Initial Conditions, Dynamic Capabilities and Performance.

1. *Mwangi J.K 2. Kiiru David*

1. *Department of Business Studies, St. Paul's University, Kenya*
2. *School of Business, Kenyatta University*

Abstract

Every organization strives to achieve the best market position, attain a competitive edge, maintain high performance and end up being a market leader. However many firms start on the right foot but as the time progress some fall or fail to achieve the same. This study looked at the role of initial condition in attaining competitive advantage as well as the overall performance. The research was a census of the commercial banks sector and the findings revealed that the initial conditions do not influence the performance though contributes gaining competitive advantage. The study looked at the moderating role of dynamic capabilities on the relationship between initial conditions and performance. The findings show initial conditions effect on performance diminishes with time. However dynamic capabilities are found to play moderating role in the relationship between initial conditions and performance of commercial banks in Kenya. The study recommends that all banks staff be educated on the various categories of dynamic capabilities to enable the utilize them to improve their performance and well as gaining competitive advantage.

Keywords: Performance, Initial Conditions, Dynamic Capabilities

Introduction

A big question that most researchers and scholars on strategizing, wrestle with, is why some firms succeed in environments that others fail in. This has raised the need to research on the causes of a firm's success and the reason behind differences in the performance of firms within the same industry (Rumelt, 1984; Pavlou, 2011). From their literature, early researchers assumed that the nature of the firm and its environment determined success or failure of a firm. However, in these days of globalization and internationalization of markets, competition has become stiffer, forcing firms to strategize and develop better business models to enable them gain and sustain competitive advantage and high performance (Porter,1998; Teece, Pisano, & Shuen, 1997).

Until 1990s, the dominant view in strategic management was that business management was determined by the appeal of the sectors in which the company was competing and by the competitive position of the company in those sectors (Porter & Miller, 1985; Rumelt, 1991; Wiggins &Ruefli, 2002). This gives an external explanation for a firm's competitive advantage capitalizing on the relative imperfections of the sector in which the firm is competing. However, in recent years the idea of analysing a firm's competitive advantage from an intra-organizational perspective based on its own capabilities has made the targeting of business strategies easier (Priem & Butler, 2001; Ray, Barney & Muhanna, 2004).

According to Central Bank of Kenya (CBK), Kenya's commercial bank sector exhibits differences in performance, with some banks reporting very high profits while others report losses before tax on their annual report.

This implies difference in performance of firms within a sector that is performing highly in comparison with other sectors and industries within Kenya's economic environment (CBK, 2012).

Each firm has a unique history, organizational culture, capabilities and current policies. These gives the firm skills and resources that is critical for success. Every period of time is also unique, as both company and environment are in a state of constant change. However, firms are seen as possessing considerable ability to build on their strengths and overcome their weaknesses to influence or alter their environment and to engineer change over time and not merely respond to it (Porter, 1991, 1998; Ambrosini, Bowman & Collier, 2009).

Commercial Banks in Kenya

The commercial bank sector is so critical in most economies that it attracts attention from all circles, including the general public and regulatory authorities. This is because banking institutions perform intermediation functions and consequently influence the level of money through deposit liabilities (Mauri, 1983; Bhatt, 1989; Askari, 1991; Yue, 1992). Hence, it's natural for depositors, investors, regulators and the general public to have vested interest in the performance of banking institutions. Globally, the banking sector has grown as a knowledge sector becoming dynamic and attempting to cope with the competitiveness due to globalisation of economies (Mavridis, 2004).

As Gathungu and Mwangi (2012) noted, globalization has accelerated change in innovation-based industries such as banking, finance and information industries.

The banking industry in Kenya is governed by the Companies Act, the Banking Act, the Central Bank of Kenya Act, plus the various guidelines issued by the Central Bank of Kenya (CBK) with the aim of introducing prudence in the banking activities. As at 30th June, 2012, the banking sector comprised 43 commercial banks, 1 mortgage finance company, 6 deposit-taking microfinance institutions, 5 representative offices of foreign banks, 115 foreign-exchange bureaus and 2 credit reference bureaus (CBK 2012). Kenyan commercial banks have come together under the Kenya Bankers Association (KBA), which serves as a lobby for the banking sector's interests. KBA serves as a forum for addressing issues affecting member banks, according to Nyangosi (2011).

Over the last few years, Kenyan commercial banking sector has continuously grown in assets, deposits, profitability and offered products. This growth is mainly attributed to the industry's wide branch network in Kenya and in the East African Community region as well as the automation of a large number of services plus the emphasis on addressing diverse customer needs other than just providing the traditional off-the-shelf banking products (CBK, 2012).

During the past few years, players in this sector have experienced increased competition due to increased innovation among the existing players and new entrants into the market. The sector is also contending with new regulations and challenges triggered by the global financial crisis.

For instance, the Finance Act 2008 which took effect on 1 January 2009, that required commercial banks to build a minimum core capital of KSh. 1 billion by December 2012 affected many banks' operations.

The global financial crisis that started in 2008 was also expected to affect the banking industry in Kenya, especially in regard to deposit mobilisation, reduction in trade volumes as well as the performance of assets (Nyangosi, 2011).

According to the CBK report for the period ending 30th June, 2012, stress tests conducted by the Central Bank indicated that the sector remained sound and resilient. It is worth noting that the financial sector in Kenya is doing better than other sectors and is developing faster than the countries overall economy. For instance, this sector grew by 9.0% in 2010 and 7.8% in 2011, whereas the economy grew by 5.8% and 4.4% in 2010 and 2011 respectively (CBK, 2011, CBK, 2012). The banking sector performance improved in the year 2011, with the sector's profit before tax increasing by 20.4 percent.

The Kenyan banking environment is characterized by different banking products, increased choices, security and accessibility. Thus, the ability of commercial banks to effectively and efficiently deliver products and services is key to performance and relevance. Over the years, the banking industry has continually introduced a wide range of new products prompted by increased competition, ICT growth and enhanced customer needs. As a marketing strategy, the new products offered assumed local brand names to suit the domestic environment in targeting the larger segment of the local customer base (CBK 2012).

Majority of commercial banks in Kenya have added internet banking, mobile phone banking and other products requiring e-banking platform to enhance delivery channels for their customers.

However, it is important that the introduction of these products be accompanied with programs to broaden consumer knowledge of the new and more innovative ways of conducting banking business (CBK 2011, 2012). For example, while Internet banking is a fast and convenient mode of conducting banking transactions, it is yet to gain wide acceptance among banking consumers because many potential customers still view this mode of banking with apprehension. Most banks have now partnered with mobile phone service providers to enable their customers use cell phones for mobile banking transactions, including, checking account balances, confirming credit or debit transactions, paying utility bills and transferring funds within and between commercial banks. And in all cases, competitive advantage tends to be in agreement with Porters (1991) drivers of competitive advantage view that superior position, superior skills and superior resources are the main drivers.

Research Problem

All firms aim at creating and sustaining competitive advantage and maintaining high performance (Porter, 1998; Pavlou, 2011). However, there are some sectors and industries which perform generally better than others within any given environment, making such industries more attractive. Looking at the Kenyan market, the banking industry is among those industries that are attractive on performance ground. Commercial banks have been performing exceptionally well, reporting positive profit growth every financial year.

