

The technologies the organization had invested in as a bank were message centres, ATM, online banking, mobile banking, and security management systems, tablet computing and e-banking.

Table 4. 2: Extent that information technologies affected the financial performance of the bank

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>Stdev</th>
</tr>
</thead>
<tbody>
<tr>
<td>ATM</td>
<td>4.818</td>
<td>0.216</td>
</tr>
<tr>
<td>Mobile banking</td>
<td>4.251</td>
<td>0.312</td>
</tr>
<tr>
<td>Online banking</td>
<td>3.429</td>
<td>0.501</td>
</tr>
</tbody>
</table>

The study sought to find out the extent that information technologies affected the financial performance of the bank. From the findings, ATM affected the financial performance of the bank to a very great extent as shown by a mean of 4.818. In addition, mobile banking affected the financial performance of the bank to a great extent as shown by a mean of 4.251. Moreover, online banking affected the financial performance of the bank to a moderate extent as shown by a mean of 3.429. The most obvious example is perhaps the banking industry,
where through the introduction of IT related products in internet banking, electronic payments, security investments, information exchanges Berger (2003), Banks now can provide more diverse services to customers with less manpower.

**Figure 4. 5: Frequency of change over in information technology**

Frequency of change over in information technology was important in the study. Majority (76.25%) of the respondents indicated that change over in information technology was done in the organization after 1-5 years, 16.95% indicated that change over in information technology was done in the organization after 6-10 years and 6.78% indicated that change over in information technology was done in the organization after 10-15 years. Seeing this pattern of growth, it seems obvious that IT can bring about equivalent contribution to profits (Brynjolfsson and Hitt 2000) Equity Bank has been operating on high levels of IT.

**Figure 4. 6: Comparison of the financial performance of the bank after any change**

The study compared the financial performance of the bank after any change. From the findings, 97% of the respondents indicated that there was positive change in financial performance of the bank after technological change while 3% indicated that there was negative change in financial performance of the bank after technological change. Widely publicized IT programs in firms such as Equity bank have been associated with superior business performance (Nolan 1994).

**Figure 4. 7: If the respondents would recommend the bank to be investing in information technology**
The study sought to find out if the respondents would recommend the bank to be investing in information technology. From the findings, 97% of the respondents recommended the bank to be investing in information technology while 3% did not recommend the bank to be investing in information technology. The bank needs to invest in information technology to impress technology as it cannot be manipulated, for security purposes and backups, to avoid fraud and be accountable so as to give clear financial statements and for fast growth of the bank.

4.4 Customer Satisfaction

Figure 4. 8: Extent that customer satisfaction affected the financial performance of the bank

The study sought to find out the extent that customer satisfaction affected the financial performance of the bank. From the findings, 59.32% of the respondents indicated that customer satisfaction affected the financial performance of the bank to a very great extent, 33.90% of the respondents indicated that customer satisfaction affected the financial performance of the bank to a great extent and 6.78% of the respondents indicated that customer satisfaction affected the financial performance of the bank to a moderate extent. Customers are the lifeblood of any organization. Without customers, a firm has no revenues, no profits and therefore no market value (Zeithaml, 2006).
Table 4. 3: Extent that customer satisfaction aspects affected the financial performance of the bank

<table>
<thead>
<tr>
<th>Aspect</th>
<th>Mean</th>
<th>Stdev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of premiums paid</td>
<td>4.392</td>
<td>0.182</td>
</tr>
<tr>
<td>Range of services accessed</td>
<td>4.802</td>
<td>0.317</td>
</tr>
<tr>
<td>Customer feedback</td>
<td>4.624</td>
<td>0.492</td>
</tr>
<tr>
<td>Number of referrals</td>
<td>4.715</td>
<td>0.516</td>
</tr>
<tr>
<td>Involvement of customers or customer representatives before investing on any internal growth strategies</td>
<td>3.471</td>
<td>0.691</td>
</tr>
</tbody>
</table>

It was important to find out the extent that customer satisfaction aspects affected the financial performance of the bank. According to the findings, range of services accessed, number of referrals and customer feedback affected the financial performance of the bank to a very great extent as shown by a mean of 4.802, 4.715 and 4.624 respectively. In addition, number of premiums paid affected the financial performance of the bank to a great extent as shown by a mean of 4.392. Moreover, involvement of customers or customer representatives before investing on any internal growth strategies affected the financial performance of the bank to a moderate extent as shown by a mean of 3.471. However it’s innovative initiatives that emphasized better shopping experience and reduction of prices to attract customers helped the company to tide over the crises and became a fortune (Gupter, 2008).

