CHALLENGES OF THE DEMUTUALIZATION STRATEGY OF THE NAIROBI STOCK EXCHANGE

BY

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DECLARATION

This research project is my original work and has not been submitted for a degree in any other university.

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DEDICATIONS

I dedicate this project to the memory of my late father Benjamin Abincha Momanyi and to my loving husband J.P Lumumba Nyaberi and our children Andrew, Bismark and Kerubo. »

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ABSTRACT

This is a case study of the Nairobi Stock Exchange (NSE). The study investigates the challenges the NSE is facing in implementing its demutualization strategy. The objective of the study was to determine the challenges the Stock Exchange is facing in implementing the demutualization strategy.

The researcher got information on the study by interviewing the top management at the Stock Exchange. As this is a case study, the presentations of the findings are in a qualitative form.

From the findings, NSE faces challenges of an institutional nature which include structural challenges, leadership challenges, cultural challenges and policies, procedures and support systems. Similarly, information was obtained on operational challenges being faced by the institution and this included tactical and operational challenges, employee involvement and communication of responsibility and accountability was identified as a challenge as well.

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CHAPTER ONE

INTRODUCTION

1.1 Background

Recent decades have seen rapid growth of the world economy. This growth has been driven in part by the even faster rise in international trade, which has been brought about by both liberalization and globalization. The rapid development of information and communication technology (ICT) has also contributed to the way business is done locally and globally. Firms are faced with competition at the local and international level because of the pervasive or omnipresent nature of the new business world order. Competition from imported products, franchised firms and e-commerce has been stiff for many firms that previously operated as monopolies for example Toyota (a Japanese firm) manufactures its Camry model in the United States and thus Toyota has taken competition to a country whose motor industry is synonymous with General Motors. (Kotler, Haider and Rein. 1993).

The effect of competition has been felt by most organizations that have lost their market share and consequently reduced profitability. This situation has been aggravated further by the consumers who have access to a vast array of products and brand choices, prices and suppliers and thus the task of winning them is more daunting than never before. Due to the continuous changes taking place, the environment for most firms has become unstable adding to the complexity of corporate management (Mountinho, 2002).

Due to the ever-changing business environment, organizations must adjust to all sorts of changes to ensure a sustained inflow of resources and a continuing outward flow of services. In other words, firms have to rethink their objectives and strategies with a view to identifying the extent to which the current strengths and weaknesses are relevant to. and capable of, dealing with the threats or capitalizing on the opportunities in the business environment (Johnson and Scholes, 2002). In an attempt to overcome the challenges resulting from globalization and liberalization, companies have adopted a variety of strategies such as strategic alliances, mergers, acquisitions and joint ventures (Kibcra and Waruinge, 1998). In Kenya, a few banks such as the Consolidated Bank, Fina Bank and Bank of India among others have come together under Pesa Point

Automated Teller Machines to provide financial services at convenient points. In the airline industry, Kjsnya Airways went into a partnership with KLM, the Royal Dutch Airlines in order to increase its network or market share. Strategic alliances, mergers, acquisitions and joint ventures have created competitive advantages for firms that have chosen them. The competitive advantages such as economies of scale, financial and technical competencies and a bigger market share have all contributed to the profitability of these firms.

1.1.1 Demutualization Strategy

Demutualization strategy involves conversion of the exchange from one that is mutually owned by its members to a company that has other owners and stakeholders. The process of demutualization is a long and challenging one. Traditionally the Nairobi stock exchange has been owned by its members who have operated on a not for profit basis and has hitherto rewarded its members by providing low trading costs or access fees although as Frank Donnan, 1999 states, the London stock exchange was from 1802 until 1948 operated on a for profit basis and paid large dividends to its members. The NSE operates like a private club with minimum external influence although the general public has invested enormous amounts of money in it. The NSE has a cooperative governance model, a close identity between ownership of the organization and the direct use of its trading facilities. The owners of the mutual enterprise are also its customers. Owner/ Customer share the net gains of the enterprise. Decisions are usually made democratically, on a one member one vote basis and often are made by committees of representatives of member firms. Decisions are therefore made to the economic interest of members. Ownership rights are restricted to members and raising of capital is limited to its members ohly. As Jeffrey W Smith, 1998 in the NASDAQ working paper discuses, historically, exchanges were locally focused and did not face any meaningful competition from exchanges in distance places. However, modern technology has enabled issuers and investors to access foreign capital markets. As nationality has become less of a defining characteristic of capital markets, global centers have grown in importance and the relevance of closed up private clubs running stock exchanges have been questioned. Strategic alliances and consolidations are the order of the day.

1.1.2 The Nairobi Stock Exchange

The NSE is the only exchange licensed to provide stock exchange services in Kenya. It is among the leading stock exchanges in Africa as it is ranked 9th in Africa. The NSE has a mutual ownership structure and is organized in the form of a company limited by guarantee and incorporated under the Companies Act chapter 486 of the Laws of Kenya. It is licensed by the Capital Markets Authority (CMA) to operate as a stock exchange in Kenya. It functions as a not for profit organization. The NSE is governed by its Memorandum and Articles of Association. In addition, the Exchange has rules and regulations. The NSE is a self regulating organization although its activities are subject to monitoring and supervision of the CMA and a system of regular audits by the CMA is in place to ensure that the necessary regulations are complied with. Trading rights are currently given only to member firms. The trading rights are given by virtue of gaining membership to the NSE. Ownership in the member firms is subject to the approval of the CMA and NSE and firms that are 100% owned by foreigners are not permitted.

The core functions of the NSE are as follows: Listing companies to raise debt and equity capital, providing trading facilities for the secondary trading of all the securities that are listed, providing on line market data and other market related products, posting trade clearing, settlement, registration and depository facilities for all secondary market transactions, transferring of securities and investor education. The key sources of income are the transaction fees, annual listing fees, quotation fees payable on new listings and membership subscription fees from stock brokering firms. The main items of expenditure are the establishment costs like rent, insurance, electricity, staff costs and information and technology costs. The NSE does not distribute profit; any operating surplus is used to develop the infrastructure of the exchange and the capital markets in general.

1.2 Statement of the Problem

According to the World Federation of Exchanges annual report and statistics, in 1993, the Stockholm Stock Exchange became the first exchange to demutualize. Since then, 21 exchanges in developed markets have demutualized representing almost 40% of the membership of the World Federation of Exchanges. By contrast the pace of demutualization in emerging markets has been much slower. As at April 2005, exchange demutualization had been completed in only 5 jurisdictions in the total 76 emerging markets In Africa only two exchanges have demutualized. The trend towards stock exchange demutualization is being driven largely by heightened competition and changes in technology. Increased competition requires more efficient exchanges in all activities including decision making processes, higher and efficient technology systems, significant investments and broader access to capital. To increase its competitive powers, the NSE made a decision to demutualize in 2003 and since then there has been little or no progress.

The NSE like many other Stock Exchanges has been and is a not-for -profit organization owned by its members. Over the past few years however, there has been a strong desire to consider alternative governance structures to its traditional mutual or cooperative model and to transform the exchange to an organization that works for-profit. The demutualization strategy was formulated in 2003 and implementation was embarked upon. Putting strategy into action is seen as an extension of the planning process: a strategy is first formulated and then it is implemented (Johnson & Scholes. 2003). As this is a new strategy in the emerging markets, this study seeks to find out what challenges the exchange could be facing in its implementation and to try suggesting some solutions to the challenges.

It is evident that no study has yet been done on demutualization of the NSE. This constitutes a knowledge gap that needs to be addressed. However there have been studies conducted on the NSE but most have featured on firms listed on the NSE (0minde.2005,) on dividend policy, (Iminza, 1997 and on the role of Strategic change (Nderu. 2005). The fact that there has been no contribution in the demutualization of the NSE is not surprising as this in a relatively new subject in the history of stock exchanges. The question to be addressed in this study is: What challenges is the Nairobi Stock Exchange facing in implementing its demutualization strategy?

1.3 Objective

The objective of this study is to:

To determine the challenges of the demutualization strategy at the Nairobi Stock Exchange.

Importance of the Study

The findings of this study will be of importance to the following classes of people:
The findings of the study will be of interest to its owners, who will know the challenges facing the implementation of the demutualization strategy and find strategic ways of meeting them. To prospective investors, the study will provide an update on the readiness of the prospective investment. To regulators any bottle neck in the implementation will have a chance of being dealt with. The study is going to provide a baseline, which will provide valuable information on the strategi'c ownership of the Stock Exchange. In Kenya and the world generally there is little research done on the subject. Most researchers have done research on ownership of companies in general but not of a stock exchange in particular.

