

## Effect of Organization Redesign Strategy on Performance of Commercial Banks in Nairobi County, Kenya

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### Abstract

The capping of interest rates by the Central Bank of Kenya in September 2016, led to massive downsizing by commercial banks in Kenya to reduce costs, survive and generate profits. However, by the end of the financial year 2017 when banks that downsized were releasing their financial reports some banks had made a profit like Kenya Commercial Bank, Cooperative bank, while others including Family bank, Barclays among others had made losses. Therefore, it is not clear whether downsizing has a positive or a negative impact on banks' profitability. The survey looked at the impact of organization redesign strategy on commercial bank financial performance. A descriptive research design was used. The research targeted 12 commercial banks in Kenya. The research targeted three managers from each bank in the following categories: senior, middle and supervisory level. Therefore, the target respondents were 36 managers. A census approach was adopted since the population size is not large. Data was gathered using structured questionnaires issued to bank managers. The data collected was quantitative and was sorted to ensure completeness. Findings revealed that organization redesign strategy had a positive and significant effect on commercial bank financial performance in Nairobi County. The study recommends that banks should diversify to increase their income levels. Banks also need to invest more in innovation, agency, and digital banking as the main drivers of bank diversification and distribution channels for banking products. Banks are also encouraged to unite to work together and survive in the market.

**Keywords:** *Organization redesign strategy, Performance, Commercial banks in Kenya*

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### 1.0 Introduction

Downsizing is characterized as a purposeful arrangement of exercises intended to improve the firm's execution and which includes a decrease in staff (Cameroon, Freeman, & Mishra, 1993). It is an arranged set of guidelines that entail a reduction in the number of employees in an organization to improve returns (Datta, Guthrie, Basuil, & Pandey, 2010). The idea has been trending in the entrepreneurship world for over two decades (MckeeRyan & Kinicki 2002). Organizations terminate employment for their employees permanently or temporarily to reduce the firms' labor cost. Amabile (1995) characterized downsizing as a purposeful administration

activity that entails a decline in personnel intended to improve an organization's competitiveness.

Organizations are faced with a myriad of challenges as a result of changes in the business environment (Freeman & Cameroon, 1993) therefore, they have to strategize on how to achieve a competitive advantage, survive as well as increase profitability. These strategies include; diversification strategy and retrenchment strategy. An organization may retrench its people, businesses, or assets. The effectiveness of each of these strategies depends on the nature of the organization as well as the business cycle. The financial crisis in Turkey that rose in November 2000 and February 2001 led to downsizing in the financial segment (Ozkanli & Bumin, 2006). Despite the supposition that greater denotes better, the possibility that smaller associations might most likely improve their productivity and aggressiveness existed since the mid-1980s (Muñoz-Bullon & Sánchez-Bueno, 2008).

Firms in both private and public sectors in Kenya have adopted downsizing practices to cope with economic pressures in the business environment. Organizations in Kenya that have adopted the strategies include Kenya Airways, Nakumatt, Coca Cola, Posta Kenya, and Toyota Kenya among others. Various ministries have also retrenched staff or business units to cut costs and increase operational efficiency. In the year 2016, Banking (Amendment) Bill was passed by National Assembly to regulate interest rates on loans and Deposits for commercial banks (CBK, 2016). Currently, the base rate of lending by CBK is set at 10%. As a result of interest capping by CBK, a good number of commercial banks in Kenya have laid-off employees and some have closed down several branches due to the anticipated reduction in profit.

Financial performance is how a company makes a profit using its resources, measured by return on assets, return on sales, and growth in sales (Wei, 2012). The performance of financial entities can be measured in several categories, according to O'Neill, Sohal, and Teng (2016), including profit growth, employee growth, asset growth, or any other type of changeable saver or management believes that an entity is a key producer of potential success. The financial outcome, according to Peng and Yang (2014), is a result of an organization's ability to acquire and manage resources in several ways to gain a competitive edge.