For instance, this sector grew by 9.0% in 2010 and 7.8% in 2011, while the national economy grew by 5.8% and 4.4% in 2010 and 2011 respectively (CBK, 2012). The commercial banks sector performance improved in the year 2011, with profit before tax increasing by 20.4 percent.

Firms in high-performing sectors, such as Kenyan commercial banks, are expected to have no performance differentiation. However, this is not the case in Kenya. Some commercial banks have been reporting dismal performance while the sector on average is reporting growth in performance. Many scholars argue that performance is influenced by various factors, among them the drivers of competitive advantage (Winter, 2003; Teece, 2007; Jiao, Wei & Cui, 2010). Dynamic capabilities are also believed to positively relate to a firm's long-term performance. Performance is viewed to be the result of a firm's competitive advantage. However, the various studies have not extensively explored the relationship between the drivers of competitive advantage and performance under a dynamic environment.

Therefore, there is need to investigate the influence of initiation conditions as a driver of competitive advantage on performance and determine whether dynamic capability has any bearing on their relationship. This study sought to investigate the relationship between initial conditions, competitive advantage and a firm's performance among commercial banks in Kenya.

Specific Objectives

i. To determine the influence of initial condition on performance of commercial banks in Kenya.
ii. To determine the moderating effect of dynamic capabilities on the relationship between initial condition and performance of commercial banks in Kenya.

Research Hypotheses

H_{O1}. There is no relationship between initial conditions and performance of commercial banks in Kenya.

H_{O2}. Dynamic capabilities do not have any moderating effect on the relationship between initial conditions and performance of commercial banks in Kenya.

Literature review

In search of theories for Sustainable Competitive Advantage (SCA) and firm performance, a number of theories have been raised. This study looked at a few of these theories and highlights their limitations as scholars and researchers continue searching for the best theory. Theories employed in this study include: Game Theory, Commitment and Uncertainty theory, Resource-based Theory, Knowledge-based Theory and Dynamic Capability Theory.

Game Theory models seek to explain the equilibrium consequences of patterns of choice by competitors over a variety of strategic variables such as capacity, research and design. These models mainly focus on identifying conditions leading to mutually consistent equilibria and the nature of these equilibria.

Each model is restricted to one or a few variables and assumes that the environment is fixed. For this reason, to determine the outcome, timing plays a key role (Gilbert, 2005).

Commitment and Uncertainty Theory gives emphasis to the lumpiness of strategy choices and the importance of uncertainty in making them. This assumes that the environment is relatively stable (though in reality it is uncertain) as a result of which commitments have long-term consequences and the possibilities for reconfiguring the value chains limited (Ghemawat, 1991). This approach tends to stress the value of flexibility in dealing with change rather than the capacity to rapidly improve and innovate to nullify or overcome it. The main shortcoming of this theory is that it considers the environment as relatively stable, yet the environment is constantly in a state of flux. The theory also takes into account discrete choices limiting a firm's discretion to shape its environment, respond to environmental changes, or define entirely new positions. This theory supported the Initial Conditions as a driver of competitive advantage.

The Resource-Based View holds the concept of core competencies and treatments that emphasize intangible assets. This is introspective and centered on the firm itself. This theory argues that firms have unique bundles of resources (Kraaijenbrink, *et al.*, 2011). As a result, they should put effort to address the conditions that allow them to achieve and sustain favorable competitive positions over time. Successful firms are viewed as being the result of their unique resources, which must be nurtured. However, CA is derived from more than just resources (Carlucci, 2010). RBV views firm resources as intermediate between activities and advantages.

Knowledge-Based view (KBV) emerged from the RBV and considered knowledge as the key or strategic asset for firms. Knowledge is assumed to be the body or social context in which strategies are developed, sustained and, consequently, protected (Grant, 1996). Therefore, knowledge process and generation is an essential element of analysis to understand strategy development for company evolution and transition (Kogut & Zander, 1992; Orlikowski, 2002; Easterby-Smith & Prieto, 2008). The commercial bank sector is considered a knowledge-based sector and hence this theory played an important role in support of the context of studying the sector.

Dynamic Capability View Theory involves longitudinal perspective, allowing investigation of the changes and the continuity in the pattern of organizational behavior over time (Danneels, 2010). During the last decades, there has been an intensive quest for the search of dynamic theory of strategy's detailed longitudinal case studies covering long periods of time because they are necessary for studying these phenomena (Porter, 1991). Dynamic Theory was necessitated by the shortcomings of the previous theories and was developed from three theories; namely, Game theory, Commitment & Uncertainty theory and the Resource-Based View theory. The theory helps this study to explore the dynamic environment in relation to firm performance.

Conceptual Review

Performance in business is termed as the accomplishment of a given task measured against preset known standards of accuracy, completeness, cost, and speed.

It’s also the degree to which a feat is being or has been accomplished (Prahalad& Hamel, 1990; Parker, 2000). For instance, the level of success of a salesperson in achieving the monthly goal of fulfilling orders for new customers. It can also be termed as the return provided by an investment or satisfying an obligation. In today's rapidly changing market environment, organizations aiming at high performance must continually evaluate whether their plans and actions are on target and if the organization is designed to successfully implement the necessary plans. According to Nayak and Nahak (2011), in order to survive and succeed, firms need to set strategic directions, establish goals, execute decisions and monitor their state and behavior as they move towards their goal.

According to Porter (1991), initial conditions influence feasible choices clearly as well as constrain them. Initial conditions may reside within an individual firm or in its environment. The initial conditions of a firm may include, among others, pre-existing reputation, skills, and activities as a result of its history.

Strategy is not a race to occupy one desired position but a more textured problem in which many positions can be chosen or created. Nevertheless, success requires the choice of a relatively attractive position, given industry structure, firm circumstances and competitors’ positions (Porter, 1991). It requires making all the firm’s activities consistent with the chosen position. If industry structure is held constant, a successful firm is one with an attractive relative position.

Logistics discipline has adopted capabilities as central to creating and maintaining competitive advantage. Initially, capabilities were described from a relatively static view as unquestionable and lasting over long time periods (Wernerfelt, 1984; Barney, 1991; Defee& Fugate, 2010). As the rapidly changing, hypercompetitive, increasingly global supply chain era has shrunk the life of competitive advantages nowadays, the static view of capabilities is swiftly becoming unfeasible (Teece*et al.*, 1997; Eisenhardt& Martin, 2000; Barney, Wright & Ketchen, 2001). Therefore, in order to be competitive in this evolving environment, the creation of dynamic capabilities may be more necessary.

The difference between dynamic capabilities and static or substantive capabilities is that the former provide the means to update and better utilization of existing (static) capabilities and creation of new capabilities (Zahra, Sapienza & Davidsson, 2006). Their use implies that the concept of competitive advantage must move beyond the static view, that presumes that sustainability is the goal, to the dynamic view that considers continuous improvement for short-term advantage to be the only achievable goal (Teece*et al.*, 1997; Verona & Ravasi, 2003). Effective dynamic capabilities contribute to the race to achieve and maintain long-term competitive advantage by allowing the firm to create a series of temporary advantages and staying one step ahead of competitors (Teece*et al.*, 1997; Eisenhardt & Martin, 2000).