Figure 4. 9: Consumer behavior after any change in internal growth strategies experienced

An experience of consumer behavior after change in internal growth strategies was important to this study. Most (58) of the respondents indicated that they experienced increase in purchase of services from the bank and 42% experienced increase in new clients. Without customers, a firm has no revenues, no profits and therefore no market value. (Zeithaml, 2006).
4.5 Retained Income

According to Paramasivan and Subramanian( 2009), Retained earnings also known as self finance and ‘‘plowing back’’ profit are another method of internal sources of finance. Retained Earnings represent profits a company has not distributed for years preferring to keep them to fund operating activities. These are profits a company has accumulated for many years and it has not paid out as dividends.

**Figure 4.10: How internal growth strategy impact on shareholder’s equity**

It was important to find out how internal growth strategy impact on shareholder’s equity. From the findings, 50.85% of the respondents indicated that internal growth strategy made customers to invest more, 42.37% indicated that internal growth strategy made customers to retain their investment and 6.78% indicated that internal growth strategy made customers to market the bank. Retained earnings are calculated by adding net income to (or subtracting any net losses from) beginning retained earnings and subtracting any dividends paid to shareholders (Christian, 2008).

The study compared the financial performance after change in internal growth strategy in the organization. From the findings, financial performance after change in internal growth strategy in the organization was done for accountability, for strategic planners’ analysis and evaluation, for financial performance metrics and for openness and internalization of financial services.

**Table 4.4: Extent that the organization use retained earnings in the areas**

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>Stdev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expansion</td>
<td>4.818</td>
<td>0.103</td>
</tr>
<tr>
<td>Dividends</td>
<td>4.106</td>
<td>0.139</td>
</tr>
<tr>
<td>Pay Debt</td>
<td>3.271</td>
<td>0.204</td>
</tr>
</tbody>
</table>

The study sought to find out the extent that the organization use retained earnings in the areas. According to the findings, the organization used retained earnings for expansion to a
very great extent as shown by a mean of 4.818. In addition the organization used retained earnings for dividends to a great extent as shown by a mean of 4.106. Moreover, the organization used retained earnings to pay debt to a moderate extent as shown by a mean of 3.271. The essential feature of organic growth is the reinvestment of the previous years’ profit in the existing business, together with finance provided by shareholders. Unlike other businesses, banks’ article of trade is brand and trust (Emefiele, 2008; Emmanuel, 2008).

4.6 Employee Reward Scheme

The purpose of the Performance Reward Scheme (PRS) is to motivate employees towards the successful implementation of strategies, and to increase overall organizational motivation and efficiency (Torrington, 2002).

Figure 4.11: If the organization had an employee reward system

The respondents were requested to indicate if the organization had an employee reward system. Majority (95%) of the respondents indicated that the organization had an employee reward system while 5% indicated that the organization had no employee reward system.

Figure 4.12: Behavior of employees to any internal growth strategy

It was important to find out the behavior of employees to any internal growth strategy. From the findings, 66.10% of the respondents indicated that employees were satisfied about internal growth strategy, 23.73% indicated that employees were neutral about internal growth strategy and 10.17% indicated that employees were very satisfied about internal growth strategy.
Table 4.5: Extent that employee reward system aspects affected the financial performance of the bank