CHAPTER TWO

LITERATURE REVIEW

2.1 The Concept of Strategy

Pierce and'Robinson (1997) have defined strategic planning as the set of decisions and actions that result in the formulation and implementation of plans designed to achieve a company's objectives involving the long term, that are future oriented and complex. Johnson & Scholes (2002) have also defined strategy as the direction and scope of management an organization takes over the long term, which achieves advantage for the organization through its configuration of resources within a changing environment to meet the needs of markets and fulfill shareholder expectations while Thompson and Strickland (1993) define strategy as the game plan management has for positioning the company in its chosen market arena, competing successfully, pleasing customers and achieving good business performance. Strategy is a three-tier process that involves corporate, business and functional level planners and support personnel. At each successive lower level, strategic activities become more specific, narrow and short term and action oriented with lower risk but fewer opportunities for dramatic impact (Pierce & Robinson, 1997).

A firm's mission is best achieved through systematic and comprehensive assessment of both its internal capabilities and external environment. Evaluation of the opportunities leads to choice of long-term objectives and operating strategies, which must be implemented, monitored and controlled (Thompson & Strikland, 1993). During strategy formulation top management craft a mission and vision to create unanimity of purpose that helps to galvanize the various functions in a common direction through which a company survives and prospers as well as provides customer satisfaction and maintains competitive advantage (Dilworth, 1996). Strategy is therefore a matter of finding the right position in the market and streamlining competencies and resources to get to the desired position (Hayes & Upton. 1998). Mintzberg and Quin (1996) see strategy as a pattern or plan that integrates an organization's major goals, policies and action sequences into a cohesive whole while Skinner (1969) argues that strategy provides direction and competitiveness. Boyer (1998) also alludes to the same philosophy.

Thompson & Strickland (1993) have propounded that strategy provides better guidance to the organization, makes managers alert to winds of change and opportunities and threats presented by the changing environment. It also provides a rationale to evaluate competing decisions a manager makes. Finally strategy helps create more proactive management posture than reactive and defensive postures. Aggressive pursuit of a creative strategy can propel a firm into a leadership position.

Hayes & Upton (1998) elude that sound strategy formulation and implementation will not only help a company to meet the challenges of competition but it can also enable a company to defend or attack competitors successfully. In so doing the company will survive and prosper in the current dynamic and turbulent environment. Strategy helps a firm to keep its customers by meeting customer expectations and the changing tastes and preferences.

Strategy also provides a common vision that provides unanimity of action in an organization (Pierce & Robinson. 1997). Strategy can give a corporate culture that is so vital for an organization and even lead to excellence in the production or service processes. Skinner (1985) and Hayes & Wheelwright (1984) and other scholars recognize operations as having a very significant role in manufacturing as it leads to achievement of competitive advantages. In their view, operations strategy can help a manufacturer improve performance to order qualifiers and order winners.

2.2 Strategy Formulation

In strategy formulation firms do a strategic analysis taking into account the internal and external environment. The internal environment encompasses the resources of the firm that may be tangible or intangible, the processes, skills and attitudes, suppliers, customers, culture, and people from which the company will identify its strengths and weaknesses. A firm has reasonable control on internal factors.

The external environment consists of competitors; social, political, legal and technological factors over which a company has no control. From the external factor analysis the company will identify the opportunities and threats presented by the environment. The aim is for the company to hedge itfcelf against the threats and take advantage of opportunities using its strengths and if possible make up for it weaknesses. In the process the company will make decisions on such matters as the breadth of the product line, the geographical scope, the competitive actions chosen, the level of social involvement, the performance objectives sought and the technology chosen. (Pierce & Robinson, 1997; Dilworth, 1996; Thompson & Strickland, 1993).

In strategy formulation firms must choose a market segment and the capabilities they must develop to serve the chosen market effectively. Lowson (2001) has alluded that core capabilities and competencies do not just happen but are deliberately built by an organization over time. Krajcwski and Ritzman (1999) advance that a company cannot be everything to customers and must therefore choose what level of quality, cost, flexibility and delivery it will build into its products to keep its chosen markets. This choice must be made during strategy formulation so it can be integrated with the technology, and processes and skills. Boyer (1998) is also in agreement with the above view.

From strategic analysis managers will develop objectives, policies and decisions consistent with the overall strategy and coherent with other functional decisions. (Dilworth . 1996). Resources are difficult to change, technically constrained and complex while markets are dynamic, heterogeneous and ambiguous (Porter 1995). Strategy seeks a reconciliation of the conflicting market requirements with the available operations resources bearing in mind the competitors capabilities. The decisions made therefore involve issues of capacity, supply networks, process technology, development and organization to meet the market requirements of quality, speed, dependability, flexibility and cost (Heizer & Render, 1998). The firm must therefore choose its competitive priorities (cost, quality, speed and flexibility).

There is also need for the firm to carry out a capabilities assessment of current, needed and planned capabilities to meet the market challenges which will lead to acquisition of the requisite resources and capacity (Heizer and Render, 1998). The expressed or achieved strategy of an organization is revealed by the pattern of decisions made over time (Dilworth. 1996) and these decisions shape the future and competitive ability of the firm. The operations strategy therefore involves planning how to develop, maintain and apply the capabilities required to satisfy customer needs better than competitors in the hyper-competitive environment (Dilworth. 1996). Operations strategy also focuses on developing, protecting and leveraging a firm's unique resources and advantages in order to change the rules of competition (Jarar et al, 2001).

Management must analyze the operating capabilities and competencies from which the core capabilities and competencies are selected that can provide effective and sustainable competitive advantages to create coherent systems and processes comprising the right proportions of each capability that is needed to face hyper competitive markets (Dilworth. 1996). In developing a strategy management must understand how to be order winners and order qualifiers (Hill, 1993) for this is what will award pay back to the firm and ensure long term survival. Order winners must meet the market criterion on cost, quality, reliability, and flexibility and delivery speed of a product or service. Order qualifier criterion will ensure a firm's products are considered for purchase. Hayes & Upton (1998) say that in developing a strategy a company must decide what kind of superiority it wants to achieve in the market place and then proceed to configure and manage its organization's operations in such a way that it can provide that form of advantage.

2.3 Strategy Implementation

The strategic management process does not end when the firm decides what strategy or strategies to pursue. Once the course of strategy has been charted the managers' priorities move towards converting the strategic plan into action and good results. Putting strategy into action is seen as an extension of the planning process: a strategy is first formulated and then it is implemented (Johnson & Scholes, 2003). One of the conventions that has led both scholars and practitioners of strategic management is the idea that there is a distinction between strategy fonnulation and strategy implementation. The convention holds that the formulation of strategy is based on identification of the organization's goals and the rational analysis of its external environment and internal resources and capabilities. (Grant, 2000).

Once a company has chosen a strategy to achieve its goals, that strategy then has to be put into action by selecting appropriate organizational structure and managing its execution through tailoring the management systems of the organization to the requirements of the strategy (Hill & Jones, 2001). Putting strategy into place and getting individual and organizational subunits to execute their part of the strategic plan successfully is essentially an administrative task (Thompson & Strickland III, 1992).

Successful strategy implementation depends in part on the organization's structure. Further, the strategic plan has to be institutionalized, or incorporated into a system of values and norms, that will help shape employee behaviour, making it easier to reach strategic goals. Strategy must also be operationalized, or translated into specific policies, procedures, and rules that will guide planning and decision making by managers and employees (Stoner et al, 2001). Thus a firm would have to build an organization capable of carrying out the strategic plan; develop strategy supportive budgets, and programmes; instill a strong organizational commitment both to organizational objectives, and the chosen strategy; link the motivation and reward structure directly to achieving the targeted results; create an organization, culture and a working environment that is in tune with strategy; install policies and procedures that facilitate strategy implementation; develop an information and reporting system to track progress and monitor performance; and exert the internal leadership needed to drive implementation forward and to keep improving on how the strategy is being executed (Thompson & Strickland, 1993). Factors such as culture, organizational structure, and aspects of operational execution are vital to the success of strategy implementation.

2.4 Challenges of Strategy Implementation

Considering that faulty implementation can make a sound strategic decision ineffective and skilled implementation can make a debatable choice successful, it is important to examine the process of implementation (Andrew, 1987). Strategy implementation is critical to success. Implementation represents a disciplined process or a logical set of connected activities that enables an organization to take a strategy and make it work. Without a carefully planned approach to implementation, strategic goals cannot be attained. Developing such a logical approach, however, represents a real challenge to the management. A host of factors, including politics, inertia, resistance to change, routinely can get in the way of strategy implementation. It is apparent that making strategy work is more difficult than strategy formulation (Hrebiniak, 2005).There are many organizational characteristics that act as challenges to strategy implementation. Such are structure, culture, leadership, policies, reward, and ownership of the strategy (Burnes, 2000). These challenges are of both an institutional and operational nature.