More than 10 commercial banks in Kenya have announced layoff and shutdown of subsidiaries, with close to 900 employees getting their employment terminated and at least 21 Branches closed. Subsidiaries' branches operating in other countries have also been affected. Industry data shows Equity Bank has sent home over 400 workers, Family Bank over 300, Standard Chartered Bank 300, First Community 106, Sidian 108, Kenya Commercial Bank (KCB) over 500, and its Rwandan branches still undergoing restructuring. The demand for both personal and business credit facilities has seriously declined, to the extent that sales staffs are not able to meet their targets and thus are sent home (African News, 2017). Despite the important role played by commercial banks in propelling economic growth, the banks have been experiencing financial challenges. In the year 2017, Equity Bank shut down seven branches in South Sudan and thus rendering the subsidiary dormant (Business Today, 2017). Further, Imperial, Chase, and Dubai banks were placed under receivership due to poor financial performance.

### **1.1 Research Problem**

Commercial banks are the most important part of the financial services sector in terms of boosting economic growth (Koch & McDonald, 2013). As posited by Sufian (2011) and Terraza (2015), commercial banks are the main financiers of economic activities. In 2016, commercial banks contributed around 5.5 percent of the gross domestic output, up from 4.8

percent in 2012. (KNBS, 2017). This is a clear indication of the significant role played by commercial banks in the Kenyan economy.

Despite the significant impact of the banking sector on economic growth, some of the commercial banks have been going through serious financial challenges (CBK, 2016). The Central Bank of Kenya placed Dubai Bank Kenya under receivership in August 2015, owing to capital issues. According to the CBK report (2016), Dubai Bank was unable to pay its financial obligations, including debts of Ksh.48 million owed to the Bank of Africa. The imperial bank was also placed under statutory management in October 2015 mainly due to mismanagement. In addition, Chase Bank was forced into receivership for failing to meet regulatory banking ratios and under-reporting insider loans. The bank insider loans stood at Ksh.13.62 billion while it only reported Ksh.5.72 billion. The banking sector has seen several acquisitions, including Diamond Trust Bank's acquisition of Habib Bank Ltd Kenya Branches (Cytonn, 2017). The collapse and subsequent takeover of these banks is evidence of poor financial performance by some of the Kenyan banks.

In addition, banking companies in Kenya recorded a negative development in Earnings Per Share (EPS) in 2017 of 0.8% compared to a positive development of 4.4% in 2016. The poor performance was due to a decrease in net interest income (NII) after closing the cost of financing. The Net Interest Margin (NIM) fell from 9.2% in 2016 to 8.4% in 2017 (Cytonn, 2017). This further demonstrates the poor financial performance of commercial banks in Kenya. This study tries to answer the question of whether the reduction strategy reduces the financial performance of commercial banks.

Numerous studies have been conducted on the performance of commercial banks. Bravo and Egaña (2017) studied the influences of the downsizing strategy on business structures and found a significant relationship between downsizing strategy and business profitability. Mwangi (2018) discovered that the size of a company has a positive impact on the financial performance of Kenyan commercial banks. Omar and Makori (2018) discovered a strong link between credit information exchange and commercial bank financial performance. Local research has not focused on the relationship between downsizing techniques and bank performance, as far as we are concerned. Data from previous research such as Egaña (2017) showed a significant relationship between a decline in financial strategy and company profitability. However, there is scanty information relating to organization redesign strategy and firm performance. Therefore, this study sought to fill the research gap by investigating the effect of organization redesign strategy on the financial performance of commercial banks in Nairobi County, Kenya.

## **2.0 Theoretical Framework**

The study was anchored on the risk management control theory, which explains the legitimate improvement and execution of strategy to manage potential risks in an association. Firms need to establish risk control measures to assist in the control of risks that could reduce firms' returns (Post, Gründl, Schmidl & Dorfman, 2007). According to Power (2007), there has been a blast of hazard discussion and associations have re-aligned their procedure around risks ideology. Internal control and administration have been re-developed based on the ability for successful hazard control (Power, 2007).