<table>
<thead>
<tr>
<th>Type</th>
<th>Mean</th>
<th>Stdev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Monetary (bonus, trips paid for by the company, gifts from a rewards catalog, or services such as cell phone or paid cable)</td>
<td>4.428</td>
<td>0.162</td>
</tr>
<tr>
<td>non-monetary rewards (tickets, restaurant coupons, certificates, thanks from the bosses, flexible schedules, a day off, picnics, recognition of birthdays, and free lunches)</td>
<td>3.801</td>
<td>0.371</td>
</tr>
<tr>
<td>Performance contingent rewards (reward for A quality work)</td>
<td>3.624</td>
<td>0.701</td>
</tr>
<tr>
<td>Job-contingent rewards</td>
<td>4.216</td>
<td>0.291</td>
</tr>
<tr>
<td>Person-contingent rewards</td>
<td>3.428</td>
<td>0.482</td>
</tr>
</tbody>
</table>

The study sought to find out the extent that employee reward system aspects affected the financial performance of the bank. According to the findings, monetary (bonus, trips paid for by the company, gifts from a rewards catalog, or services such as cell phone or paid cable) and job-contingent rewards and affected the financial performance of the bank to a great extent as shown by a mean of 4.428 and 4.216 respectively. In addition, non-monetary rewards (tickets, restaurant coupons, certificates, thanks from the bosses, flexible schedules, a day off, picnics, recognition of birthdays, and free lunches) and performance contingent rewards (reward for A quality work) affected the financial performance of the bank to a great extent as shown by a mean of 3.801 and 3.624 respectively. Moreover, person-contingent rewards affected the financial performance of the bank to a moderate extent as shown by a mean of 3.428. Two major components of control systems will positively affect employee feelings of empowerment that is performance feedback and performance based reward system. Organizations measure performance to evaluate alternatives for the future action and to reward those who have performed (Thomson s 2004).

### 4.7 Correlation Analysis

In order to establish the relationship between information technology, customer satisfaction, retained earnings and employee reward scheme and financial performance Pearson correlation analysis was used. A correlation is a number between -1 and +1 that measures the degree of association between two variables. The correlation coefficient value (r) ranging
from 0.10 to 0.29 is considered to be weak, from 0.30 to 0.49 is considered medium and from 0.50 to 1.0 is considered strong. A positive value for the correlation implies a positive. A negative value for the correlation implies a negative or inverse association.

Table 4.6: Correlation Matrix

<table>
<thead>
<tr>
<th></th>
<th>Financial performance</th>
<th>Customer satisfaction</th>
<th>Employee reward scheme</th>
<th>Retained earnings</th>
<th>Information technology</th>
</tr>
</thead>
</table>
| Financial performance| Pearson Correlation 1 | Sig. (2-tailed) .
|                      | Pearson Correlation .618 | 1                      |
| Customer satisfaction| Pearson Correlation .764 | .
|                      | Pearson Correlation .523 | 1                      |
| Employee reward scheme| Pearson Correlation .522 | .016 | .
|                      | Pearson Correlation .743 | .597 | 1                      |
| Retained earnings    | Pearson Correlation .829 | .012 | .028 | .
|                      | Pearson Correlation .533 | .720 | .531 | 1                      |
| Information technology| Pearson Correlation .017 | .009 | .002 | .014 | .

The data presented before on information technology, customer satisfaction, retained earnings and employee reward scheme were computed into single variables per factor by obtaining the averages of each factor. Pearson’s correlations analysis was then conducted at 95% confidence interval and 5% confidence level 2-tailed. The table above indicates the correlation matrix between the factors (information technology, customer satisfaction, retained earnings and employee reward scheme) and financial performance. According to the
table, there is a positive relationship between financial performance and information technology, employee reward scheme, customer satisfaction, retained earnings of magnitude 0.829, 0.522, 0.764 and 0.618 respectively. The positive relationship indicates that there is a correlation between the factors and the financial performance. This infers that information technology has the highest effect on financial performance, followed by employee reward scheme, then customer satisfaction while staff retained earnings have the lowest effect on the banks’ financial performance.