The publication of seminal work on Dynamic Capabilities by Teece, *et al.*, (1997) made the topic one of the most active research areas in the field of strategic management.

Moreover, the construct remains open to a variety of conceptualizations and interpretations in all areas, even its most basic aspects such as definition of dynamic capabilities (Stefano, Peteraf & Verona, 2009). According to Barreto (2010), variation in understanding dynamic capabilities has not only contributed to the richness and vibrancy of the research but also created confusion over the meaning and utility of the construct. This has led some scholars to doubt the existence of dynamic capabilities and view it as just a fanciful concept (Winter, 2003). However, Arend and Bromiley (2009) warn that lack of clarity on basic understanding can hinder fruitful conversation, obstruct progress on the theoretical front, and prevent empirical work from cumulating.

Conceptual Framework

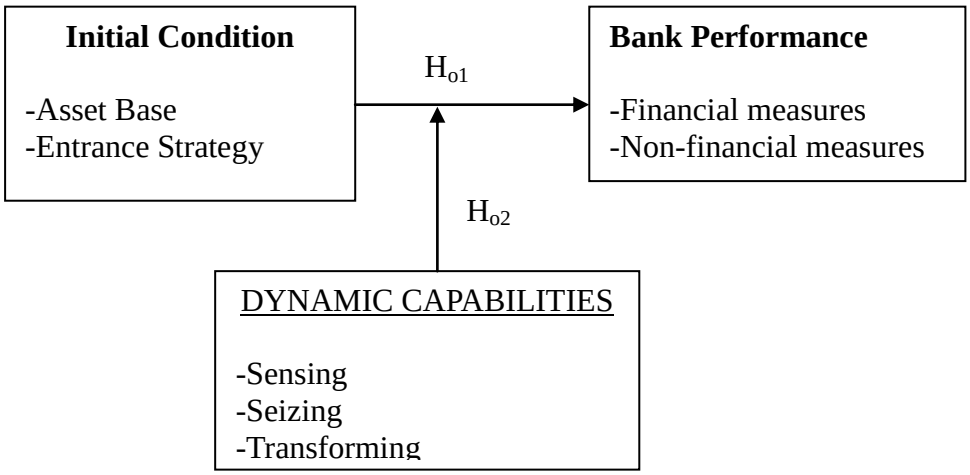


Figure 1. Conceptual Framework

The study measured performance using financial and non-financial measures. Financial measures used are ROA, ROE, and profit before tax. Non-financial measures used are: customer base increase, development of new products, growth on branch network and growth on new automated teller machines and sites.

The independent variable was initial conditions as a driver of competitive advantage; the moderating variable was dynamic capabilities; and bank performance was the dependent variable.

Methodology

Research Design

The study used a mixed design of explanatory and cross-section research design. Explanatory research attempts to clarify why and how there is a relationship between two or more aspects of a situation or phenomenon (Catherine, 2002; Ranjit, 2005). Explanatory research aims at answering the question why. This type of research attempts to go above and beyond exploratory and descriptive research to identify the actual reasons a phenomenon occurs (Kothari, 1985, Kumar, 2005). Explanatory research also attempts to build and elaborate on theories and add to predictions and principles where possible (Kothari, 2009). The study also adopted cross-sectional survey method. The researcher's choice of cross-sectional survey method was prompted by the awareness that it allowed collection of quantitative data from a population in an economical way (Saunders *et al*., 2009).

Target Population

The study population comprised all commercial banks licensed and listed by CBK as at 31st December 2011. According to CBK 2011 Bank Supervision Annual Report, there were 43 commercial banks. Thus, the total population was 43 commercial banks. The study involved all the 43 commercial banks licensed and listed by Central Bank of Kenya as at December 2011.

The study was carried out at the banks' head offices, with the banks' top management as the respondents. The study was carried out within Nairobi County where all the commercial banks have their head offices within central business district and some in the outskirts. This eased accessibility of the target participants during data collection.

Saunders *et al*., (2009) encourage the use of census where the target population is small and within reach for survey studies. Since this target population was only 43 and all respondents were within reach, census design was adopted and therefore there is no need for sampling. The procedure adopted was convenient, as the target respondents were bank's representatives at the head office. Different banks have designated officers who respond on behalf of the bank to public and scholarly research issues. The researcher sought help from each bank's head office for identification of the respondent.

Data Collection Instruments

The study used semi-structured questionnaires to collect primary data from the respondents. Secondary data was also collected from the various banks as well as CBK's website. Secondary data was mainly on the bank's financial performance over the last five years. A tool was developed to collect secondary data.

A pilot test was carried out with the commercial banks' branch managers and supervisors within Nairobi city. These were not part of the main study which targeted head offices. A total of 16 respondents participated in the pilot test. The primary purpose of the pilot test was to check face and content validity of the instrument.

In addition, the pilot test was used to estimate the average time taken by the respondents to complete the questionnaires. The results of the pilot test assisted in editing and alignment of the research variables to their respective questions. Also, this enabled eliminate ambiguous words and terminologies in the final questionnaire. A lot of ambiguity was noted in respect of terms used in testing dynamic capability and had to be revised as necessary.

This research study used internal consistency method to estimate reliability, and the Cronbach's Alpha was computed by determining the manner in which different items of the instrument were related to each other and to the entire instrument. Field (2009) argues that a Cronbach's Alpha value equal or greater than 0.5 is regarded to be an indication of reliability. Therefore, the researcher considered the Alpha coefficient greater than 0.5 to indicate reliability of the research instrument.

The entire instrument was reliable, with Cronbach'sAlpha of 0.969. Cooper and Schindler (2007) indicate that for an instrument to be regarded as reliable, the value of Cronbach's Alpha coefficient has to be at least 0.5. Thus, the instrument was considered to be reliable for carrying out the survey.

Data Collection Procedures

Before collecting data, the researcher got authorization from the Ministry of Higher Education, under the National Commission for Science, Technology Research and Innovation. The researcher was issued with research permit number NACOSTI/P/14/1442/3544 by the National Commission for Science, Technology, Research and Innovation.

Also, the researcher sought approval from the various commercial bank CEO's offices from where directions were given to the respondents. The questionnaires were delivered to the respondents and collected later to increase the chances of a higher rate of response. Secondary data was collected using a developed data collection tool from CBK's Bank Supervision Annual Report.

Data Analysis and Presentation

The main aim of this process is to assemble or construct data in a meaningful or comprehensible fashion. Yin (1994) observes that data analysis consists of examining, categorizing, tabulating or recombining the evidence to address the initial propositions of a study. Once the questionnaires were received back, they were screened and edited to remove deficient, incoherent and erroneous responses. The study used descriptive statistics for the analysis of the data characteristics and presented results using tables and figures. The frequencies, mean, standard deviations and percentages were used to interpret the information. Exploratory Factor Analysis was used to identify constructs and develop composite indices for all variables which were used for the inferential statistic analysis. Then simple and multiple and hierarchical multiple regressions were run on SPSS Version 20 for inferential statistic analysis. The various analyses carried out using the SPSS were presented and discussed.