2.4.1 Institutional Challenges

Structural Challenges

Organizational structure imposes certain boundaries of rationality, but is necessary due to the individual's limited cognitive capabilities (March and Simon, 1958). Changes in strategy often call for changes in the way an organization is structured. This is because, when an organization changes its strategy, the existing organizational structure may be ineffective (Wendy, 1997).

Miller and Colleagues (1988) point out that there is an intrinsic association between strategy making and structure. The structure of an organization importantly influences the flow of information and the context and nature of human interaction. It channels collaboration, specifies modes of coordination, allocates power and responsibility, and prescribes levels of formality and complexity. The underlying argument that relates structural conditions to the strategic problem is the way an organization perceives and processes information particularly strategic stimuli (Galbraith and Merril, 1991). Chandler (1962) hypothesized that structure is determined by strategy, and correspondingly that the successful implementation of a strategy can be aided by the adoption of an appropriate organizational structure.

An organizational structure is a firm's formal role configuration, procedures governance and control mechanisms, and authority and decision making process. All firms require some form of structure to implement their strategy. Structure dictates how policies and objectives are established. Resource allocation of an organization is dependent on the kind of structure an organization has. There is no one optimal organizational design or structure for a given strategy or type of an organization (David. 1997; Pearce and Robinson. 2002). Principally structures are changed when they no longer provide the co-ordination, control, and direction managers and organizations require to implement strategies successfully (Hitt et al, 1997). However, organizations can become so captured by their structures and systems. In such organizations

'Strategy follows structure, they pursue strategies constrained by their structures and systems (Hall & Saias, 1980).

According to McCarthy and Colleague (1996), an organization's structure and behavior within an organization should be in harmony with and support the strategy of the organization. It is a major advantage for managers to understand and utilize the organizational structure to aid them in the implementation of the strategy. In doing so, they will be dealing with organizational situations from a point of view that encompasses all organizational realities and ties them together in a logical form.

Leadership Challenges

Leadership has a fundamental influence on the success of a strategy. Rarnajee (1999) observes that the influence is in three major areas, that is, does the leader have a vision? That is, are the leaders of the organization able to perceive quickly the trends? Does the leader have powers? That is, are the leaders of the organization, through whatever devises they choose to use. able to translate strategic aspirations into operating realities? Does the leadership have the political astuteness necessary to neutralize the negative effects of conflicting internal interests and transform these sectional interests into a vector of coordination policies and activities that support the overall company? Leadership is the process of influencing others towards the achievement of organizational goals (Bartol and Martin, 1991)

The leadership challenge is to galvanize commitment among people within an organization as well as stakeholders outside the organization to embrace change and implementation strategies intended to position the organization to do so. Leaders galvanize commitment to embrace change through three interrelated activities, the activities being to clarify strategic intent, building an organization, and shaping organizational culture (Pearce and Robinson, 2002). A critical ingredient in strategy implementation is the skills and the abilities of the organization's leader. A leader is an individual who is able to influence the attitudes and opinions of others. Unfortunately most senior managers are merely able to influence employees' actions and decisions. Leadership is not a synonym for management. Leadership is a higher order of capability. The ability to influence the attitudes and opinions of others to achieve a coordinated effort from a diverse group of employees is a difficult task. However, one of the key methods available to management is creating an overall sense of direction and purpose through strategic planning (Byars, 1991).

Cultural Challenges

Culture means the powerful and complex set of values, traditions, and behavioural patterns that somehow bond together the people who comprise an organization. The culture of an organization can have profound effects. As Acsoff (1965) points out, behaviour is not value free i.e. individuals show preferences for certain behaviour and may persist with it even if it leads to sub optimal results. For a strategy to be successfully implemented, it requires an appropriate culture. When firms change strategies, and sometimes structures, they sometimes fail because the underlying values do not support the new approach (O'Reilly 1989). Strategists should, therefore, strive to preserve, emphasize, and build aspects of an existing culture that support proposed new strategies. Kazmi (2000) observes that culture may be a factor that drives strategy rather than the other way round.

Historically, too much emphasis may have been placed on the formal processes of coordination used to implement successful strategies. They may have been successful in slower moving less complex environment but by themselves they may be inadequate in meeting the challenges of the 21st Century (Johnson & Scholes 2003). If the existing culture is antagonistic to a proposed strategy then it must be identified and changed. Culture plays an important role in delivering a successful strategy. Knowing or envisaging what a strategy is and designing a structure and a process to put this into effect does not in itself mean that people will make it happen. There will be a tendency towards inertia and resistance to change; people will tend to hold onto existing ways of doing things and existing beliefs about what makes sense. Managing strategic change must therefore address the powerful influence of the paradigm and the cultural web on the strategy being followed by the organization. (Johnson & Scholes. 2003). It is important to look at the Japanese approach to culture which is recognized by many as a major contributory factor to their success. First, in most general terms, the major concepts of Japanese corporate culture take off from their national ethos. An abiding culture in Japan is *'uchi'* (us) and *'solo'* (they). In their corporate culture *uchi'* includes the organization and everything in it (Barnajee 1999). This implies tremendous employee cohesion. Nowhere is the concept of strategy and culture more important than in institutionalizing strategy. Artifacts, espoused values, and basic assumptions form the basics of understanding organizational culture.

According to Elliott Jaques, an organizational culture is the customary or traditional way of thinking and doing things, which are shared to a greater extent by all members of the organization and which new members must learn and at least partially accept in order to be accepted into the service of the firm (Stoner Et al, 2001). When an organization's culture is consistent with its strategy, the implementation of strategy is eased considerably. Kotter and Hesketfs concept of "adaptable culture" is an attempt to build organizational culture on a foundation of paying attention to key stakeholders such as employees, customers, and stockholders, thus ensuring that the culture can change when the organization's strategy must change. It is thus impossible to successfully implement a strategy that contradicts the organization's culture (Stoner Et al, 2001). Changing a firm's culture to fit strategy is usually more effective than changing a strategy to fit existing culture (David. 1997).

Reward or Motivational Challenges

The reward system is an important element of strategy implementation. Johnson and Scholes, 2002) observe that incentives such as salary, raises, stock options, fringe benefits, promotions, praise, criticism, fear, increased job autonomy and awards can encourage managers and employees to push hard for successful implementation of strategy. According to Galbraith and Merril (1991) it is well understood that the basic underlying objective of an incentive program is to directly influence the action and the behaviour of those covered under the programme. A properly designed program must correspond in terms of motivating relevant decisions to the desired strategic outcome. In order to be certain that strategy implementation is integrated into day-to-day operations, it is crucial that the reward system be congruent with the strategies being implemented. That is, implementation success or failure should trigger direct positive or negative consequences in both individual compensation and non-monetary rewards (Judson 1991).

If strategy implementation is a top priority, then the reward system must be clearly and tightly linked to strategic performance. Motivating and rewarding good performance by individuals and organizational units are key ingredients in effective strategy implementation (Pearce &

Robinson, 1997). Motivating and controlling managerial personnel in the execution of strategy are accomplished through an organization's reward mechanism such as compensations, raises, bonuses, promotions and demotions. The rewards are not simply monetary. They focus on rewards such as recognition and approval which can be given more frequently than money (O'Reilly, 1989). In 1987 Procter & Gamble introduced a profit sharing plan that divided profits between the company and the workers. President Cooper Procter, one of the founders of Procter & Gamble said at that time, "The chief problem of big businesses today is to shape its policies so that each worker will feel he is a vital part of the company with a personal responsibility for its success and a chance to share in that success" (Cope. 1989).

Policies

David (1997) observes that changes in an organization's strategic direction do not occur automatically. On a day-to-day basis, policies are needed to make a strategy work. A policy is a general guideline for decision making (Stoner & Colleagues, 2001). Policy refers to specific guidelines, methods, procedures, rules, forms, and administrative practices established to encourage work towards stated goals. According to Galbraith & Merril (1991) and Stoner & Colleagues (2001) policies set boundaries, challenges and limits on the kinds of administrative actions that can be taken to reward and sanction behaviour. They clarify what can and cannot be done in pursuit of an organization's objectives. Most organizations have some form of policies rules, and procedures that help in implementing strategy in cases where routine action is required (Stoner & Colleagues, 2001). Policies enable both managers and employees to know what is expected of them thereby increasing the likelihood that strategies will be implemented successfully. Hussey (1988) observes that whatever the scope and form of the policies, they serve as a # mechanism for implementing strategies and realizing objectives. They provide the means of carrying out strategic decisions.

