THE INTERNATIONAL JOURNAL OF BUSINESS & MANAGEMENT

Integration Strategy and Performance of Commercial Banks in Nairobi City County, Kenya

Gachango Samuel Nelson
MBA Student, Department of Business Administration,
School of Business, Kenyatta University, Kenya
Dr. Samuel Maina
Chairperson, Department of Business Administration,
School of Business, Kenyatta University, Kenya

Abstract:
This study's purpose was to examine whether forward integration strategy has an influence on performance of commercial banks in Nairobi city county Kenya. The study conceptualized forward integration strategy as a synergy of acquiring banking agents, adoption of mobile banking and acquiring new banking outlets. The study was principally anchored on the value chain analysis theory. The study's target population included 44 accredited commercial banks domiciled and providing services within Nairobi City County. The study's sample size was 120 heads of departments in the forty-four commercial banks. Primary data was collected using open-ended questionnaires and secondary data was obtained through reviewing online documents such as the annual report from the Central Bank of Kenya. Data was analysed using descriptive statistics and regression analysis. The study revealed that forward integration strategy had an unequivocal and noteworthy influence on commercial bank's annual revenue, labour turnover, operating efficiencies, market confidence, asset value and productivity. The research study recommends that banks should adopt forward integration strategy through increasing their banking agents and mobile banking penetration. Moreover, banks should also increase their number of banking outlets to tap to the subsequent increased rich customer base and deposits.

Keywords: *Forward integration strategy, organization performance, commercial banks in Nairobi City County Kenya*

1. Introduction

At the start of the 21st century, many commercial banks across the world were preoccupied with growth driven by opening new physical branches. However, from 2008, banks embarked on a paradigm shift in focus from expansion driven by many physical outlets to expansion driven by technology, need for customer satisfaction and innovation. The change was sparked by the global financial crisis in 2008. The crisis was followed by a lull in the profits reported by many banks around the world. The sectors recovery began in 2011 when performance reported showed banks revenues had started to grow (Spiegel, 2013). This chaotic market situation created by the crisis triggered the need for banks to adopt strategies to not only remain competitive in the market but to also survive future havocs. Miller (2014) noted that banks' leaders preoccupation shifted towards building sustainable models of doing business especially models that fostered survival in the intensely competitive industry and also models that promoted growth.

From an international perspective, large banking companies have emerged and their influences on the industry have also started showing up. These multinational banking corporations have forced other players to develop counter-measures to deal with the competition they pose. The desire to succeed has also demanded business manager to resort to radical solutions. Among some of the world's most prominent acquisitions within the banking industry is the acquisition of Merrill Lynch by Bank of America during the 2008 crisis period. This was occasioned by the need for Merrill Lynch to survive after being exposed to the toxic mortgage-backed securities. This acquisition enabled Bank of America to tap into Merrill Lynch's services distribution network and outlets resulting in an increase in the revenues earned by Bank of America. The strategy also resulted in enhanced synergy that had an influence on the efficiencies reported by Bank of America (Thavapalan, 2016)

Mutua (2015) noted that Kenyan commercial banking sector experienced a fast growth between 2000 - 2015. The growth was attributed to the innovations and adoption of new technologies especially those aimed at greater customer convenience and satisfaction. Additionally, a number of multinational banking companies entered the Kenyan banking industry. The growth in the industry was characterized by increased inefficiencies and level of gearing of these banks.

Financial institutions that reported exponential profits have faced stiff competition from alternative financial institutions. This has been occasioned by the mushrooming of credit companies and the emergence of Savings and Credit Cooperatives that are flexible and dynamic in their offering. Commercial banks are competing for customer deposits and to sell loans with these institutions. Additionally, regulatory authorities have developed regulations to ensure fairness and protection of customers. This competition has prompted banking executives to pursue aggressive strategies that had previously been ignored or deemed to only apply in other non-service-based sectors (Tambi, 2015). The strategies that these bank executives have adopted are centred around fostering innovation and technology utilization while ensuring enhanced customer experience.

Integration strategies are action plans by managers whose main objective is to control the value chain. The main focus of such a manager is to expand the downstream and upstream activities of the business (Miller, 2014). Control or dominance by a business of its value chain enables the business to build a competitive advantage over its rivals in the industry. The strategy has been popular among the production and trading based businesses. Spiegel (2013) noted that manufacturing entities experienced rapid growth in revenues and efficiencies when they arranged their affairs in a manner that reduced their value chain costs such as acquiring suppliers and customer distribution channels.