The study used Multiple Regressions Model. Multiple Regression Equation is considered the appropriate method of analysis when the research involves a single dependent variable presumed to be related to two or more independent variables (Hair, Black, Babin & Anderson, 2010).

Multiple regression analysis aims at predicting the changes in the dependent variable in response to changes in independent variables.

Multiple Regression Equation is a technique that can provide both prediction and explanation to the researcher, according to Hair *et al.*, (2010). According to Field (2009), Multiple Regression models require a sample size of between 30 and 100 for best analytical results. The research target was a population of 43 respondents and thus the Regression Analysis was fit for data analysis.

To determine the relationship between each independent variable and performance (dependent variable), the research analyses used Simple Linear Regression and Hierarchical Multiple Regression. This was in addition to descriptive analysis including frequencies, variance and standard deviation.

The research used the following equations:

Effect of bank activities on performance

$BP=\alpha+\beta IC+\varepsilon$.....(i)

Where α = model equation intercept

β= regression coefficient

ε= error term

BP=Commercial bank's performance

IC=initial conditions

Moderating effect of dynamic capbilities on relationship between drivers of competitive advantage and banks performance

Model 1: $BP=\alpha+\beta IC+\beta DC+\varepsilon$

Model 2: $BP=\alpha+\beta IC+\beta DC+\beta(IC*DC)+\varepsilon$.....(ii)

Where DC=dynamic capabilities

IC= Initial Conditions

IC*DC = interaction factor

Research Findings

Response Rate

The researcher issued 43 questionnaires (one questionnaire per commercial bank), out of which 41 were received back. One questionnaire was disqualified due to incompleteness, thus 40 questionnaires were considered as suitable for the analysis. This translated to 93.02% of the targeted total of 43 questionnaires. According to Saunders *et al.*, (2009), a response rate of 50 percent is adequate, 60 percent good and a response rate of 70 percent and above considered very good. Therefore, the response rate of 93.02% achieved was adequate for drawing conclusions on the study objectives.

Performance

To understand the banks' view on performance, the respondents were asked to rate their bank's views on various performance factors. The responses were on a scale of 1-5, where 1=below average, 2=average, 3=above average, 4=good, and 5=excellent.

The percentages, mean and standard were computed as presented in Table 1

Table 1 Results of Performance Rating

Statement	Response percentage rate in scale 1-5						
	Below average	average	above average	good	excellent	Mean	Std. Deviation
Overall performance	0	5.0	15.0	52.5	27.5	4.03	.800
Profit before tax	2.5	7.5	20.0	47.5	22.5	3.80	.966
Profit after tax	2.5	7.5	25.0	42.5	22.5	3.75	.981
Return on investment	0	10.0	17.5	42.5	30.0	3.93	.944
Return on assets	0	10.0	15.0	52.5	22.5	3.88	.883
Return on equity	2.5	2.5	27.5	47.5	20.0	3.80	.883
Customer base growth	5.0	5.0	32.5	32.5	25.0	3.68	1.071
Development of new products	2.5	5.0	25.0	35.0	32.5	3.90	1.008
Adoption and application of new technology	0	5.0	17.5	32.5	45.0	4.18	.903
Innovation	0	10.0	32.5	27.5	30.0	3.78	1.000
Staff retention within the bank	2.5	22.5	20.0	42.5	12.5	3.40	1.057
Opening new branches	7.5	10.0	22.5	37.5	22.5	3.58	1.174
New ATM machines and sites	10.0	20.0	25.0	12.5	32.5	3.38	1.390
Aggregate score						**3.77**	**1.005**

Source: Survey Data 2014

A mean score of 3.77 and SD of 1.01 indicate that majority of the respondents view their bank's performance to be above average. Overall performance was rated with high M=4.03, SD=.80 where 5% rated average, 15%, above average, 52.5% good and 27.5% excellent performance. In regards to new ATM machines and sites, the ratings were: 10% below average, 20% average, 25% above average, 12.5% good, and 32.5% excellent. The mean score was 3.38 and SD 1.39. This indicates that various banks view addition of ATM service differently and many do not view it as a competitive edge.

Unstructured interview revealed that this is due to the new banking mode of agency banking, which many banks are adopting at the expense of ATM, while others use universal ATM machines, outsourced as a way of reducing operational cost and risk. Return-on-investment was rated as excellent by 30%, good by 42.5 %, above average by 17.5%, average by 30%. None of the respondents rated it as below average. The mean was 3.93 and SD .944, implying a high mean and moderate SD. This indicates that the banking industry is performing well by shareholders' equity returns.

The results were in agreement with the secondary data collected from CBK and various bank websites and the information used to analyse performance of the commercial banks sector for the last five years (2008-2013). As recommended by Moutinho and Phillips, (2002), El-bannany (2008), and Jehena and Avelina (2012), both financial and non-financial measures of performance were applied to analyse the sector's performance. Market share categorization and customer base growth were used to evaluate non-financial performance, while profit before tax, ROA and ROE were used to evaluate financial performance. The results indicated a performance growth by both measures (financial and non-financial) for the entire sector.

Market Share Categories

The secondary data revealed that commercial banks in Kenya are grouped into three categories: small, medium and large, based on the market share.

A bank with market share below 1% is labeled ‘small’; one with a market share bigger than 1% but less than 5% is labeled ‘medium’; and one with a market share above 5% is labeled ‘large’. The market share index used is a computed composite of net assets, deposits, capital, number of loan accounts and number of deposit accounts (CBK, 2013). Out of the 43 commercial banks, 6 are categorized as large, 15 as medium and the rest 21 as small. Table E (appended) gives full list and grouping of each individual bank for the last five years. In the period of the last five years, only Guaranty Trust Bank Ltd and Ecobank Kenya have made a significant impact on their market share. Ecobank did poorly and went lower, from medium to small, whereas Guaranty Trust bank improved and was promoted to medium from small.

Customer Base Increase

The Kenyan commercial banks sector has reported customer base expansion for the last five years as shown in Table 2

Table 2 Summary of Kenya Commercial Banks Sector Customer Base Growth

Year	Customer base Percentage growth
2009	28.97
2010	2,064.40
2011	16.78
2012	83.42
2013	21.94

Source: Secondary Data 2014

The customer base growth indicates that the entire sector grew by 28.97% (2009), 2,064.4% (2010), 16.78% (2011), 83.42% (2012) and 21.94% (2013). A detailed growth analysis per individual bank is in Table F in Appendices Section. Therefore, we can conclude that the sector is doing well on customer base growth. However, as Teece (2006) warns, customer preferences and needs keep on changing and thus banks require dynamic capabilities to retain the consistent growth over time. These results were in support of the research survey finding indicating an above-average performance with mean= 3.68 and SD= 1.07

Profit before Tax Growth

Over the last five years (2008-2013), the sector has reported high profit, indicating good financial performance. Figure 2 presents the sector's average growth, while table G1 (appended) gives full details of individual banks' performance. The data of computed profit before tax excluded one bank which did not post results since it's under receivership.