The industry within which the commercial banks operate is an epitome of a risky industry that requires the managers to be on the lookout to avoid unforeseen losses. It is, therefore, crucial for executives to constantly redesign their organizational strategies by blending in the

constantly fluctuating market to avoid losses and out-perform its competitors. This theory thus informs the redesign strategy variable in this study.

## **2.1 Empirical Review**

Sujud and Hachem (2018) looked at the relationship between mergers and acquisitions and bank returns in Lebanon. The methods of research used were an analysis of ratio and paired sample test which was applied to relate pre-and post-merger financial performance. The findings indicated that profits improved but not significantly. The merge positively impacted shareholders' equity returns and on return on assets. Merging also increased earnings per share, which positively influenced earnings per share. It was thus, concluded that consolidating of banks does not affect the profitability of Lebanese banks.

Oladimeji, Akingunola, and Sanusi (2017) looked into the impact of business process reengineering (BPR) on the outcomes of organizations in the Nigerian Deposit Money Bank. The result revealed that BPR implementation will affect the banks' outcomes. Based on the results, it was concluded that the application of BPR in the financial sector is crucial to achieving desired results in the area of operations and profitability. In a study by, Gachimu and Njuguna (2017) on financial performance and strategic positioning of banks in Kenya, it was found that Kenyan banks employ some positioning approaches which are market segmentation, technological innovation, and location strategies for competition purposes. It was thus, evident that innovation in these strategies increased the financial performance of the banks.

In addition, Morogo (2015) tried to determine the impact of BP's reengineering as a plan in KCB. When designing the case, we found that KCB Bank achieved better results after revising its process. Banks are known to invest heavily in training, innovation, and cost management. The study made a substantial contribution to KCB and other financial institutions' process design and strategy creation to obtain a competitive edge. Therefore, it is concluded that organizations need to develop strategies to deal with the dynamic economic conditions of the business world.

Nyandoro (2015) likewise analyzed the change management practices and banks' performance in Kenya. A survey technique was employed. It was discovered that corporate governance, strategic planning, committed leadership, and communication to stakeholders influenced commercial banks' performance. Thus, financial institutions are strongly recommended to react positively to the strategic changes and create a fit between operations and new internal and external contexts. With the use of a descriptive survey, Dickson and No (2013) studied the effect of corporate restructuring on Kenya's commercial bank performance. Employees were found to be given leadership opportunities through delegation.

## **3.0 Research Methodology**

The study adopted a descriptive research design. The research targeted 12 banking firms in Kenya. The target participants were 36 managers from all the 12 banks from the operations Department. The three-level managers from the operations department were selected using a stratified sampling technique. This research adopted structured questionnaires in gathering data. Descriptive and inferential statistics were used to analyze the data.

## **4.0 Results and Discussion**

### **4.1 Descriptive Analysis**

#### ***Organization Redesign Strategy***

Descriptive analysis findings on organization redesign strategy are presented in Table 1.