Hong (2012) expounded forward integration strategy to be a strategy where a business focuses on controlling the value chain at the distribution point or the route to market. This strategy is focused on controlling the downstream activities of the business by either acquiring the distribution channel or the distributor or the distribution technology. A company is motivated to dominate the distribution network to reduce the inefficiencies associated with distribution. Managers also perceive this strategy as a way of understanding the interrelationship between the distribution strategy and the profit margins. Forward integration strategy is a strategy that has been used by a number of business leaders to enter new markets or expand their existing markets. Business executives have used this strategy to build relationships with their customer by fostering personal relationships with them (Ndung'u, 2011).

1.1. Statement of the Problem

According to CBK (2020) Kenya's banking system grew with an average 2-digit percentage point from year 2009 to year 2019. An example is that the net income after tax made by the licensed banks rose by 14.7% in the first quarter of year 2019 as analysed against year 2018 first quarter. The banking sector revenues also increased from 1.9 trillion shillings to 2.1 trillion shillings between 2018-2019. The growth was mainly driven by the growth in tire one commercial banks. In addition, commercial banks efficiency indicators such as the liquidity ratios and return on assets ratios generally improved over the period. The market confidence assessed based on the number of new customers who registered bank accounts also increased from 2008 to 2020 from 15 million bank accounts to 20 million bank accounts.

Ndung'u (2011) opines that bank executives have come under increasing pressure to maintain the momentum of growth from their various stakeholders. The shortfall in profitability amongst some banks due to factors such as technological changes and competition due to innovation continue to spell doom to some banks. These indicate a need to design and implement radical strategies to survive and attain sustainability. Clarity of the strategies adopted by commercial banks is also important and studies carried out by other researchers may not have evaluated exhaustively on the effects of forward integration strategy on the financial and non-financial performance of commercial banks. It is against this backdrop that it became necessary to embark on the current study.

1.2. Theoretical Review of Literature

This study was anchored on Porter Michael's value-chain analysis and the transaction cost theories. The study reviewed the theories as appraised and critiqued by other authors and their applicability to this study. The value chain analysis theory postulated by Michael looks into the consequences on revenues and profits in the entire value chain of converting raw goods or services into finished and sellable products or services (Hong, 2012). In a commercial bank's perspective, inbound logistics contain all the acts by those who supply inputs and suitably apply to the providers of funds, capital and deposits used to fund the operations. Mulu (2019) noted that the tasks performed by any entity affect the final goods or services quality. Outbound logistics involve all the tasks performed when delivering value to consumers.

Support activities involve all the tasks that are auxiliary but very crucial in ensuring a smooth sale or transaction. A service-based business' support activities enable customers to pre-test and ultimately adopt the products being offered. Ogolla (2015) observed that business leaders. The theory assumes that business leaders attain their goals when they structure their business sequence, product flow chain or service flow chain in a manner to maximize the available opportunities while operating efficiently. The theory provides insights when analyzing forward integration strategy as it annotates the services and products flow in businesses. The theory also has a bearing on an entity's performance as value chain activities influence efficiency and ultimately the profitability. Value-chain analysis theory provides an emphasis on the need to be focused on surviving in a rapidly changing business environment (Porter, 2012)

On the other hand, the transaction cost theory focuses on the goals of every forward-looking entity to organize transactions in a manner to reduce the cost of exchange between the seller and the buyer. This theory presumes that organizations design their transactions and activities with the main aim being to minimize their cost, to increase customer and supplier satisfaction and to earn above normalpaybacks within a certain industry setting (Hitt, 2016). Management of businesses pivots their attention on the interconnection between operating costs and short-run and long-run competitive advantages (Smart, 2013).

Kariuki (2013) postulates that an organizations structure is interrelated to the costs of transactions. Management should structure their businesses to leverage efficiency through reducing the business costs to achieve a boost on the bottom-line. Competitors easily trounce a business whose transaction costs are high and unsustainable. Marangu (2017) broadly expounded transaction costs to be the value given to manage and operate an entity's economy system. The author provides a distinction between the production costs and the transaction costs as transaction costs are heavily reliant on the decision maker's choices. A good leader often weighs on the implication of their decisions on the costs associated with doing business. The transaction cost theory anchors well with forward integration strategy as an integration strategy. The transaction cost theory brings forth the need for business managers to acquire distributors while putting in place measures to check the cost of operations. In commercial banking sector's perspective, the theory provides a greater understanding on the relationship between transaction costs when providing services and the overall performance of any business entity.