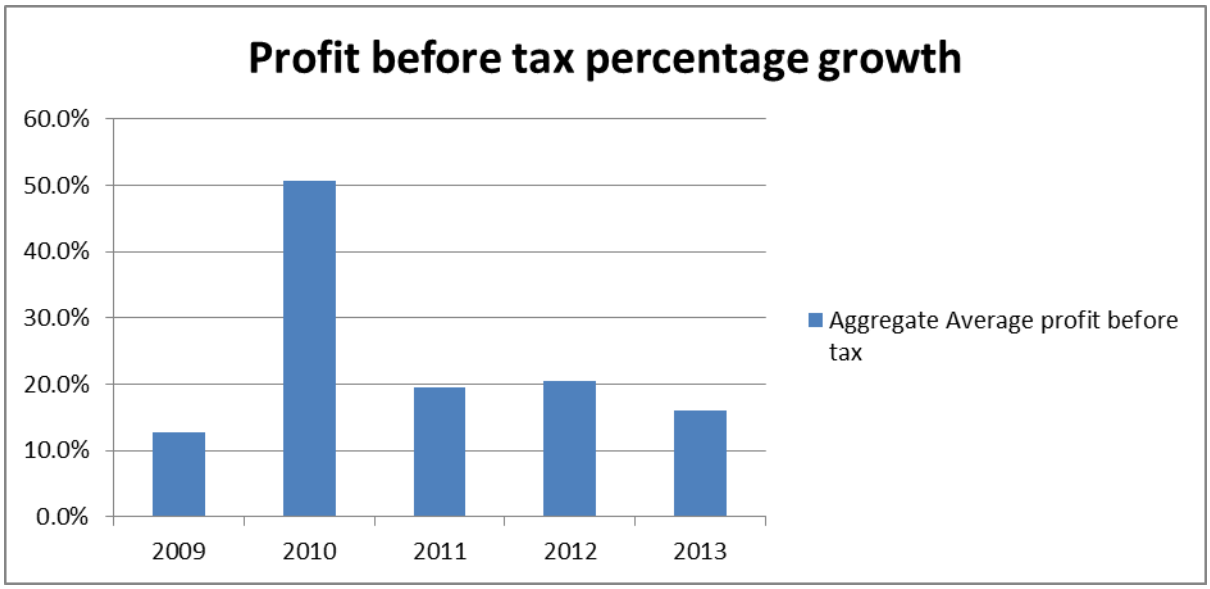


Figure 2: Kenya Commercial Banks Sector Profit Before Tax Growth

Source: Secondary Data 2014

The computed results indicate the sector's growth of 12.7% in 2009, 50.6% in 2010, 19.5% in 2011, 20.5% in 2012 and 16.1% in 2013. This supports the research survey results which reported a mean of 3.80 and a SD.966

Return on Asset

From secondary data, the results showed a growth over the past five years for sector and individual banks respectively.

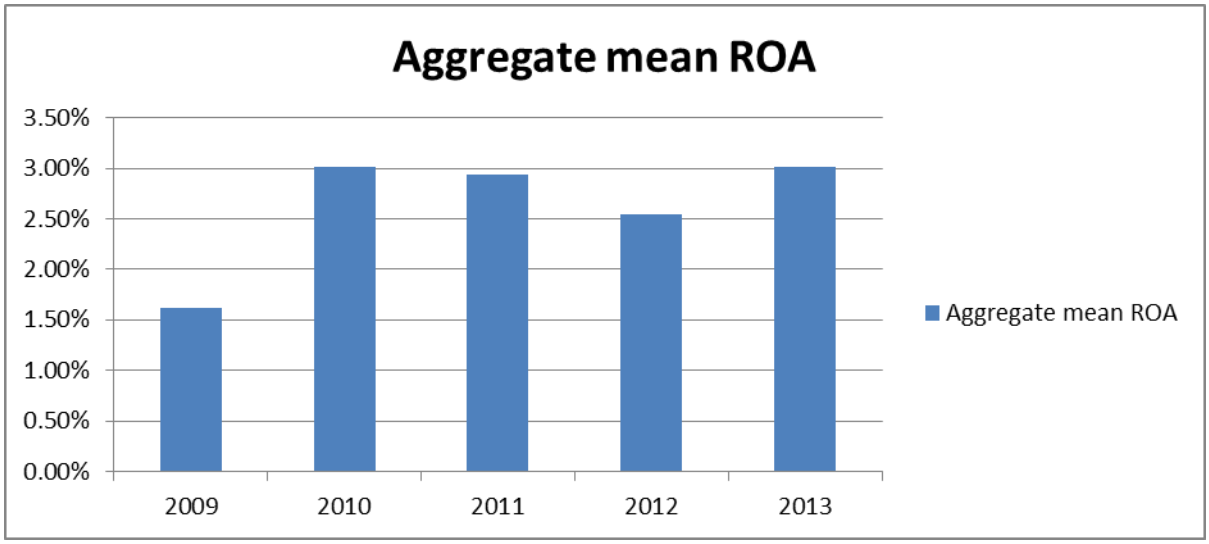


Figure 3: Summary of ROA Growth of Kenyan Commercial Banks Sector

Source Secondary Data 2014

The commercial bank sector exhibits growth on ROA over the last five years as indicated in Fig 3. On average, the sector grew by 1.61% in 2009, 3.02% in 2010, 2.94% in 2011, 2.54% in 2012, and 3.01% in 2013. This supports the survey finding in Table 4.4 where the respondents rated ROA as above average, with the mean of 3.88 and SD of 0.883.

Return on Equity

The secondary data collected indicated that there has been a positive growth on ROE in the entire commercial bank sector in Kenya. Figure 5 gives a summary of the sector's average growth.