2.4.2 Operational Challenges

Tactical and Operational Plans

Most managers in an organization do not directly develop the organization's strategic plan (Reid, 1990). Those who are usually interested in the benefits and results of planning are frequently not responsible for implementation of the strategic plan. It is a disparate activity relying on input from some and interpretation by others (Donelly & Colleagues, 1992). In well managed organizations a relationship exists between strategic planning and the planning done by managers at all levels (Wallace, 1987).

Operational planning is based on forecasts of future demand for the output of the system. But even with the best possible forecasting and the most finely tuned operation system, demand cannot always be met with the existing system capacity in a given time period (Stoner & Colleagues, 1996). Once the strategic plans and goals of the organization are identified, they become the basis of planning activities undertaken by tactical and operational managers. Goals and plans become more specific and involve shorter periods of time as planning moves from the strategic level to the operational level. If done properly planning results in a clearly defined blue print for management action at all levels in the organization (Gluck, 1985).

According to Bateman and Zeithaml (1990) tactical planning translates broad strategic objectives and plans into specific goals and plans that are relevant to a definite portion of the organization, often a functional area like marketing or personnel. Tactical plans focus on the major actions required by the unit to fulfill its part of the strategic plan. On the other hand operational planning identifies the specific procedures and processes required at lower levels of the organization. Operational managers usually develop plans for very short periods of time, and focus on routine tasks such as production runs, delivery schedules, and personnel requirements.

Resource Allocation

Resource allocation is a critical management activity that enables strategy implementation (David, 1997). Its insufficiency is a common strategy implementation challenge. Allocating resources to particular divisions and departments does not mean that strategies will be successfully implemented. This is because a number of factors commonly prohibit resource allocation. David (1997) observes that in organizations that do not use a strategic management approach to decision making, resource allocation is often based on political or personal factors such as overprotection of resources, emphasis on short run financial criteria, organizational policies, vague strategy targets, reluctance to take risks, and lack of sufficient knowledge. Strategic management enables resources to be allocated according to priorities established by annual objectives. Nothing can be so detrimental to strategic management and to organizational success than for resources to be allocated in ways not consistent with priorities indicated in approved annual objectives. All organizations have at least four types of resources that can be used to achieve desired objectives. These are financial resources and technological resources, physical resources, human resources and technological resources (Thompson 1990).

Communication of Responsibility and Accountability

Communication is key to successful strategy implementation. Poor sharing of information or poor knowledge transfer and unclear responsibility and accountability can also lead to failure of strategy implementation (Hrebiniak, 2005). Attempts at coordination or integration across organizational units can suffer if unclear responsibilities and poor sharing of information needed for strategy implementation prevails. Indeed, complex strategies often demand cooperation and effective coordination and information sharing. Not achieving the requisite knowledge transfer and integration, certainly, cannot help strategy implementation. Through involvement in the process, managers and employees become committed to supporting the organization. Dialogue and participation are essential ingredients to strategy implementation (David, 1997).

Management and Employee Involvement

A serious mistake made by many organizations in their initial enthusiasm for planning has been to treat strategy formulation as an exclusively top management function and the middle level managers are given a support role (Shrivastava, 1986). This approach can result in formulation of strategy in a vacuum by planning executives who have little understanding or knowledge of the operating realities. As a result they formulate strategies that cannot be implemented (Hill & Jones 2001). According to Judson (1996) when implementation is treated as a "phase 2 problem after the plan has been formulated, the strategy may be good in theory, but quite impractical in reality. There is therefore the need to involve in the formulation process, the managers and the supervisors who must carry it out.

It should be recognized that the most important resource in an organization is its people David 1997). So.the roles people play, how they interact through formal and informal processes and the inter relationships that they build are crucial to the success of strategy (Burgelman, 1983; Nonaka, 1988). Traditionally this has been seen as the province of organization design, and views about regulation through design can be traced back to the twentieth century management scientists (Pettigrew & Fenton, 2000). These approaches were commensurate with a view of strategy making as essentially top-down and the rest of the organization was seen as concerned with implementation (Johnson & Scholes, 2003; Hedberg, 1981; Westley, 1990). Participation in the strategy formulation ensures that the managers and the supervisors understand the strategy, believe in it and are committed to carrying it out. More and more organizations are decentralizing the strategic management process, recognizing that planning must involve lower level managers and employees (David 1997). The notion of centralized staff planning is being replaced in organizations by decentralized line managers planning. The process is learning, helping, educating, and supporting activity among top executives. Strategic management dialogue is more important than a nicely bound strategic management document. The worst thing strategists can do is to develop plans themselves and then present them to the operating managers to execute. Through involvement in the process the managers become "owners" of the strategy. Ownership of the strategy by the people who have to execute it is a key to success (David 1997).

Operational Objectives

A strategically driven and aligned measurement system, strategic measures analysis and reporting techniques (SMART) can be viewed as a three-tiered hierarchy of measures, working from the top-down. Any operational system is generally too complex to serve as a practical link between the strategic business objectives of an SBU and the many functions and departments that comprise its operating system (Judson, (1996). Thus even after an operating system has been successfully designed and placed into actual use, considerable managerial discretion remains. This is because decisions must be made on a short-term basis - month to month, day to day, even hour to hour - as to how the system will be operated and controlled (Stoner & Colleagues, 2001). Judson (1996) "unbundles" the macro economic system into a number of business operating systems (BOS). A BOS encompasses the primary flow of work and supporting functions, people, technology, workflows, policies and procedures required to execute a single strategy.

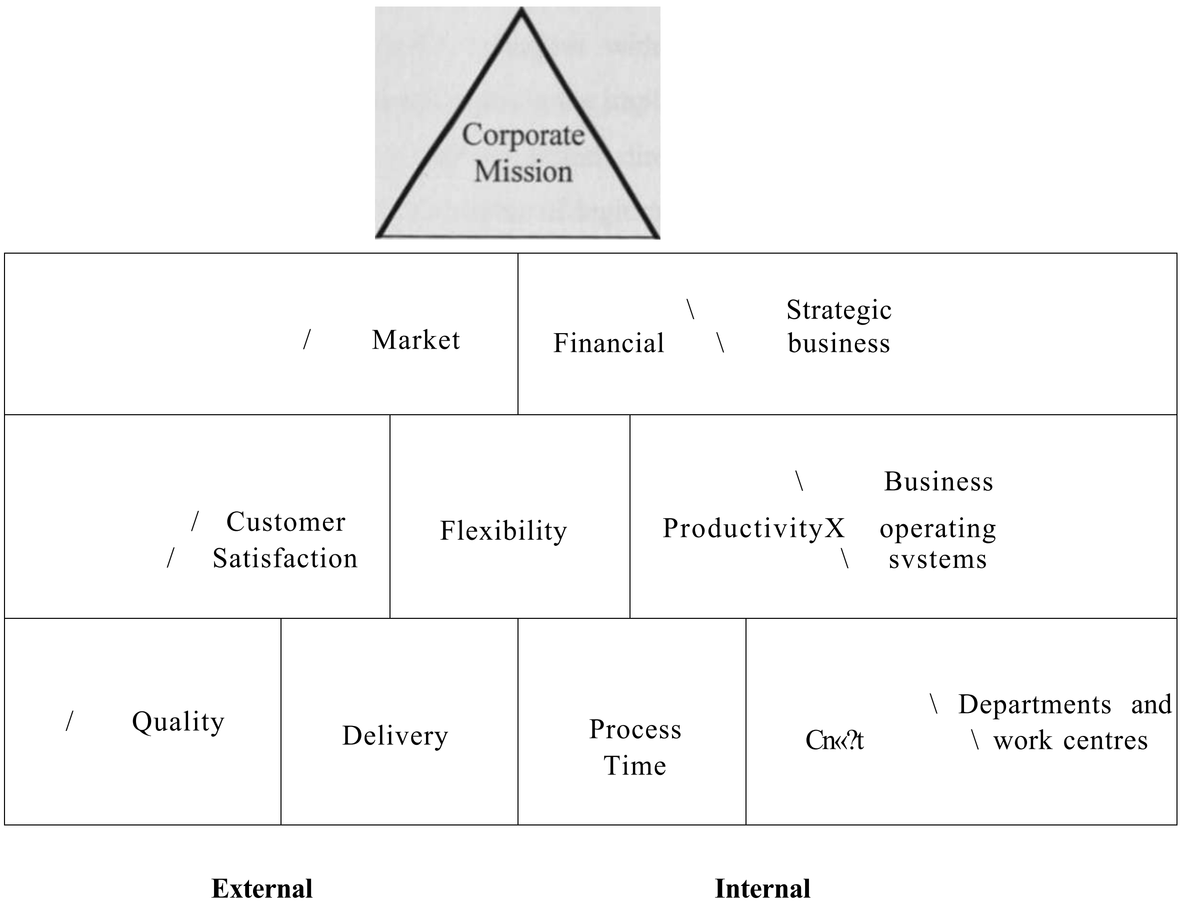

Figure: The SMART Performance Pyramid

Source: Judson, A. S., (1996) *Making Strategy Happen,* 2nd Edition. Blackwell, p.35

Annual Objectives

Annual objectives lie at the very heart of strategy implementation Stoner & Colleagues (2001). They identify precisely what should be accomplished each year to achieve organizational goals. In the process, they also provide managers with specific targets for the coming year's performance. They clarify managers' roles in the implementation of an organization's strategy.