This notwithstanding, all the factors had a significant p-value (p<0.05) at 95% confidence level. The significance values for relationship between financial performance and information technology, employee reward scheme, customer satisfaction, retained earnings were 0.017, 0.043, 0.027 and 0.039 respectively. This implies that information technology was the most significant factor, followed by employee reward scheme, then customer satisfaction while staff retained earnings was the least significant.
CHAPTER FIVE
SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

5.1.1 Information Technology

The study found that the organization invests in new information technology. The technologies the organization had invested in as a bank were message centres, ATM, online banking, mobile banking, and security management systems, tablet computing and e-banking. ATM affected the financial performance of the bank to a very great extent. In addition, mobile banking affected the financial performance of the bank to a great extent. Moreover, online banking affected the financial performance of the bank to a moderate extent. Change over in information technology was done in the organization after 1-5 years. There was positive change in financial performance of the bank after technological change. The bank needs to invest in information technology to impress technology as it cannot be manipulated, for security purposes and backups, to avoid fraud and be accountable so as to give clear financial statements and for fast growth of the bank.

5.1.2 Customer Satisfaction

The study found that customer satisfaction affected the financial performance of the bank to a very great extent. Range of services accessed, number of referrals and customer feedback affected the financial performance of the bank to a very great extent. In addition, number of premiums paid affected the financial performance of the bank to a great extent. Moreover, involvement of customers or customer representatives before investing on any internal growth strategies affected the financial performance of the bank to a moderate extent. Most of the respondents experienced increase in purchase of services from the bank.

5.1.3 Retained Income

Internal growth strategy made customers to invest more. Financial performance after change in internal growth strategy in the organization was done for accountability, for strategic planners’ analysis and evaluation, for financial performance metrics and for openness and internalization of financial services. The organization used retained earnings for expansion to a very great extent. In addition the organization used retained earnings for dividends to a great extent. Moreover, the organization used retained earnings to pay debt to a moderate extent.
5.1.4 Employee Reward Scheme

The study found that the organization had an employee reward system. Employees were satisfied about internal growth strategy. Monetary (bonus, trips paid for by the company, gifts from a rewards catalog, or services such as cell phone or paid cable) and job-contingent rewards and affected the financial performance of the bank to a great extent. In addition, non-monetary rewards (tickets, restaurant coupons, certificates, thanks from the bosses, flexible schedules, a day off, picnics, recognition of birthdays, and free lunches) and performance contingent rewards (reward for A quality work) affected the financial performance of the bank to a great extent. Moreover, person-contingent rewards affected the financial performance of the bank to a moderate extent.

5.2 Conclusion

The study concludes that the bank had invested in new information technology. Information technology has caused tremendous growth in banking industry. Through the introduction of IT related products in internet banking, electronic payments, security investments, information exchanges, and banks provide more diverse services to customers with less manpower. IT have brought about equivalent contribution to profits. Equity Bank has been operating on high levels of IT.

The study concludes that customers are therefore the lifeblood of any organization. Without customers, a firm has no revenues, no profits and therefore no market value. Customer satisfaction affected the financial performance of the bank to a very great extent. Range of services accessed, number of referrals and customer feedback affected the financial performance of the bank to a very great extent. In addition, number of premiums paid affected the financial performance of the bank to a great extent.

The study concludes that the organization used retained earnings for expansion, dividends to a great extent. The organization also used retained earnings to pay debt to a moderate extent. Market development growth strategy requires a working knowledge of existing markets and the ability to gaps in the market place that can be exploited to the advantage.

The study concludes that monetary (bonus, trips paid for by the company, gifts from a rewards catalog, or services such as cell phone or paid cable) and job-contingent rewards affected the financial performance of the bank to a great extent. Motivated employees play a
key role in an organization’s success. Organizations measure performance to evaluate alternatives for the future action and to reward those who have performed

5.3 Recommendations

The study recommends banks to invest in new information technology. Information technology causes tremendous growth in banking industry. Banks need to provide more diverse services to customers with less manpower. Equity Bank needs to operate on high levels of IT.

The study recommends the banks to involve customers or customer representatives before investing on any internal growth strategies. The banks need to diversify the services. Customers should be encouraged to refer other customers if satisfied with services served.

The study recommends banks to have a formal strategy that is anchored on: customer retention; customer service; employee satisfaction; dynamic branch management; leveraging a multi-brand portfolio to create attractive value propositions for each market segment; and customer profitability.