2. Empirical Review of Literature

Hong (2012) performed a study on integration effects on the healthcare enterprises value chain management in Korea. The study uncovered that 71.3% of healthcare enterprises reported tremendous growth and prominence in their brand reach when they undertook forward integration interventions. The study's participants reported that their main motivation to pursue the strategy was their desire to efficiently and interactively provide their services and products to their consumers. Consumers reported greater satisfaction when interactions with these healthcare enterprises was personalized and insinuated their desire to come back for repeat services when the need arose. The study also opined that these healthcare enterprises viewed the strategy as a way to escape the negative outcomes that are associated with broken distribution chains especially where the reliance on external distributors is compromised. The study was interview and secondary data based during data collection

Bamidele (2019) looked at the ramifications of forward integration strategies on stakeholder growth within the insurance sub-sector in Nigeria. The author noted that forward integration strategy shifted insurance distribution activities from shadowy and inefficient parties to the insurance companies themselves therefore building their substantial dominance over their insurance products flow. The study noted that the move eliminated the additional costs associated with insurance agencies. The study however noted that this forward integration strategy was particularly prominent with managers whose appetite and perceptions towards risks and returns were higher. Managers who adopt forward integration strategy improved their margins as a result of good prices (Kamanda, 2016).

In a study on the growth patterns of Tanzania's small and micro-finance institutions, Nyamsogoro (2010) identified forward integration as one of the strategies used. Respondents agreed that the strategy had a relationship with the composition of their boards and the organization structures that had been set. The study postulated that forward integration strategy created immense bargaining power with customers especially borrowers. Increase in the bargaining power with consumers of the services led to a 13% increase in the net-profitability after taxes reported by these microfinance institutions. The study focused on closing the gap between the growth strategies and efficiencies and profits reported by the finance institutions.

Aduloju (2018) examined how recapitalizing and integrating vertically and horizontally through mergers and acquisition affected the insurance businesses' performance in Nigeria. The results of the research work revealed that there is an interrelationship between capital efficiencies and integration. Through integration, insurance companies increased their capital base and financial muscle therefore were able to gain a bigger market share than before. Insurance companies used a sophisticated model of acquiring banks that provided a huge pool of customers who also needed insurance services. Further, provision of the insurance services within the banking hall increased the customer confidence hence more business. The research study's downside is that it was restricted in the scope as it paid its attention on Nigeria's insurance sector.

Muendo (2015) discerned a number of challenges facing the execution of integration strategies at a medical training college in Kenya. The study's noted that the main challenges included the price paid up for acquisitions which was deemed high, deficient working capital after the acquisitions, and lack of certainty on how the new entities management would integrate in the overall company's structure. The respondents in this study perceived the expensive distribution route to market to be the biggest inhibitors to their adoption of the integration strategy. Competition for cheaper alternatives by the players in the industry inspired many leaders to put the strategy at the back seat when exploring new strategies to adopt. Marangu (2017) researched the interrelationship between acquisitions and financial performance of banks that are not traded on the stock exchange. The study revealed that forward integration focused acquisitions had a significant influence on the monthly recurring revenues earning by the banks.

3. Methodology

The study applied descriptive design. Descriptive study design depends on non-qualitative (quantitative) data and observational data (Gall, 2013). The study used 44 banks that are fully fledged to operate in Nairobi City in Kenya as the observation units. The commercial banks targeted included banks that were under statutory management because they continued to hold operating licenses. Further, a sample comprising of 30 banks was used with the quantity of respondents being 120, drawn from each of the 4 major departments in each bank. The researcher put into use the simple-random sampling method to pick on the respondents from each stratum. A ratio of 0.5 and 95% confidence level was adopted for the study.

The primary collection tool that was deployed was a self-administered structured questionnaire. The research participants were called forth to share their answers of the questionnaires while ensuring that they gave the best as per their ability and knowledge. Questionnaires were considered suitable as they are easily deployable and faster to analyze and closebased on the data that has been picked up (Milne, 2014). Content analysis was applied to dissect qualitative data. The study leveraged SPSS and Microsoft Excel for quantitative reports. The researcher complied with the research's prescribed code of conduct by observing practices such as confidentiality and approbation.

4. Findings

Data was analysed Table 1 showcased the results of the responses on the extent to which they concurred that forward integration strategy influences commercial banks' financial and non-financial performance in the city county of Nairobi, Kenya. 5-point Likert Scale was used and the survey outcome was portrayed.