Annual objectives serve as guidelines for action, directing and channeling efforts and activities of the organizations. They provide a source of legitimacy in an enterprise by justifying activities to stakeholders (Alexander, 1985). Annual objectives also serve as standards of performance and as such give incentives for the managers and employees to perform. They, thus provide a basis for organizational design. According to David (1997) annual objectives are essential for strategy implementation success because they represent the basis for allocating resources; they form a primary mechanism for evaluating managers, and a major instrument for monitoring progress toward achieving long term objectives; and establish organizational and departmental priorities. According to Stalle & Colleagues (1992) they add breath specifically in identifying what should be accomplished to achieve long-term objectives.

Annual objectives should be consistent across hierarchical levels and form a network of supportive aims. They should be measurable, consistent, reasonable, challenging, clear, communicated through out the organization characterized by an appropriate time dimension, and accompanied by commensurate rewards and sanctions. Ansoff (1968) argued that objectives are not helpful unless they are measurable and precise. Well designed objectives that clarify a manager's -role in the implementation of an organization's strategy, are clearly linked to the organization's long-term-goals, and they are measurable. It is important that they quantify performance so there can be little dispute over a unit's results Stoner & Colleagues (2001).

Budgetary Allocation

Budgets are critical in strategy implementation for they support the objectives and operating plans. Hrebiniak & Joyce (1984) observes that there are two relations between the budgeting and the planning process. One begins with a budget, at least an implied one, and then asks what objectives can be achieved given the actual or projected financial resources. In the alternative approach, the budget follows from and is justified by the planning process. Emphasis first is on identified key result areas and positive outcomes to be attained by focusing on a given set of objectives and action plans. Hrebiniak & Joyce (1984) further observe that the main problem with prior determination of budgets is that future activities may be tied in with and dependent upon the past. This can lead to an excessive dependence on previous activities and a myopic approach to planning.Judson (1996) observes that in a strategy based budgeting process, each function or department determines the minimum budget required for it to continue its existence and considers step by step the specific action programs supporting the business strategy and the operating plan, and forecasts any demand each action step might make on the department for work. For each strategy and associated action program, the department totals the expenses required by line item and offsets these with any anticipated revenues.

2.5 Successful Strategy Implementation

Strategies are of no value unless they are effectively translated into action. Aosa (1992) observes that once strategies have been developed, they need to be implemented. The job of strategy implementation puts plans into action and achieves the intended results. The test of successful strategy implementation is whether actual organization performance matches and exceeds the targets spelled out in the strategic plan. Shortfalls in performance signal weak strategy, weak implementation or both. In deciding how to implement strategy, managers have to determine what internal conditions are needed to execute the strategic plan successfully (Thompson & Strickland, 1993).

Strategy is implemented in a changing environment. Thus execution must be controlled and evaluated if the strategy is to be successfully implemented and adjusted to changing conditions. Some companies face a situation in which the fundamental changes to implement a new strategy are minor '- the basic strategy appears appropriate yet past performance has been ineffective (Mintzberg & Quinn. 1991). Owen (1982) observes that most of the texts on strategy implementation aphorize the worthlessness of a good strategy for whose implementation no provision has been made: "Better a first class implementation procedure for a second class strategy than vice versa."

Successful strategy implementation involves creating a series of tight fits, these being between strategy and organization structure; between strategy and the organizations skills and competencies; between strategy and budget allocations; between strategy and internal policies, procedure and support systems; between strategy and the reward structure; and between strategy and the corporate culture. Plans are more likely to be implemented successfully when there is a close alignment and linkage among the business strategy, operating plan and such established systems as budgets and rewards (Judson 1996). The tighter the fits the more powerful strategy execution becomes and the more likely targeted performance can actually be achieved.

Recent studies of companies over long periods show that most successful firms maintain a workable equilibrium for several years (or decades) but are also able to initiate and carry out sharp widespread changes when their environments shift. Such upheaval may bring renewed vigor to the enterprise. Less successful firms, on the other hand get stuck in a particular pattern. The leaders of these firms either do not see the need for reorientation or they are unable to carry through the necessary frame breaking changes. While not all reorientation action succeed, those organizations that do not initiate reorientation as environments shift under-perform (Mintzberg & Quinn, 1991).

2.6 Competitive Strategy

Competitive strategy consists of business decisions a firm undertakes in order to attract more customers and fulfill its expectations. These decisions enable the firm to gain leadership position and outperform its competitors. The firm is therefore able to ward off competition and strengthen its market share (Thompson & Strickland, 2003). For competitive strategy to be realized, the contribution and support of all functions is necessary. Competitiveness of a company is its ability to compete and prosper in the market place and can be thought of as a measure of productivity or the efficiency and effectiveness of converting inputs and resources into useful products and services.

Competitive strategy analyses the core competencies and capabilities of a firm vis-a-vis the competition and the customer needs so as to select the positioning the firm will take in order to survive and compete successfully. Competitive strategy therefore shapes the operations strategy and defines the competitive priorities in which companies will compete. Prahalad and Hamel (1990) argue that an organization's resources can be combined to attain competitiveness.Long term success however demands the creation of ever more powerful systems that are difficult for competitors to replicate and are steadily being improved. It involves the effective management of all the resources available at the heart of which are people in the organization who alone have the capacity to build new abilities with time (Upton. 1995). The approaches and initiatives a company takes to meet customer needs, outperform competitors and achieve long-term goals constitute its competitive strategy. (Thompson & Strickland, 2003).

2.7 Demutualization Strategy and Challenges

Demutualization involves conversion of the exchange from one that is mutually owned by its members to a company that has other owners and stakeholders. The distinguishing feature of a mutually owned exchange is that the owners of the enterprise, its decision makers and direct users of trading services usually are the same persons. The process of demutualization is a long and challenging one. Traditionally the Nairobi stock exchange has been owned by its members who have operated on a not for profit basis and has hitherto rewarded its members by providing low trading costs or access fees although as Frank Donnan. 1999 states, the London stock exchange was from 1802 until 1948 operated on a for profit basis and paid large dividends to its members.

According to Frank Donnam (1999) over the past few years, there has been a trend among exchanges to consider alternative governance structures to the traditional mutual or cooperative models. **In** most cases, the exchange is transformed into a for profit shareholder owned enterprise. A demutualized exchange may take many forms, each comprising its own issues. Some exchanges have demutualized and become public companies listed on the same exchanges, others have demutualized but have remained private corporations, still others are subsidiaries of publicly traded holding companies.

2.7.1 Factors Deriving Demutualization

The trend towards stock exchange Demutualization is largely driven by heightened competition and changes in technology, improved governance, investor participation, globalization and consolidation and unlocking stock exchange value (Sam Mensah. 2005). Increasing competition, whether between traditional exchanges or between exchanges and other trading systems, requires exchanges to become more efficient in all activities, including their decision making processes (IOSCO. 2001).

2.7.1.1 Improved Governance and Managerial Structure

While demutualized stock exchanges will continue to provide most of the same services, they will have different governance structures in which outside shareholders are represented by boards of directors. The mutual association model functions well if an exchange is a provider of trading services with limited competition and interests of members are homogeneous. If greater competition exists and the interests of members diverge from one another and from the exchange, the mutual governance model consensus decision making becomes slow and cumbersome (Roberta S, 2005). The exchange is unable to respond quickly and decisively to changes in-the market. The profit oriented corporate model will enable management to make actions that are in the best interests of customers and the exchange itself. With the separation of ownership and trading privileges, an exchange will achieve greater independence from its members with respect to its regulatory functions. Owner's interests will also be aligned with those of the exchange; both will seek to maximize the profits of the exchange. Strategic decisions will also be made by management in a much more efficient manner. Demutualized exchanges will be forced to account to their share holders not only regarding the bottom line, but also regarding issues arising in corporate governance (Sam Mensah, 2005).