The study recommends banks to put in place monetary (bonus, trips paid for by the company, gifts from a rewards catalog, or services such as cell phone or paid cable) and job-contingent rewards. The banks should ensure they put in place non-monetary rewards (tickets, restaurant coupons, certificates, thanks from the bosses, flexible schedules, a day off, picnics, recognition of birthdays, and free lunches) and performance contingent rewards (reward for A quality work).

The study recommends that the Central bank of Kenya should come up with policies encouraging the banks to adopt the most advanced technologies in the market and have a standardized reward policy framework for all the employees in the banking sector since these two were found to have a great effect on the financial performance of Equity Bank.

The study further recommends that the investors in the banking industry should consider the level of information technology adoption and the level of retained earnings among the banks when deciding on the bank to invest on since these have a great effect on the financial performance of banks.
5.4 Suggestions for Further Research

A similar study could be carried out in other banks to find out whether the same results will be obtained and to allow for generalization of results. The study focused on banking industry thus another study should be carried out in other industries to find out if the same results will be obtained.
REFERENCES


Kariuki (1993) CBK Annual Reports: Nigeria; Nigeria Deposit Insurance Corporation, Annual Reports and miscellaneous: Uganda and Zambia; miscellaneous


Penrose, E.(1959), The theory of the growth of the firm. Oxford: Oxford University Press,


Appendix I: Introductory Letter to the Respondents

KENYATTA UNIVERSITY,

P.O BOX 43844 - 00100

NAIROBI

DATE: 10 February 2013

Dear Sir/ Madam,

RE: AN INVESTIGATION INTO INTERNAL GROWTH STRATEGIES EFFECT ON FINANCIAL PERFORMANCE OF COMMERCIAL BANKS. (CASE STUDY OF EQUITY BANK NAIROBI)

I am a postgraduate student at Kenyatta University undertaking a Masters Degree in Business Administration (MBA).

As part of the requirements for the award of degree, I am required to conduct a research on the effects of internal growth strategies effect on financial performance. The effect of this letter is to request you to avail the necessary information from the point of view of your bank. The information you will give will not be used for any other purpose other than the intended research. A prompt response to the attached questionnaire will be appreciated.

Thank you,

Sabina Mutia

[MBA STUDENT]
Appendix II: Questionnaire

Please fill in the following questionnaire as accurately as possible. Any information given will be treated with confidentiality and will be used conclusively for the purpose of the research.

PART A: Personal information

Put a tick (√) in the appropriate box or fill in the blank spaces as required.

1. Designation of the respondent………………………………………………………………………………

2. How long have you worked with this organization?
   - Less than 1 year [ ]
   - 2-4 years [ ]
   - 5-9 years [ ]
   - Over 10 years [ ]

3. What is your highest academic qualification?
   - Primary [ ]
   - Secondary [ ]
   - Tertiary/College [ ]
   - University [ ]
   - others (specify)……………………………………

4. Which other professional training do you have? ………………………………………

PART B:

INFORMATION TECHNOLOGY

5a. Do you invest in new information technology?    Yes [ ]    NO [ ]

6. To what extent do the following information technologies affect the financial performance of the bank?

<table>
<thead>
<tr>
<th></th>
<th>Very great</th>
<th>Great</th>
<th>Moderate</th>
<th>Low</th>
<th>Not at all</th>
</tr>
</thead>
<tbody>
<tr>
<td>ATM</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mobile banking</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Online banking</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
7. How often do you do a change over in information technology?
   1-5 years [ ]  6-10 years [ ]
   10-15 years [ ]  15 and above [ ]
   NEVER [ ]

8. How do you compare the financial performance of the bank after any change?
   Positively change [ ]  Negatively change [ ]  No change [ ]

9. In your own opinion do you recommend the bank to be investing in information technology?
   Yes [ ]  No [ ]
   If Yes give reasons
   …………………………………………………………………………………………………………………
   …………………………………………………………………………………………………………………
   …………………………………………………………………………………………………………………

CUSTOMER SATISFACTION

10. What is the extent to which customer satisfaction affect the financial performance of the bank?
   To no extent [ ]  Low extent [ ]
   Moderate extent [ ]  Great extent [ ]
   Very great extent [ ]

11. To what extent do the following affect the financial performance of the bank?

<table>
<thead>
<tr>
<th></th>
<th>Very great extent</th>
<th>Great extent</th>
<th>Moderate extent</th>
<th>Low extent</th>
<th>Not at all</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of premiums paid</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Range of services accessed</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Customer feedback</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of referrals</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Involvement of customers or customer representatives before investing on any internal growth strategies</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
12. What is the consumer behavior after any change in internal growth strategies that you have experienced?