**Table 1: Organization Redesign Strategy**

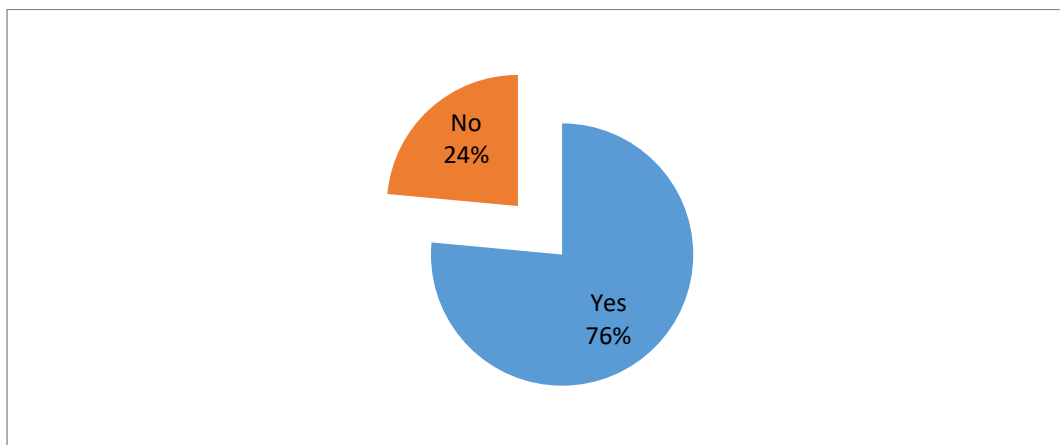
Statement	Strongly disagree	Disagree	Neutral	Agree	Strongly Agree	Mean	Std. Dev
The bank has been forced to shift its process of operation to avoid losses	17.60%	20.60%	8.80%	44.10%	8.80%	3.06	1.32
Banks are investing in alternative sources of income such as bank assurance	14.70%	14.70%	14.70%	44.10%	11.80%	3.24	1.28
The bank stresses innovation, as well as agency and digital banking, as significant diversification drivers for banks and financial product distribution channels.	2.90%	2.90%	5.90%	64.70%	23.50%	4.03	0.83
Some of the banks have experienced increased consolidation through acquisition activities	8.80%	0.00%	20.60%	44.10%	26.50%	3.79	1.12
<b>Banks have been forced to merge in order to gain synergy to remain in the market</b>	26.50%	11.80%	2.90%	35.30%	23.50%	3.18	1.59
Some of the branches have been closed	2.90%	5.90%	8.80%	67.60%	14.70%	3.85	0.86
<b>Average</b>						<b>3.53</b>	<b>1.17</b>

The respondents (52.9%) agreed that banks were forced to change their work processes to avoid losses. This is supported by the 3.06 average. The results also show that the majority of respondents, namely 55.9%, think that banks invest in alternative sources of income such as bank insurance. This is supported by the 3.24 average. In addition, the results showed that the majority of respondents, namely 88.20%, agreed that banks emphasize innovation and agency and digital banking as the main drivers of bank diversification and distribution channels for banking products. This was confirmed with an average of 4.03.

The results also showed that the majority of respondents, namely 70.6%, agreed with the statement that several banks experienced increased consolidation through acquisition activities. This was confirmed with an average of 3.79. The results show that 58.8% of the participants agreed that banks are forced to unite to work together to survive in the market. This is indicated by an average of 3.18. In addition, the results showed that the majority of respondents surveyed, namely 82.3%, agreed that some shops were closed. This is confirmed by a mean of 3.85. The overall average of 3.53 meant that most respondents agreed with what was said about the organization's redesign strategy. This means that most banks have implemented an organizational redesign strategy.

The respondents were questioned whether the financial performance of commercial banks in Nairobi County, Kenya is influenced by organizational reform strategies. Figure 1 depicted the results.