2.7.1.2 Investor Participation

According to Sam Mensah (2005) a stock exchange must be responsive to the needs of its many stakeholders, including participating organizations, listed companies, and institutional and retail investors. Exchanges may perceive a need to shift within the exchange from one group of members to another and to afford institutional customers direct access to exchange facilities.

Separating trading rights from ownership may be a politically and economically feasible way to effect such a shift. Unlike a mutual structure where only broker dealers may be members, a demutualized exchange affords both institutional investors and retail investors the opportunity to become shareholders. The assets managed by institutional investors and trading needs of institutional investors differ dramatically from those of retail investors. A demutualized exchange will have greater flexibility to accommodate the needs of institutional investors as customers and potentially as owners.

2.7.1.3 **Competition**

Core competencies are the unique resources and strengths that sustain a firm's competitive advantage and include collective knowledge and skills an organization focuses on to distinguish it from its competitors. They centre on an organizations ability to integrate a variety of specific technologies and skills in developing new products and form the building blocks of core capabilities. Capabilities reflect an organizations ability to use its competencies and refer to the dynamic routines acquired by the firm. This is the managerial capacity to improve continuously the effectiveness of the organization. (Dilworth, 1996).Core capabilities are built along the lines of cost, quality, speed, flexibility, service support, innovation and customization.

Firms that recognize that a large segment of the market buys on the basis of price pursue cost/price strategy. They therefore build in cost advantages that they use as a competitive weapon. Firms that recognize that a segment of the market will spend more to get quality pursue product quality/reliability. They design products and processes to provide quality and therefore gain a competitive advantage in quality or reliability. Delivery speed is followed by firms which observe that what customers need most is the speed at which they can get what they want and therefore configure their processes to capture the target customers. Flexibility/variety/volume is a strategy followed by firms that see customers as having varying needs due to the dynamic environment and choose to survive by being flexible to meet the customer's needs in either volume or variety. Service support/after sales service is a priority chosen by companies, which see customers as valuing service support more. They therefore gain competitive advantage in superior service support, which is usually crucial when regular maintenance of the product is required. In some products and services, products change rapidly and firms develop innovative capacity to retain customers. Such firms deploy substantial R&D budgets and human resources training to retain their position as leaders in innovation. Customization strategy is followed by firms which recognize that customers have different needs and therefore modify their goods or services to meet the varying customer needs from which they derive competitive advantage (Chase et al, 2001; Dilworth, 1996; Oakland, 1998).

Exchanges have lost their monopoly as the sole providers of trade execution and related services. The widespread proliferation of alternative trading systems (ATS) and electronic communication networks (ECN), driven by technological innovation have allowed efficient matching of buy and sell orders of customers at lower transaction costs, while offering transparency, trader anonymity and extended trading hours. Large global traders are able to cross orders and only report the net position to the exchange thus avoiding transaction costs.

2.7.1.4 Globalization and Consolidation

Competitive pressures have triggered a wave of restructuring and mergers and alliances among securities markets to maximize economies of scale, accessibility and market reach while providing global trading facilities. Exchanges have been pushed to demutualize as a result of global competition for order flow and the search for greater revenues. Globalization has threatened or even decimated the exclusive franchise that exchanges once enjoyed. Whereas a domestic exchange was once the only alternative for listing a particular financial product, now issuers have a variety of options. They may list on the domestic exchange, choose another exchange such as for a single listing, or have a dual listing to the advantage of both exchanges. An IOSCO survey found that demutualization in emerging markets has also been driven by the increasing competition for global order flow and fears about lack of liquidity and marginalization of domestic markets. Order flow and liquidity could easily migrate to major markets. Demutualization is seen as a catalyst to transform the stock exchange business model to facilitate a more effective response to competition.

2.7.1.5 Resources for Capital Investment

Johnson & Scholes (1999) have explained strategic resources to consist of the following-: Tangible assets that constitute the physical possessions of the firm like real estate, production facilities, raw materials, machinery, equipment and plants. Intangible assets that are the non-physical possessions of the firm like reputation, brand names, culture, technical knowledge and patents. Organizational capabilities are the complex combinations of assets, people and processes that firms use to transform inputs into outputs.

Prahalad and Hamel (1990) add that strategic resources include the knowledge and skills actually applied throughout the processes and the technology, which form the basis for delivering products and services. Hill (1989) has put it that the resource based view starts with an extensive analysis of those operating capabilities and competencies existing within the firm and then management selects a few core capabilities according to their superior returns potential. Operations strategy then reconciles the clash between the nature of external markets and the nature of internal resources. Note that resources are difficult to change, technically constrained and complex while market requirements are dynamic, heterogeneous and ambiguous.

A competitive stock exchange must be able to respond quickly to global competitive forces and technological advances. With the capital raised from an initial public offer (IPO) or a private placement a stock exchange should have both the incentive and the resources to invest in the competitiveness of its information systems. To be competitive, products and services must be timely and cost effective, but also reliable. The move from floors to screens has required considerable capital investment. Demutualization offers an opportunity to buy out trader interests since they are no longer necessary and shift power to other firms, while raising capital for continued modernization of trading information systems. Continued investment in technology may serve as an effective way to meet competition from ATSs and upstairs trading as well as justifying the scale of the traditional integrated exchange model (Roberta S, 2005).

2.7.1.6 Unlocking Stock Exchange Value

Demutualization provides an opportunity to unlock the value of a stock exchange though the realization of the value will ultimately depend on the listing of the exchange. In the majority of exchanges, the value of the exchange is usually distributed to member brokers. Demutualization and listing provides an exit mechanism for the former brokers to sell down equity thereby broadening the shareholder base and decoupling of broker interests from that of the exchange (Roberta S, 2005).

2.7.1.7 Emerging Market Considerations

Structured strategy is the formal planning process where top management deliberately draws long term and wide plans for the future of an organization which are then cascaded down for implementation and control (Hill &Jones, 2001). This can be defined as the top-down strategy. However Emergent strategy does not rely on deliberate planning efforts, but rather, the way organizations are positioned and the skills and competencies they have acquired enable them to develop creativity and innovation arising from variety and diversity within the organization. When those implementing plans have been exposed to learning and have sufficient understanding of the environment and are motivated to see and take advantage of opportunities, an organization can then achieve its goals through emerging strategies (Hill and Jones, 2001). This process that derives a lot from operational experience is called a bottoms-up perspective of strategy and underscores the need for companies to minimize staff turnover, encourage skill acquisition and learning which can be used to enhance competitiveness. (Prokesh, 1993).Robins (2004) has emphasized that with the learning and knowledge based organization, knowledge is linked in unique ways to come up with novel and innovative ways that are surprising and which get competitors flat footed. This is more aligned to emergent strategy and can change the paradigms of the game so as to set new rules. Emergent strategy is more difficult to imitate as it resides in the minds of the innovators and provides real competitive advantage (Hayes & Upton, 1998). However Hill & Jones (2001) advocate that both structured and emergent strategy should be maintained by organizations as both compliment one another to make a total whole.

There are some additional drivers of demutualization that seem to be peculiar to emerging markets. Some emerging market regulators view demutualization as a means of collaborating with strategic shareholders with specialized know how with the object of importing the domestic market. Demutualization is also seen as a means of accelerating the development of technology related infrastructure and capabilities. There are some significant differences in the weight of the factors that drive demutualization when we compare developed and emerging markets. For example, the threat of competition from ATS and ECN trading and the ability to raise capital have not been predominant for demutualization. Demutualization in emerging markets has been largely policy led while in developed markets its generally led by the exchange or industry based on market considerations.

2.7.2 **Implications of Demutualization**

According to IOSCO. 2001, building higher efficiency trading systems requires significant investments in new technology, highlighting the trend and need for broader access to capital. In addition certain responses to competition, such alliances and mergers between exchanges, may be facilitated by demutualization. As competition increases and exchanges move from mutual entities to for profit enterprises, new elements enter the environment. The interests of the owners of the exchange may diverge from those of the principal customers trading off its services. The commercial nature of the exchange has become more evident: maximizing profits becomes an explicit objective, Donnam (1999).

CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Research Design

This research was conducted through a case study of the Nairobi Stock Exchange. In-depth interviews were conducted with the top level managers. An interview guide was used. Questions were issuecl in advance to help the respondents recall facts, make reference and to generally prepare for the interview. The researcher then made appointments and met the respondents at their convenience. The method of research was elected because the study required an in-depth understanding of the challenges of Demutualization of the Nairobi Stock Exchange. This design is valuable for an in-depth contextual analysis. Cooper and Schindler (2003) assert that case studies place more emphasis on a full contextual analysis of fewer events or conditions. An emphasis on detail provides valuable insight for problem solving, evaluation and strategy.