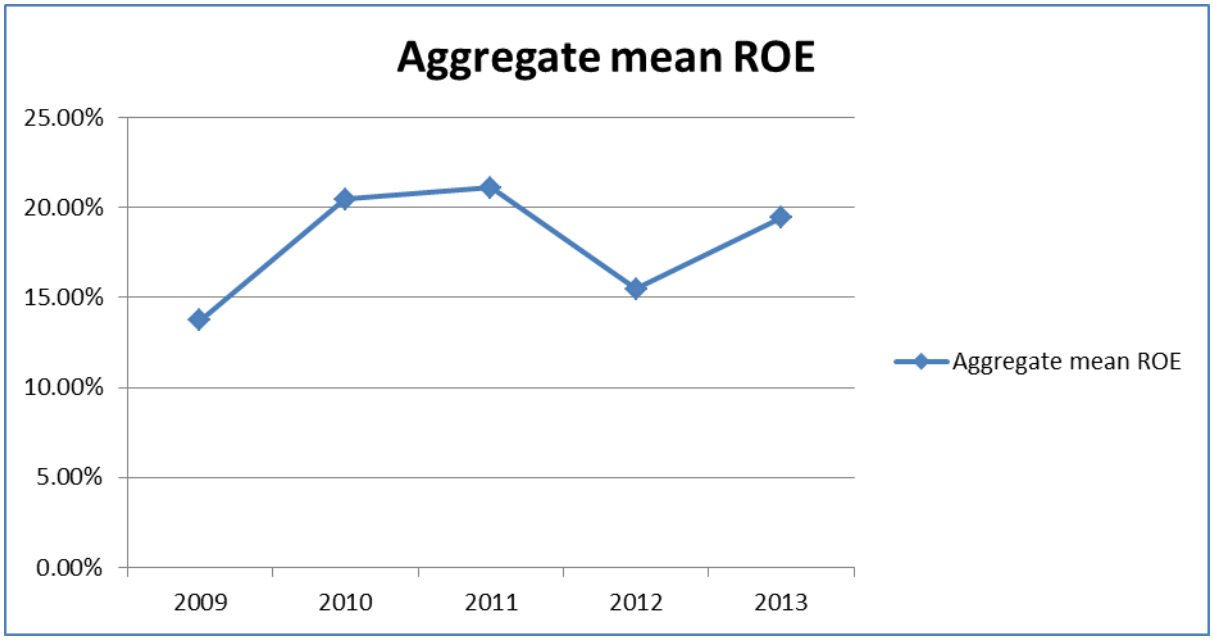


Figure 4.6 Summary of Kenya Commercial Bank Sector ROE Growth

Source: Secondary Data 2014

The computed result, excluding one bank which has not posted reports, shows a positive growth over the last five years. The sector exhibits growth of 13.73% in 2009, 20.46% in 2010, 21.12% in 2011, 15.46% in 2012, and 19.45% in 2013. This is in agreement with the research findings where ROE was rated high, with a mean of 3.80 and SD of 0.883.

Initial Condition

To assess the role of initial conditions to performance, the respondents were asked to rate initial condition factors on a scale of 1-5, where 1= strongly disagree, 2=disagree, 3=not sure, 4=agree, and 5=strongly agree.

Respondents were to indicate the position of their banks in relation to the stated factors by ticking the corresponding scale. Their responses were computed in percentage, mean and standard deviation as presented in Table 5

Table 5 Respondents' Rating of Initial condition

Statement	N	Min	Max	Mean	Std. Deviation
Firms that began as commercial banks have better performance in the industry.	40	1	5	3.38	1.275
Banks that began as deposit-taking microfinance firms have better opportunity for good performance	40	1	5	3.48	.933
A merger of two banks leads to better performance.	40	1	5	3.35	1.252
Banks that start as branches of the mother bank in another country have a better performance opportunity	40	1	5	3.43	1.035
Banks that start as a franchise of another bank operating in a different country have better chances of good performance	40	1	5	3.23	.974
Banks depend on the vision of the founders for their growth	40	1	5	3.88	.966
The performance of a bank depends on the initial market position	40	1	5	3.25	1.193
Entry strategies influence banks' performance	40	1	5	3.93	.730
Aggregate score				**3.488**	**1.045**

Source: Survey Data 2014

The aggregate mean of 3.488 indicates that majority of banks are not sure of the role of initial condition to their firms. The SD of 1.045 is slightly large and shows that banks hold different views in regard to initial condition. The best rated factor is the entry strategies' influence on performance (M=3.93 SD=.730), where 5% disagreed, 15% were not sure, 65.5% agreed and 17.5% strongly agreed. This indicates that banks develop their strategies by modifying the initial strategies of the founders and through innovation. The factor on franchises was poorly rated, with a mean of 3.23 and SD.974, where 2.5% strongly disagreed, 22.5% disagreed, 32.5% were not sure, 35% agreed and only 7.5% strongly agreed. This shows that there is no competitive advantage over the rest for any franchise bank.

From qualitative data analysis, the study found out that most of the respondents did not have important background information of their banks, such as the year when their firm started operating in Kenya. Also, majority of respondents did not know about the initial business of their firm. From the interview, it emerged that most banks concentrate on performance, so their trainings are tailored towards enhancing performance and they rarely discuss their history during staff recruitment and orientation. The dynamism in the sector has led to strategic thinking and planning, focusing on the future instead of the past; hence, many do not consider initial position of the bank to influence its current performance.

This seems to be in agreement with the study by Maina (2011), who found out that location dynamics were considered to influence firm performance more than initial position. Porter (1998) argues that the initial condition is important for firm performance over a period of time, as it determines the market position.

However, if one looks at a firm from a specific position without prior knowledge of the initial position, they may fail to acknowledge the effect of the initial conditions.

Sensing Dynamic Capabilities

To evaluate sensing dynamic capabilities within Kenyan commercial bank sector, the respondents were required to rate stated factors. Respondents were to rate their bank's utilization of sensing dynamic capabilities on a scale of 1-5, where 1= below average, 2= average, 3=above average, 4= good, and 5 = excellent. The computed percentage, mean and standard deviation were presented in Table 6

Table 6 Banks Utilization of Sensing Dynamic Capabilities

	Response percentages						
Statements	Below average	average	above average	good	excellent	Mean	Std. Deviation
Have ability to direct internal R&D and selecting new technologies.	2.5	15.0	25.0	35.0	22.5	3.60	1.081
Have ability to tap developments in	2.5	17.5	22.5	40.0	17.5	3.53	1.062
Have ability to tap supplier and complementor innovation.	2.5	17.5	30.0	35.0	15.0	3.43	1.035
Have ability to identify target market segments and changing customer needs.	2.5	10.0	12.5	52.5	22.5	3.83	.984
Aggregate score						**3.594**	**1.041**

Source: Survey Data 2014

The computed results indicated a moderate rate with an aggregate mean of 3.594 and SD of 1.041. This can be translated to mean that the banking sector utilization of sensing dynamic capabilities is above average and they probably need to be enlightened on how to employ these capabilities to achieve better performance. The factor testing the ability of banks to identify target market segments and changing customer needs was rated best, with a mean of 3.83 and SD of 0.984, where 2.5% rated below average, 10% average, 12.5% above average, 52.5% good, and 22.5% excellent. This indicates that commercial banks are alert on market dynamics and customer preferences. The ability to tap suppliers and complementor innovation was rated poorly (M=3.43, SD =1.035), with 2.5% rating below average, 17.5% average, 30% above average, 35% good, and 15% rated excellent. This could indicate a lapse in knowledge-sharing outside the bank.

Seizing Dynamic Capabilities

The participants were requested to rate the ability of their banks to seize available and indentified opportunities on a scale of 1-5, where 1= below average, 2= average, 3=above average, 4= good, and 5 = excellent.