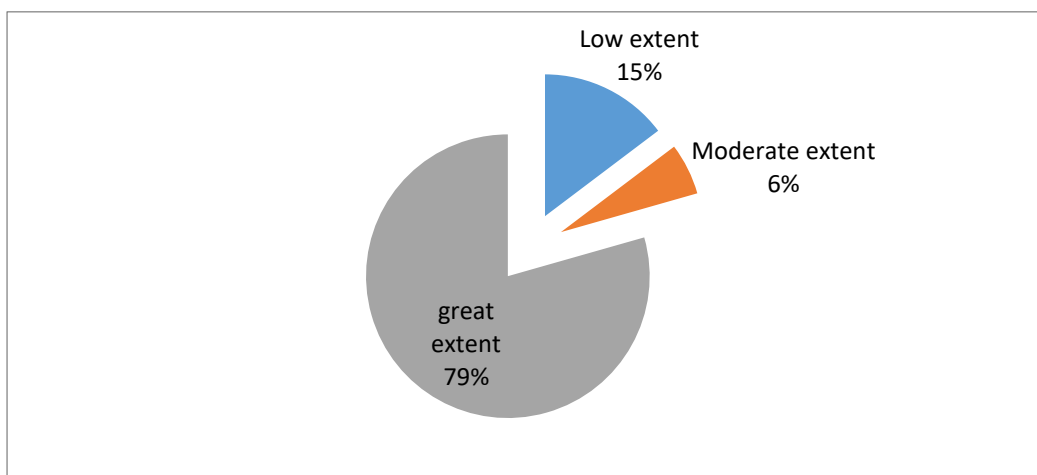




**Figure 1: Organization Redesigns Strategy and Financial Performance**

According to the findings in Figure 1, 76 percent of respondents believe that an organization's redesign strategy has an impact on financial performance, while only 24 percent believe that it has no impact on financial performance.

The respondents were also asked whether a company's redesigned strategy had an impact on its financial performance. Results were presented in Figure 2.



**Figure 2: Extent Organization Redesigns Strategy influence Financial Performance**

The participants, 79%, felt that organization redesigns strategy influence financial performance to a great extent. In addition, 15% of the respondents indicated that organization redesigns strategy influences financial performance to a low extent while only 6% indicated moderate extent.

### ***Financial Performance***

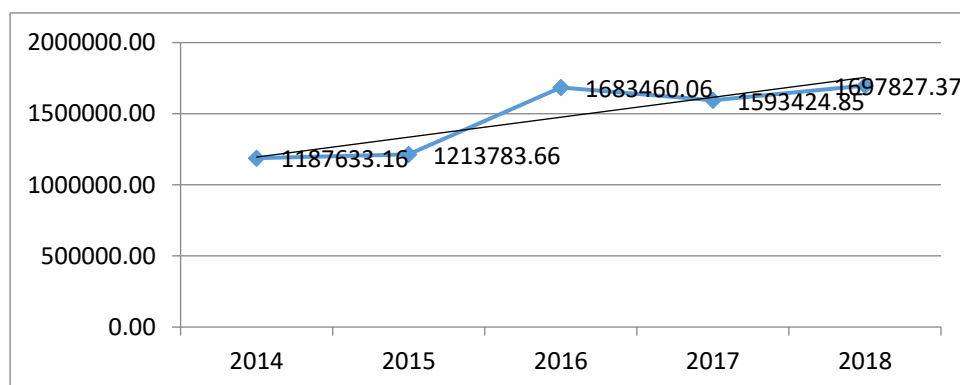
The dependent variable in this study was financial performance. The descriptive results were presented in Table 2.

**Table 2: Financial Performance**

Statement	Very low	low	Moderate	High	very high	Mean	std. dev
Profitability	5.90%	0.00%	20.60%	41.20%	32.40%	3.94	1.04
Return on Investment	5.90%	11.80%	29.40%	38.20%	14.70%	3.44	1.08
Return on Assets	8.80%	8.80%	5.90%	44.10%	32.40%	3.82	1.24
Return on Equity	5.90%	11.80%	5.90%	52.90%	23.50%	3.76	1.13
<b>Average</b>						<b>3.74</b>	<b>1.12</b>