3.2 Data collection

In-depth interviews were conducted with the top-level managers, charged with strategy implementation. An interview guide was to be used. The respondents were briefed in advance of questions to help them recollect facts, or make reference where necessary before the actual interview date. Secondary data was also to be obtained from internal documents such as annual reports.

3.3 Data Analysis

As this was a case study, the presentations of the findings were of a qualitative form. Considering the kind of data intended as per the interview guide, conceptual and qualitative content analysis was the best-suited method. Nachmias & Nachmias (1996) define content analysis as a technique for making inferences by systematically and objectively identifying specified characteristics of messages and using the same approach to relate trends.

CHAPTER FOUR

DATA ANALYSIS AND FINDINGS

4.1 Introduction

The study sought to establish the challenges faced by the Nairobi Stock Exchange in implementing the demutualization strategy. The method of data collection was personal interviews by the aid of an interview guide which was given to the respondents in advance to enable them recollect relevant facts. The chapter presents the analyses and findings of the study. The researcher interviewed the top managers at the NSE and the results are presented to highlight the convergence of ideas from the respondents. Incorporated in the research findings is supplementary data provided by the respondents.

4.2 Findings

The researcher found out that the ownership structure of the NSE was mutually held. Members or owners enjoy rights of ownership, decision making (one member one vote) and trading. That demutualization denotes the change in the legal status of the NSE from a mutual association with one vote per member that is usually consensus based, to a company limited by shares. Demutualization involves separation of trading rights from ownership rights. It further signifies that an exchange has become a for profit firm in a competitive financial markets environment.

The demutpalized stock exchange will continue to provide most of the same services but will have a different governance structure in which outside shareholders will be represented by an elected boards of directors .The researcher also found out that decision making at the mutually owned organization was slow, a factor that made the NSE unable to respond quickly and decisively to the changes in the market. Once the demutualization strategy is fully implemented, it is projected that the profit oriented corporate model will enable management to take decisions and actions that are in the interests of customers and the exchange itself. The demutualization strategy will afford both the individual and institutional or corporate investors a chance to invest in the NSE. Ordinarily the institutional investors demand higher performance from corporations in which they have invested

A strategic objective is a result (intended measurable change) that an organization can materially affect. The timeframe of a strategic objective is typically 5-8 years for sustainable programs, but may be shorter for programmes operating under short-term transitional circumstances or under conditions of uncertainty. Strategic objectives of an organization aim at achieving positive results for the organization to enable it achieve sustainable competitive advantage. Some of the strategic objectives that have been pursued by the NSE over the years include:-

Year	NSE strategic objective	Resultant strategic Action
2004	Creation of Central depository system	Electronic holding of shares
2006	Introduction of electronic trading	Automated trading at the NSE
Ongoing	Wide area Network	Remote trading
Ongoing	Demutualization	Wide ownership of the NSE

NSE's demutualization strategy has specific strategic objectives of changing the ownership structure in order to convert into a profit making organization and to gain a competitive edge. Strategies will have no value to an organization unless they are effectively translated into action. Aosa (1992) observes that once strategies have been developed, they need to be implemented. The job of strategy implementation puts plans into action and achieves the intended results, fhus execution must be controlled and evaluated if the strategy is to be successfully implemented and adjusted to changing conditions. From the results in the table above, it is clear that the NSE frequently monitors the progress in implementing the demutualization strategy, fhe close monitoring points out the success rate and the various areas that need emphasis and improvement.

The respondents also confirmed knowledge of the implementation of the demutualization strategy. All respondents also confirmed that the strategic planning process encompassed determination of both broad and specific objectives which formed an integral part of the strategic plan. The respondents who fully participated in the formulation of the demutualization strategic plan together with hired experts further confirmed that there was translation of the organization's mission into long range and short range performance objectives. The respondents further confirmed that the objectives were translated into action plans that inter alia captured the intended activities and the expected output measurement criteria.

4.3 Challenges of the Implementation of the Demutualization Strategy

The researcher sought to establish the challenges the NSE is facing in implementing the demutualization strategy. The study established that the NSE is facing both institutional and operational challenges. Consequently, information was obtained on the challenges being experienced and this included institutional challenges which were structural challenges, leadership challenges, cultural challenges and policies, procedures and support systems. Similarly, the study established the operational challenges facing the stock exchange to be tactical and operational challenges, resource allocation management and employee involvement and communication of responsibility and accountability.

4.3.1 Structural challenges

The respondents indicated that since the strategy implementation was on the ownership of the company, company structure was of paramount importance especially at the top. To implement the strategy would involve change of the traditional structure of a mutually held organization (where members enjoy rights of ownership, decision making and trading as well as consensus-based decision making) to a company limited by shares with one vote per share with majority decision-making. The implementation of the strategy involved separation of trading rights from ownership rights. Demutualization will make the exchange become a for-profit firm in a competitive financial market environment. In this regard the respondents said they will face the potential of making profit and also of failure like any business. The NSE will have to stand alone for its financing. The implementation therefore faces challenges from some members who feel that the Stock Exchange is a well-functioning organization which does not need changes in its ownership structure. The owners were reported to be slow in decision making hence negatively impacting on the implementation.

4.3.2 Leadership challenges

As demutualization is a global trend, it was clear from the responses received that both the NSE and the CMA were interested in the implementation of the strategy in Kenya so as to give the Kenyan market a competitive edge. Both institutions commissioned studies on implementation of the strategy in Kenya and made presentations to the public on various dates. At the initial stages both organizations wanted to be seen as the ones behind the introduction of the demutualization strategy in Kenya, they however reached an agreement that their interest is in the implementation and not in by whom it should be done.

4.3.3 Cultural challenges

Cultural changes posed a major challenge to the implementation of the demutualization strategy. The owners of the stock exchange have been socialized to making decisions that mutually favor them without regard to other market players. With the implementation of the demutualization strategy the stock exchange ownership and decision making processes had to change and the culture that had been established by the mutual owners had to be changed in order to accommodate other stakeholders and the separation of trading rights from ownership rights. Under the new ownership structure, the NSE faces the challenge of being more responsive to its many stakeholders, including participating organizations, listed firms as well as institutional and retail investors.

4.3.4 Policies procedures and support systems challenges

According to findings respondents confirmed that policies, procedures and support systems were considered key to the implementation of the demutualization strategy. The respondents confirmed that the existing policies, procedures and support systems were not supportive of the implementation of the strategy and a strategic way had to be found to deal with the challenges posed. The main challenges posed included the existing regulation, infrastructure and leadership policies.

4.3.5 Regulation

The implementation of the demutualization strategy had two regulatory challenges; what the role of the government would be in regulating a private company and what role the private stock exchange would play in regulating its activities and its members. There is also posed a challenge on whether in becoming a private company, the NSE will in its attempts to maximize profit undermine self regulation. The NSE usually operates as a self regulatory organization in trading where it sets its own rules and conducts its own surveillance and enforces rules. It also oversees the trading system to avoid abuses in the market. Although the members are licensed by the Capital Markets Authority, the NSE has its own rules that govern the conduct of members. The major challenge that is faced in implementation of the demutualization strategy is whether in its attempt to make profits the exchange will undermine self regulation and whether separate entities need to be established to conduct regulatory functions.

4.3.6 Communication of Responsibility and Accountability

The respondents confirmed that the responsibility and accountability with regard to the strategic plan was critical to the organization. This was particularly so because the formulation of the demutualization strategy had very little involvement from the employees. However communication of the responsibilities and accountability has not been very efficient as it is felt that this strategy involves the owners and not the employees of the company. The respondents indicated that while the top level managers got involved in the formulation of the strategy, the lower level managers will be involved in the implementation of the strategy to operate as a for profit private organization.

CHAPTER FIVE: CONCLUSION

5.1 Summary, Discussions and Conclusions

5.1.1 Summary

The objective of the study was to determine the challenges the Nairobi Stock Exchange was facing in the implementation of a demutualization strategy. The findings of the study indicate the NSE's motive to strategically align itself to global trends and competition. One of the strategies that has been adapted is the demutualization strategy. Through the findings of the study it is apparent that the NSE hired experts to advice on the strategy formulation and implementation. Although the implementation is not complete yet, the NSE hopes to accrue immense benefits from the strategy. In the process of implementing the strategy, the exchange has faced several challenges as expounded in chapter four of this research. The challenges include structural and operational challenges.