- They purchase our services more [ ]
- They withdrawal [ ]
- We get new clients [ ]
- No effect [ ]

**RETAI NED INCOME**

13. How does the internal growth strategy impact on shareholder’s equity?

- They invest more [ ]
- They market the bank [ ]
- Retain their investment [ ]
- They withdrawal their shares [ ]
- No effect [ ]

14. How do you compare financial performance after any change in internal growth strategy?

15. To what extend do you use retained earnings in the following areas?

<table>
<thead>
<tr>
<th>Area</th>
<th>Very great extent</th>
<th>Great extent</th>
<th>Moderate extent</th>
<th>Low extent</th>
<th>Not at all</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expansion</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dividends</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pay Debt</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**EMPLOYEE REWARD SCHEME**

16. Do you have an employee reward system? YES [ ] NO [ ]

17. What is the behavior of employees to any internal growth strategy?

<table>
<thead>
<tr>
<th>Behavior</th>
<th>Very satisfied</th>
<th>Satisfied</th>
<th>neutral</th>
<th>Not satisfied</th>
<th>I don’t know</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
18. To what extent do the following affect the financial performance of the bank?

<table>
<thead>
<tr>
<th>Type</th>
<th>Very great extent</th>
<th>Great extent</th>
<th>Moderate extent</th>
<th>Low extent</th>
<th>Not at all</th>
</tr>
</thead>
<tbody>
<tr>
<td>Monetary (bonus, trips paid for by the company, gifts from a rewards catalog, or services such as cell phone or paid cable)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>non-monetary rewards (tickets, restaurant coupons, certificates, thanks from the bosses, flexible schedules, a day off, picnics, recognition of birthdays, and free lunches).</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Performance contingent rewards (reward for A quality work)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Job-contingent rewards</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Person-contingent rewards</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Any other class, please specify</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

THANK YOU
Appendix III: Equity Bank Branches in Nairobi

<table>
<thead>
<tr>
<th>NCBD Branches</th>
<th>NRBI East Branches</th>
<th>NRB West Branches</th>
<th>NRBI South Branches</th>
<th>NRBI North Branches</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fourways corporate</td>
<td>Kamkunji</td>
<td>Nairobi west</td>
<td>Kasarani</td>
<td>Kawangware</td>
</tr>
<tr>
<td>Fourways retail</td>
<td>Gikomba</td>
<td>Embakasi</td>
<td>Westlands retail</td>
<td>Kangemi</td>
</tr>
<tr>
<td>Tom mboya</td>
<td>Industrial area</td>
<td>Mombasa road</td>
<td>Westlands corporate</td>
<td></td>
</tr>
<tr>
<td>Mama ngina</td>
<td>Enterprise road</td>
<td></td>
<td>Eastleigh</td>
<td>Karen</td>
</tr>
<tr>
<td>Community retail</td>
<td>Donholm</td>
<td></td>
<td>Ridgeweways</td>
<td></td>
</tr>
<tr>
<td>Community corporate</td>
<td>Buruburu</td>
<td></td>
<td>Ngara</td>
<td></td>
</tr>
<tr>
<td>Harambee</td>
<td>Kayole</td>
<td></td>
<td>Githurai</td>
<td></td>
</tr>
<tr>
<td>Kimathi</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Knut house</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Moi avenue</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity centre</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity centre corporate</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Otc</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tea room</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kentatta avenue</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>City hall</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>16</strong></td>
<td><strong>7</strong></td>
<td><strong>3</strong></td>
<td><strong>7</strong></td>
</tr>
</tbody>
</table>

Total number of branches is 36