Table 7 Respondents' Rating on Seizing Dynamic Capabilities

Statements	Response percentages						
	Below average	average	above average	good	excellent	Mean	Std. Deviation
Ability to describe the customer solution and the correct business model	0	7.5	17.5	47.5	27.5	3.95	.876
Ability to select correct decision-making procedures	2.5	10.0	22.5	45.0	20.0	3.70	.992
Ability to build loyalty and commitment	0	2.5	17.5	50.0	30.0	4.08	.764
Ability to select enterprise boundaries to manage complements and "control" platforms	0	5.0	22.5	55.0	17.5	3.85	.770
Aggregate score						**3.894**	**.850**

Source: Survey Data 2014

The computed aggregate mean of 3.894 and SD of .850 indicate a high rating, implying that banks do utilize seizing dynamic capabilities above average. The ability to build loyalty and commitment was rated highest among all the factors, with a mean of 4.08 and SD of 0.764, where 2.5% rated average, 17.5% above average, 50% rated it good, and 30% rated it excellent. This shows that banks employ dynamic capabilities to create and modify loyalty and remain committed to the customers despite the changing environment. Ability to select correct decision-making procedure seems to be an area that banks needs to employ, seizing DC to improve, which was rated with a mean of 3.70 and SD of 0.992, where 2.5% rated it below average, 10% average, 22.5% above average, 45% good, and only 20% rated it excellent.

Transforming Dynamic Capabilities

To assess how the commercial bank sector in Kenya utilizes transforming dynamic capabilities, the respondents were required to rate their banks. The respondents were requested to rate the ability of their banks to use dynamic capabilities to transform the opportunities so as to realize competitive advantage and performance on a scale of 1-5, where 1= below average, 2= average, 3=above average, 4= good, and 5 = excellent.

Table 7 Transforming Dynamic Capabilities among Kenyan Commercial Banks

			Mean	Std. Deviation
Statements	Min	Max		
Managing strategic fit so that asset combinations are value enhancing.	0	12.5	3.63	.925
Adopting loosely coupled structures; embracing open innovation; developing integration and Coordination skills.	1	5	3.53	.960
Knowledge management: learning; knowledge transfer; know-how integration; achieving know-how and intellectual property protection.	1	5	3.65	.949
Governance: achieving incentive alignment; minimizing agency issues; Checking strategic malfeasance; Blocking rent dissipation.	1	5	3.90	.982
Aggregate score			**3.675**	**.954**

Source: Survey Data 2014

The results on Table 7 indicate that the bank's utilization of transforming capabilities is above average (M=3.675, SD =.954).

This shows that the banks do not utilize the transforming dynamic capabilities maximum and may need to work on improving this. Factor on governance was highly rated, with majority, 47.5%, rating it good, 27.5% rated it excellent, 15% above average, 7.5% average, and only 2.5% rated it below average. The mean score was 3.9 and standard deviation was 0.982, indicating that we can generally conclude that banks utilize the transforming DC on governance at a high rate.

Several scholars support the importance of dynamic capabilities in supporting competitive advantage and performance of firms in dynamic environments (Teece, *et al*., 1997, Eisenhardt & Martin, 2000, Zahra, *et al*., 2006). However, Zott (2003) argues that dynamic capabilities are indirectly linked with firm performance, a view that gets support from Bowman and Amrosini (2003). Winter (2003) states that DC are essential requirements for any firm to survive in a dynamic environment. From the unstructured interviews, the banks acknowledge the importance of the sensing, seizing and transforming dynamic capabilities in improving their performance in the rapidly changing environment. Secondary data shows that Kenyan banking environment is quite dynamic and the competition seem to be stiff among the various banks. The study therefore concludes that there is need to understand the employment of DC in the commercial bank sector and assumes that DC influence performance.

Index Construct of Performance

The financial data was collected from central bank of Kenya's website and secondary data was collected for five years between 2009 and 2013. The five year average helps minimize the influence of current one year observation.

According to Mugambi *et al.,* (2011), to avoid biases of one year point estimates, five year period is considered sufficient. The perspectives of financial performance measured employed were profit before tax, ROA and ROE. To be able to construct composite index combining both financial and nonfinancial, the ratio data was transformed into interval scale. Therefore the range was calculated for each of the financial measures and was divided by 5. Then the observations were entered in the SPSS data editor in a 5 scale. Multicollinearity test was positive between ROA (VIF=5.916, tolerance= 0.169) and ROE (VIF=6.433, tolerance= 0.155) indicating high collinearity. To rectify this anomaly ROE was dropped from further analysis.

Nine items were used to test for performance on a 5 point likert scale. Exploratory factor analysis revealed KMO measure of sampling adequacy of 0.754 above the threshold of 0.5. The Bartlett's Test of sphericity (Chi-square=159.922, df= 36, p=0.000) was significant at 0.001, implying principal component method of extraction fitted data set. All items had communality above the threshold of 0.5. The orthogonal varimax rotations under factor analysis converged after four interactions and the items combined to form three factors namely financial, Business growth and Staff retention. Financial performance factor comprised of ROA and profit before tax and the two were summated to form an interval scale labeled “financial performance”.

Non-financial performance factors were grouped into two perspectives labeled "Business growth" and "Staff retention". Business growth factor is made up by; Customer base growth, Development of new products, Adoption and application of new technology, Innovation, Opening new branches and New ATM machines and sites. The six items were summated and formed composite scale labeled "Business growth".

Table 8 Exploratory Factor Analysis for Performance

Rotated Component Matrix[a]	Component and factor loading		
Item Description	1	2	3
Profit before tax		.855	
Return on assets		.896	
Customer base growth	.809		
Development of new products	.795		
Adoption and application of new technology	.758		
Innovation	.742		
Staff retention within the bank			.952
Opening new branches	.826		
New ATM machines and sites	.813		

Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization.

a. Rotation converged in 4 iterations.

Source; Survey Data

To come up with one measure of performance, the summated scores of non-financial and financial measures were combined. A composite index labeled "performance" was derived by summating financial performance index, business growth index and staff retention scale. This performance index is the dependent variable measure.

Index Construct of Initial Conditions

To test for banks initial conditions, eight items were used on a 5 point likert scale. Exploratory factor analysis revealed KMO measure of sampling adequacy of 0.672 above the threshold of 0.5. The Bartlett's Test of sphericity (Chi-square=47.134, df= 15, p=0.000) was significant at 0.001, implying principal component method of extraction fitted data set. All items except two had communality above the threshold of 0.5. The two items were, dependence of the founder's vision and starting as a deposit taking microfinance. The two items were thus excluded from further analysis. The orthogonal varimax rotations under factor analysis converged after three iterations forming two factors with eigen value greater than unity were extracted accounting for 61.35% of the variance.

The two factors formed two new composites labeled 'bank origin' and 'entry strategy'. Bank origin comprised of two items; beginning as a commercial bank and beginning as a branch of a mother bank. 'Entry strategy' comprised of four items including, merger, franchise, market positioning and initial strategy. The items were summated in their respective components to form the respective indices. The two composite scales were entered in the data editor of SPSS.

To form a composite index for initial condition, bank origin and entry strategy were summated. The composite index was entered in data editor of SPSS and was used as measure for an independent variable namely, initial conditions. The composite index was used to test hypothesis one.

Index Construct of Dynamic Capabilities

Twelve items were used to test for dynamic capabilities on a 5 point likert scale. Exploratory factor analysis exposed KMO measure of sampling adequacy of 0.788 above the threshold of 0.5. The Bartlett's Test of sphericity (Chi-square=192.714, df= 28, p=0.000) was significant at 0.001, implying principal component method of extraction fitted data set. Exploratory factor analysis was conducted severally and four items were dropped from further analysis on basis of communality value and confounding factors. The item on ability to direct internal R&D and item on ability to tap developments were eliminated on ground of confounding among the components. While item on ability to build loyalty and item on ability to select enterprise boundaries were eliminated due to low communality value which were below the threshold of 0.5.