5.1.2 Discussions

Competitive pressures have triggered a wave of restructurings, mergers and alliances among many of the world's security markets to minimize economies of scale and scope, accessibility and market reach while providing global trading facilities. For instance Euronext was established by a merger of national stock exchanges in France. The Netherlands. Belgium and Portugal and integrated equity markets in Sweden. Finland. Denmark and Norway. On the opposite end NASDAQ has also developed global alliances to attract more liquidity for the United States. In Asia, several exchanges have trading links and dual listing agreements with NASDAQ.

Difficulties in strategy implementation are partly occasioned by obstacles or impediments to the implementation process. NSE in its implementation of the demutualization strategy has faced many impediments but has found or is in the process of finding strategic ways of handling them. The NSE has built an organizational capability supportive of the strategy.

Successful strategic implementation involves creating a series of tight fits between strategy and the organization skills, and competencies; between strategy and the budgets; between strategy and internal policies; procedures and support systems; between strategy and reward systems and between strategy and corporate culture. The tighter the fits, the more powerful the strategy execution becomes and the more likely targeted performance can actually be achieved.

5.1.3 Conclusions

From the forgoing discussions, the following conclusions may be made regarding the challenges of implementing the demutualization strategy at the Nairobi Stock Exchange. Strategy implementation no doubt appears to be the most difficult part of the strategic planning process and many strategies fail at the implementation stage. It is clear that for an organization to successfully implement its strategy, it must ensure the existence and alignment of all strategy supportive aspects of the organization. This means that for an organization to experience successful strategy implementation and achieve its targeted performance, there must be a tight fit between strategy and the organization skills and competencies; between strategy and the budgets; between strategy and internal polices; procedures and support systems; between strategy and reward systems and between strategy and corporate culture. The absence of these fits will lead to the failure of the strategy at the implementation stage.

T he NSE like many other stock exchanges in the world market has been pushed to demutualize as a result of global competition for order flow and search for greater revenues. With domestic issuers having the option to list in other stock exchanges, liquidity may move from the Kenyan markets to major markets. The demutualization strategy is therefore being viewed as the catalyst that will transform stock exchange business, model and facilitate an effective response to competition.

In the process of implementing the demutualization strategy, the NSE has faced several challenges like the presence of a structure that is not accommodative to the implementation of the demutualization strategy, leadership challenges involving owners and the CMA, cultural challenges as the owners of the stock exchange are used to the traditional way of ownership which guarantees them both ownership and trading privileges, this culture has to change in order to accommodate the implementation of the strategy. The implementation has also faced challenges in regard to the existing legal framework, policies, procedures and support system challenges and communication of responsibility and accountability. The organization is however determined to become the first stock exchange in Africa to successfully implement this strategy.

5.2 Limitations of the study

The study was limited by scarcity of resources like time especially on the part of the respondents. The researcher had a lot of constraints in making appointments to see the interviewees. Some respondents were also not willing to take part in the study. Predetermined questions were used sent to the 'participants before the interview and during the interview the participants wanted to limit the discussions strictly to the interview guide and this may have prevented the respondents from providing specific information.

5.3 Suggestions for further Research

The study was just an eye opener to the exciting process of demutualization of the Nairobi Stock Exchange. The researcher therefore recommends that further study be conducted on specific issues like the benefits of the demutualization strategy and the progress of demutualization of stock exchanges in the emerging markets. Further research should also be conducted on the viability of the listing the stock exchange.

5.4 Implications for Policy and Practice

From the findings of the study, it is clear that the implementation of the demutualization strategy at the NSE is policy led as opposed to developed markets where the implementation has largely been industry led based on market considerations, fhe challenge on the existing capital market legislation posing a challenge as to who regulates a demutualized exchange should be considered and a favorable decision made. The demutualization process should be used as an opportunity to collaborating with strategic shareholders with specialized know-how with the object of importing knowledge and technical efficiencies into the stock exchange .Demutualization should also be used as a means of accelerating the development of technology-related infrastructure and capabilities

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APPENDICES

Appendix: 1 Introduction letter

Rose Lumumba,

Department of Business Administration

University of Nairobi

P.O Box 30197,

Nairobi.

August 2007

Dear Sir/Madam.

RE: Collection of Survey Data

I am a postgraduate student at the University of Nairobi, at the faculty of Commerce. As part of my course work assessment, am required to submit a management research project. In this regard, am undertaking a research on challenges of Demutualization strategy of the Nairobi Stock Exchange.

This is to kindly request you to assist me by responding to the attached interview guide. The information you provide will be used exclusively for academic purposes.

My supervisor and I assure you that the information you give will be treated with strict confidence and at no time will your name appear in my report. A copy of the final paper will be availed to you upon request.

Your co-operation will be highly appreciated.

Thank you in advance.

Yours faithfully,

Rose Lumumba **Dr. Martin Ogutu& Caren Angima**

MBA Student **Supervisors**

Appendix 2: Interview Guide

Section A

1. **Position/Title of Interviewee**
2. **Department**
3. **Length of service in the Department**

Strategic Management Process:

1. Does NSE Limited have a demutualization strategic plan?
2. Is the strategic plan formal or informal (written or unwritten)?
3. Does the NSE Limited have both vision and mission statement?
4. Does NSE Limited have performance objectives and performance and performance targets?
5. Has NSE Limited implemented its demutualization strategic plan(s)?
6. Does it monitor and evaluate its strategic plan? If so how often?
7. Does it review its strategic plan?
8. What influences review of the strategic plan and how often does it review its strategic plan?

Section B: Strategy Implementation

1. State briefly whether implementation of the demutualization strategy at NSE Limited has been successful. Why do you say so?
2. Did any changes take place in the organization during strategy implementation?
3. What kind of changes were these? State whether they were structural, cultural, leadership or otherwise.

Section C: Challenges of Strategy Implementation: Institutional and Operational Challenges

1. Structure

1.1 State whether NSE considers structure an important factor to strategy implementation. Why do you say so?

1.2 Is the organizational structure a problem at NSE? Why?

1.3 What aspects of the organizational structure are problematic, if any?

2. Leadership Challenges

2.1 State whether NSE considers leadership an important factor to strategy implementation. Why do you say so?

2.2 Is leadership a problem NSE Limited? Why?

2.3 What aspects of leadership are problematic, if any?

3. Cultural Challenges

3.1 State whether NSE considers culture an important factor to strategy implementation. Why do you say so?

3.2 Is the culture a problem at NSE Limited? Why?

3.3 What aspects of the culture are problematic, if any?

4. Reward or Motivational Challenges

4.1 State whether NSE Limited considers reward or motivation important to strategy implementation. Why do you say so?

4.2 Is reward or motivation a problem at NSE Limited? Why?

4.3 What aspects of the reward or motivation are problematic, if any?

5. Policies

5.1 State whether NSE considers policies important to strategy implementation. Why do you say'so?

5.2 Do the existing policies support strategy implementation?

5.3 If the answer is no, state why you consider the policies a problem?

5.4 What aspects of the policies are problematic?

6. Tactical and Operational Plans

6.1 Does NSE have tactical and operational plans?

6.2 State whether NSE considers tactical and operational plans important to strategy implementation. Why do you say so?

6.3 Do the tactical and operational plans support strategy implementation?

6.4 If the answer is no, state why the tactical and operational plans are a problem?

6.5 What aspects of the tactical and operational plans are problematic?

7. Resource Allocation

7.1 State whether NSE considers resource allocation an important factor to strategy implementation. Why do you say so?

7.2 Is the resource allocation a problem at NSE Limited? Why?

7.3 What aspects of the resource allocation are problematic, if any?

8. Management and Employee Involvement

8.1 Who formulates strategy at NSE? Is it the board or the managing director or the senior management or the middle management or is it participatory?

8.2 Does the approach adopted by the NSE pose a problem to strategy implementation?

8.3 If the answer is yes. state why the approach is problematic to strategy implementation.

9. Operational Objectives

9.1 Does NSE have operational objectives?

9.2 State whether NSE Limited considers operational objectives important to strategy implementation. Why do you say so?

9.3 Do the operational objectives support strategy implementation?

9.4 If the answer is no, state why the operational objectives are a problem?

9.5 What aspects of the operational objectives are problematic?

10. Budgetary Allocation

10.1 State whether NSE considers budgetary allocation an important factor to strategy implementation. Why do you say so?

10.2 Is the budgetary allocation a problem at NSE?

10.3 What aspects of the budgetary allocation are problematic, if any?

11. Communication of Responsibility and Accountability'

11.1 State whether NSE considers communication of responsibility and accountability important factor to strategy implementation. Why do you say so?

11.2 Is the communication of responsibility and accountability a problem at NSE?

11.3 What aspects of the communication of responsibility and accountability problematic, if any?