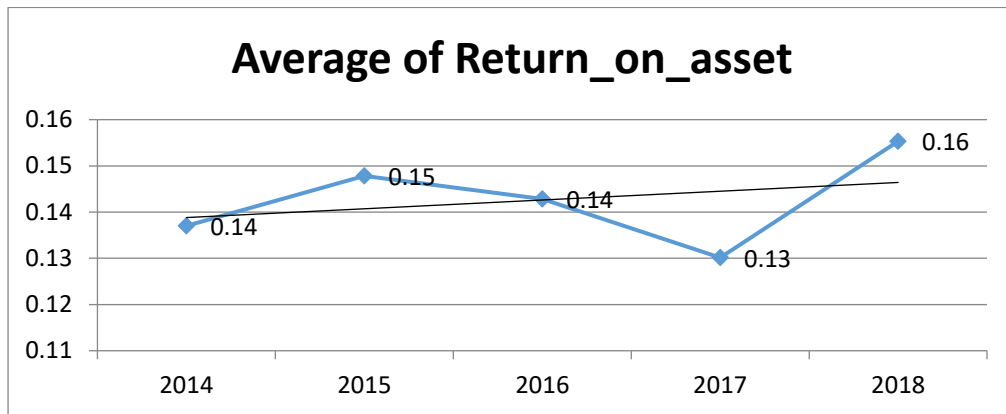
According to the findings in Table 2, 41.2 percent of respondents believe their bank's profitability is high. This was backed up by a 3.94 average. Furthermore, 38.2 percent of respondents said their bank's return on investment is high. This was supported by a mean of 3.44. The results further showed that 44.1% of respondents indicated that the return on assets in their bank is high. This was confirmed by a mean of 3.82. 52.9% indicated that the return on equity in their bank is high. This was confirmed by a mean of 3.76.

Further, the graphs below show the trend analysis based on indicators of financial performance: profitability, ROA, ROE and return on investment.



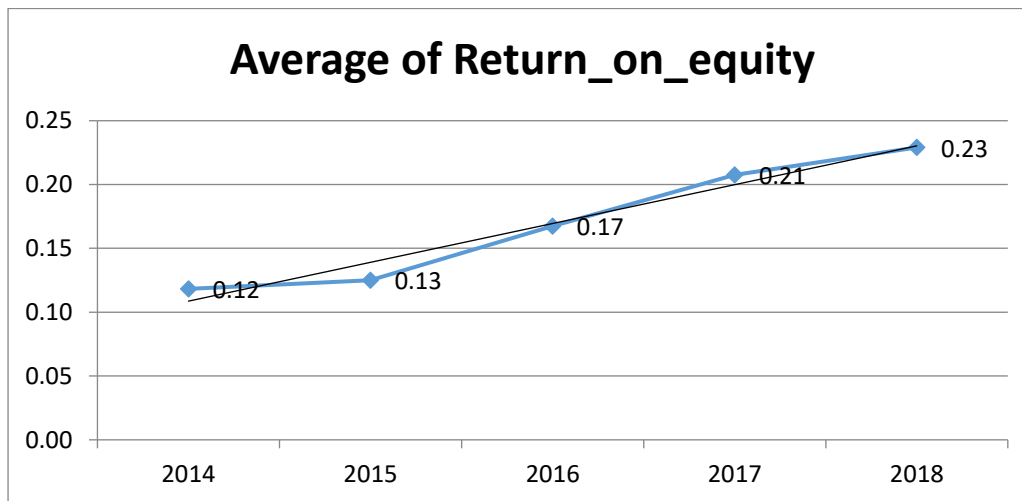
**Figure 3: Trend results for profitability**

Results in Figure 3 revealed that the mean of profitability was 1187633.16 in the year 2014. In addition, results revealed that the average rose to 1213783.66 in the year 2015 and further rose to 1683460.06 in the year 2016. However, the mean of profitability reduced to 1593424.84 in the year 2017 and further increased to 1697827.37 in the year 2018. Overall, the graph shows an increasing trend in the profitability of the commercial banks over throughout the measurement period.