Statement	Mean	Std. Dev
Increases the bank's annual revenue.	3.69	0.7724
Has lowered the bank's labour turnover.	3.53	0.8246
Has increased your bank's operating efficiencies.	3.59	0.9241
Helps the bank to maintain market confidence and retained customers.	3.80	0.8113
Has improved bank's asset value and productivity.	3.83	0.8902
Aggregate mean Score and Standard deviation	3.69	0.8445

Table 1: Descriptive Statistics on Forward Integration Strategy

The results as displayed on table 1 disclose that the respondents moderately acknowledged that forward integration strategy has a consequence on the commercial banks' financial and non-financial performance. It is established by the aggregate mean of 3.69 and 0.8445 standard deviation. Research participants also moderately concurred that forward integration strategy has improved bank's asset value and productivity as revealed by mean of 3.83 and standard deviation of 0.8902. Immediately following this are respondents who assented that forward integration strategy has a moderately maintained market confidence and retained customers, has increased bank's annual revenue, has increased bank's operating efficiencies and has lowered bank's labour turnover as portrayed by the corresponding means of 3.80, 3.69 and 3.59 and standard deviations of 0.8113, 0.7724 and 0.9241.

Table 1 outcomes were in concurrence with those of a study by Bamidele (2019). The author noted a significant interconnectivity linking forward integration and banking sector divisional performance. Along with this, Nyamsogoro (2010), while conducting a research study on growth patterns of Tanzania's micro and small finance businesses noted a moderate interrelation existed betwixt forward integration strategy and their accomplishments within Tanzania especially with regard to profit growth.

5. Model Summary for Forward Integration Strategy and Commercial Banks' Financial and Non-Financial Performance

The model of multiple regression analysis reveals the results as shown on table 2

Model.	R.	R Square.	Adjusted R Square.	Std Error of the Estimate	F.	P-value.
1	.852	.726	.702	.48879		.004

Table 2: The Model Summary

Model 1 presented on table 2 links forward integration strategy to performance and has an adjusted R Square Value of $R^2 = 0.726$. It implies that forward integration strategy had a higher explanatory power over bank's performance because of the variation of 72.6% of the banks' performance with fluctuations in the forward integration strategy. It also meant that 27.4% of fluctuations in commercial banks' performance in Nairobi are delineated by other predictors besides forward integration strategy.

The ANOVA report as shown on table 3 revealed the interlink age between forward integration strategy variable and commercial banks' performance.

Model		The Sum of Squares.	Df.	Mean Square.	F.	Sig.
1	Regression	3.47	4	.865	3.619	.004[b]
	Residual	21.272	89	.239		
	Total	24.742	93			

Table 3: ANOVA

The significance value is 0.004. The study concluded that the model was statistically significant to predict how forward integration strategy affect bank's performance. This is because this value was lower than 0.05. It is also in agreement with Bamidele (2019) findings that there is high chance that forward integration strategy contributes heavily to banks' financial and non-financial performance. Additionally, F at 0.05 significance level was 3.619 hence the model can be concluded upon to be significant.

	The Unstandardized Coefficients.		**The Standardized Coefficients**		
	B.	Std. Error.	Beta.	T.	Sig.
Model 1(Constant).	3.966	.605		6.553	.000
Forward Integration Strategy.	0.305	.090	.487	3.407	.001
a. Dependent Variable: Commercial banks' financial and non-financial performance					

Table 4: Coefficients of Regression

Table 4 inferred that the model used by the study to link regulatory framework to bank's performance was reasonable and suitable. The model comprehensively portrays that forward integration strategy has positive effect on commercial banks but the results are not highly significant. This is incongruence with a study carried out by Ndung'u (2011). The argument is also supported by D'Aveni (2014).

6. Conclusion and Policy Recommendation

From the study's revelations, respondents acknowledged that banks'takeover of banking outlets positively affects their performance. The study's findings also indicate that banks' affectation of banking agencies and mobile banking model has a significance in their performance. This research infers that forward integration model may revamp a bank's overall productivity, earnings, efficiencies and market's confidence.

Forward integration strategy ofobtainingadditional physical outletssuch as banking agents and use of mobile banking expands the bank's geographical reach and market which in turn increases the revenues earned. The study concluded that banks efficiency, labour turnover, productivity and market confidence resulting from forward integration have an implication on aggregate non-financial and financial performance of any bank.

6.1. Policy Implication

The researcher lays out a recommendation that commercial banks should explore forward integration strategy by adopting mobile banking model, obtaining bank agents and increasing their bank branch network. These policy actions promote the banks' ability to serve its customers. The study additionally recommends that banks' leaders should look for ways to increase their service offering to improve banks' performance.

The research study recommends to the Central Bank of Kenya to adopt a policy to enhance and support solutions aimed at fostering the distribution and expansion strategies of commercial banks. The regulator should encourage interventions that seek to enhance diversity while still maintaining the ethical and legal requirements to increase the banks' growth and performance.

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