Table 10 Exploratory Factor Analysis for Dynamic Capabilities

Rotated Component Matrix[a]	Component and factor loading	
Item Description	1	2
Have ability to tap Supplier and Complementor Innovation.		.918
Have ability to identify target market segments and changing customer needs.		.868
Ability to describe the customer solution and the correct business model	.807	
Ability to select correct decision-making procedures	.597	
Managing strategic fit so that asset combinations are value enhancing.	.846	
Adopting loosely coupled structures; embracing open innovation; developing integration and Coordination skills.	.757	
Knowledge Management: learning; Knowledge transfer; know-how Integration; achieving know-how and intellectual property protection.	.843	
Governance: achieving incentive alignment; minimizing agency issues; Checking strategic malfeasance; Blocking rent dissipation.	.743	

Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization.

a. Rotation converged in 3 iterations.

Source Survey Data 2014

The orthogonal varimax rotations under factor analysis converged after three interactions forming two components namely 'Seizing DC' and 'Transforming DC'. The two factor components had eigen value greater than unity were extracted accounting for 72.88% of the variance. Two items; ability to tap supplier and complementor innovation and item on ability to identify target market segments were summated to form the composite index labeled seizing DC. The component labeled 'transforming DC' was made up by summation of six items. The two indices were entered into SPSS data editor.

Summation of seizing DC and transforming DC formed a composites index labeled 'dynamic capabilities'. This composite index was fed to SPSS data editor and was the measure for dynamic capabilities which was the moderating variable. This was used to test hypothesis two.

Testing Hypothesis One

$H_0$1. *There is no relationship between Initial Conditions and performance of commercial banks in Kenya.*

Hypothesis one was used to determine the relationship between Initial Conditions and performance of Kenyan commercial banks. Equation Three was used for the Regression Model on effect of initial condition on performance.

$BP=\alpha+\beta BIC+\varepsilon$.....(i)

Table 11 Regression Results for Initial Conditions on Performance

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.226[a]	.051	.026	.59306

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.720	1	.720	2.048	.161[b]
	Residual	13.365	38	.352		
	Total	14.086	39			

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.821	.704		4.006	.000
	Initial Conditions	.291	.203	.226	1.431	.161

a. Dependent Variable: Performance

b. Predictors: (Constant), Initial Conditions

Source Survey Data 2014

Table 11 shows a weak relationship between Initial Conditions and Performance at r=.226. The model adjusted R^2 of .026 implies that only 2.6% of variance in bank performance can be explained by Initial Conditions, while the remainder can be explained by other variables not considered in the model.

The fitness of the regression model $F_{(1, 38)} = 2.048$ and p-value =.161 (p>.05), thus the model is statistically not significant. This implies that we should fail to reject the null hypothesis and conclude that there is no relationship between Initial Conditions and Performance of commercial banks in Kenya.

This finding seems to go against the expectation of majority of scholars. However, empirical review indicated that the market dynamism of Kenya commercial bank sector has provoked strategic thinking and planning. Therefore, banks tend to focus on the future other than the past. This was in agreement with Maina (2011) who found out that location dynamics were considered to influence firm performance more than initial position.

Porter (1998) argues that Initial Conditions is important for firm performance over a period of time, as it determines the market position. However, looking at a firm from a specific position without prior knowledge of the initial position may lead to failure of acknowledging the effect of the Initial Conditions.

The findings were also supported by Hsiu-Ling, Chen and Shiu (2007) whose study found that the impact of Initial Conditions on Performance diminishes with age. This could have been the case since most of commercial banks in Kenya have been in operation for more than 20 years. Tan and Floros (2012) suggest that Initial Conditions has less effect on Performance in a dynamic market environment.

Testing Hypothesis Two

$H_0$2. *Dynamic capabilities do not have moderating effect on the relationship between Initial conditions and performance of commercial banks in Kenya.*

Hypothesis two was used to test the moderating effect of dynamic capabilities on the relationship between initial conditions and performance of commercial banks in Kenya. To test this hypothesis, Hierarchical Multiple Regressions was applied.

Table 12 Regression Results for Moderating Effect of Dynamic Capabilities

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.746[a]	.557	.507	.42212	.557	11.012	4	35	.000
2	.769[b]	.591	.531	.41176	.034	2.784	1	34	.104

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	7.849	4	1.962	11.012	.000[b]
	Residual	6.237	35	.178		
	Total	14.086	39			
2	Regression	8.321	5	1.664	9.816	.000[c]
	Residual	5.765	34	.170		
	Total	14.086	39			

Source Survey Data 2014

The results show a change of R^2 by .034, which means that the Moderated Model increased by 3.4%. Adjusted R^2 changed from 0.507 to 0.531, indicating a 2.4% improvement of variance of performance, explained by the Moderated Model. The results indicate that the two models were statistically significant. Model 1 had $F_{(4, 35)} = 11.012$ and p-value=.000 ($p<.05$), while model 2 had $F_{(5, 34)} = 9.816$ and p-values= .000 ($p<.05$) hence support the rejection of $H_0 2$.

Based on the moderation rule by MacKinnon, Fairchild, & Fritz, (2007), Dynamic Capabilities has a moderating effect on the relationship between initial conditions and Performance of commercial banks in Kenya. Hence, we reject the null hypothesis and conclude that Dynamic Capabilities have moderating effect on the relationship between initial conditions and Performance of commercial banks in Kenya. The findings support that Dynamic Capabilities influences the relationship between the drivers of Competitive Advantage and Performance among the commercial banks in Kenya directly and indirectly.

The findings were in agreement with the findings of the study by Zott (2003), linking DC indirectly to Performance and stating their influence on drivers of Competitive Advantage. Bowman and Ambrosini (2003), support the indirect effect of DC on Performance, whereas Helfat*et al*., (2007) argue that DC do not lead to competitive advantage but influence drivers of CA.

Conclusion

The results indicated a positive significant relationship between the drivers of competitive advantage, initial conditions and performance of the commercial banks sector in Kenya. This study found the relationship between initial conditions and performance as statistically insignificant. This leads to the conclusion that initial conditions do not significantly influence commercial bank performance in Kenya.

The findings of this study can be used to draw various conclusions on the performance of the commercial bank sector in Kenya and the recommendations made may only be limited to this sector.

Recommendations

The study found out that dynamic capabilities positively influence the relationship between initial conditions and performance. Since the results showed that dynamic capabilities play some role on performance, the study recommends that the management should lobby for training of all employees so as to understand the application of the various categories of DC within their firms. They can ensure that all staffs are trained regarding volatility of their market and the correct change measures to address new challenges.

The management should lobby to have the government provide level playing ground in all industries so as to allow the firms utilize DCs for their CA gain. KBA and CBK should also lobby for robust training on DCs within the banking industry.

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