**Figure 4: Trend results for return on asset**

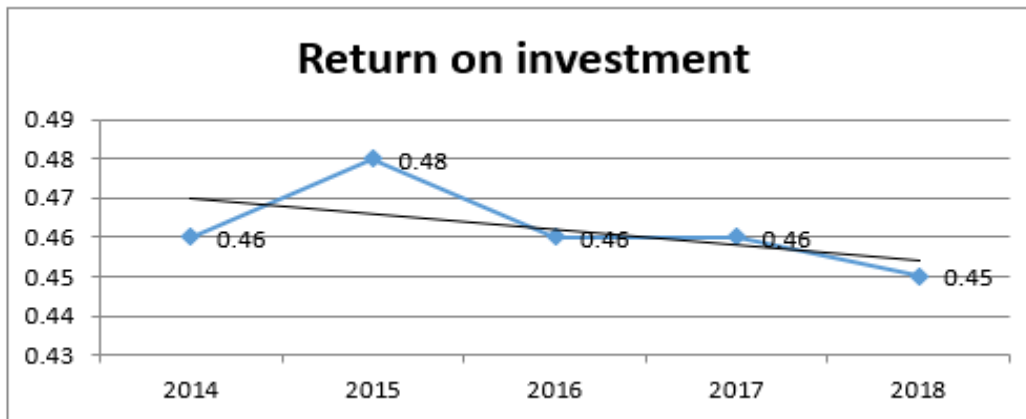
The findings in Figure 4 indicated that the mean of return on assets was 0.14 in the year 2014. In addition, results revealed that the mean increased to 0.15 in the year 2015 but decreased to 0.14 in the year 2016. The mean of ROA further reduced to 0.14 in the year 2017 and increased to 0.16 in the year 2018. The graph indicates upward and downward fluctuations of the banks' return on assets.



**Figure 5: Trend results for return on equity**

Results in Figure 5 revealed that the mean return on equity was 0.12 in the year 2014. In addition, results revealed that the average rose to 0.13 in the year 2015 and further rose to 0.17 in the year 2016. The mean of ROE further increased to 0.21 in the year 2017 and further increased to 0.23 in the year 2018. In general, the graph demonstrates an increasing trend in the value of return on equity of the banks.





**Figure 6: Trend results for return on investment**

Results in Figure 6 revealed that the mean return on investment was 0.46 in the year 2014. In addition, results revealed that the mean ROI increased to 0.48 in the year 2015 but declined to 0.46 in the year 2016. The mean of ROI was constant at 0.46 in the year 2017 and further decreased to 0.45 in the year 2018. The graph illustrates an overall declining trend in the value return on investments.

#### 4.2 Correlation Analysis

This section provides results on the correlation between the study variables. The results were used to show the relationship between variables in terms of strength and direction.

**Table 3: Correlation Matrix**

		Financial performance	Organization Redesign Strategy
Financial performance	Pearson Correlation	1.000	
	Sig. (2-tailed)		
Organization Redesign Strategy	Pearson Correlation	.496**	1.000
	Sig. (2-tailed)	0.003	

The findings in Table 3 demonstrated that organization redesign strategy had a positive and significant relationship with financial performance ( $r=0.496$ ,  $p=0.003$ ) at a 95% confidence level. This implied that improvement in organization redesign strategy is positively and significantly related to an increase in the financial performance of Commercial Banks in Kenya.

These findings corroborated those of Sujud and Hachem (2018), who established that a reorganization plan improved earnings. The study findings also supported those of Oladimeji, Akingunola, and Sanusi (2017) who concluded that BPR in the financial sector is crucial to achieve desired results in the area of operations and profitability. Similarly, Gachimu and Njuguna (2017) established that organization redesign strategy was key in enhancing financial performance.

## 5.0 Conclusion

The study concluded that the organizational redesign strategy was positively and significantly related to the financial performance of commercial banks in Nairobi County, Kenya. In addition, bank acquisition activities have intensified. By combining different banks, synergies are achieved to safeguard the market. The implication is that organizational redesign strategy contributes positively to the improved financial performance of commercial banks.

## 6.0 Recommendations

The study recommends that commercial banks should diversify to increase their income levels. Banks also need to invest more in innovation, agency, and digital banking as the main drivers of bank diversification and distribution channels for banking products. This will help increase their efficiency. Banks are also encouraged to unite to work together and survive in the market.

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