

# Influence of Firm System on the Performance of Cement firms in Kenya

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**Abstract:** The purpose of this paper is to examine the influence of firm system on the performance of cement firms in Kenya.

**Design/methodology/approach** – Census enquiry was used to get the purposive sample of 120 sectional managers in all the 6 cement firms in Kenya, who filled out the questionnaire. The results were analyzed using descriptive research design, inferential statistical analyses and linear regression tests.

**Findings** – Correlation analysis established that firm system was positively and significantly correlated with the firm performance.

**Originality/value** – The success and failure of any organizational entity or business concern depends greatly on its ability to integrate available resources, whether human or material, and combine them in the most efficient and productive manner.

**Keywords:** McKinsey 7S framework, Firm system, Performance.

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## 1. INTRODUCTION

The McKinsey 7S framework developed in 1980s by McKinsey consultants; Tom, Robert and Julien with the help from Richard and Anthony; has the hard element of “System” in its matrix (Obiga, 2014). The framework provides the institutional framework within which strategy implementation takes place (Machuki, Aosa & Letting, 2012). Firm system being essential to firm’s performance, the cement firms in Kenya had strategies on improving internal systems including; re-engineering business processes, certification of quality management system, certification of occupational health and safety assessment system, certification in environmental management system, investment in business integrated systems and improvement on Business Intelligence system.

Cement industry plays a vital role in the socioeconomic development of a country. The need to understand the challenges affecting performance of the industry cannot be overstated. The RoK (2015) records indicated that the performance of the building and construction sector in Kenya improved with a growth of 13.1% in 2014 compared to 5.8% in 2013 and growth of 71.8% in wage employment in the period 2009/2014. Cement consumption grew by 21.8% in 2014 to stand at 5,197 thousand tonnes. Commercial bank credit extended to the real estate sector grew up by 13.6% from Kshs 70.8 billion in 2013 to Kshs 80.4 billion in 2014 (KNBS, 2015).

The building and construction industry’s projection is very promising as the vision 2030 framework (RoK, 2007) envisaged massive infrastructural development in a range of sectors including ports, railways, special industrial zones, general housing, road construction and rehabilitation. All projects estimated to cost Kshs. 20 billion per annum over 10-year period. The Business Monitoring International (2015) report forecasts a 9% growth of the sector in Kenya over 10-year period (2015/2024).

There are 6 cement firms in Kenya namely; Athi River Mining Limited, Bamburi Cement Limited, East African Portland Cement, Mombasa Cement, National Cement and Savanna Cement (Dyer & Blair, 2012). The annual reports and financial statements of the cement firms listed on the Nairobi Securities Exchange denote variability and decline in performance. The RoK (2015) records of 2009/2013 showed that the gross profit margin for Athi River Mining (ARM) averaged 31%;

Bamburi, 30% and East African Portland Cement Company (EAPCC), 23%. The operating profit margin for Bamburi averaged 22%; ARM, 19% and EAPCC, 3%. The net profit margin for Bamburi averaged 16%; ARM, 12% and EAPCC, 5% while the return on assets averaged 15% for Bamburi; ARM, 5% and EAPCC, 3%. The continued decline in profitability of the firms was likely to have an adverse effect in the economy, such as decline in employment opportunities, job losses, loss of revenue to the government and adverse effects on the socioeconomic life of the employees.

Kamel et al., (2012) pointed out that the dynamic changes affecting the company are more frequent, irregular and diverse, with greater amplitude than in the past. Therefore companies need to monitor threats and detect potential opportunities in times compatible with their adjustment period. This involves the use of an information system where the accuracy of the information requested and the time factor would be essential. Lambe (2014) explained that the success and failure of any organizational entity or business concern depends greatly on its ability to integrate available resources, whether human or material, and combine them in the most efficient and productive manner. For instance, lack of adequate knowledge and skills on information technology and the ability to manage the Management Information System process by various organizations is one of the major factors that affect the efficient performance of management information system in Nigeria (Munirat et al., 2014).

To achieve its corporate goals and objectives, a business organization should pay more attention to the development of good and formidable systems. Thus this study attempts to improve our understanding about these issues by examining the influence of firm system on the performance of cement firms in Kenya. The cement industry in Kenya was chosen as it is unique in the sense that it's capital and energy intensive, highly automated with low labour intensity and an industry with a homogeneous product whose demand has increased considerably in the 20th century (Cembureau, 2016).

## **2. THEORETICAL FRAMEWORK**

The theoretical framework in this study is the system theory. A system is a group of interacting components that conserves some identifiable set of relations with the sum of their components. All occurrences are interconnections of relationships among component parts of a system (Yawson, 2012). System theory (Amagoh, 2008) was a concept first advanced by Ludwig von Bertalanffy in 1940 but did not gain prominence until the 1960's. The great system theory is primarily concerned with how systems operate, and integrates a broad range of systems by naming and identifying patterns and processes common to all of them. A systems theory is hence a theoretical perspective that analyzes a phenomenon seen as a whole and not as simply the sum of elementary parts. The focus is on the interactions and on the relationships between parts in order to understand an entity's organization, functioning and outcomes (Mele, Pels & Polese, 2010).

System theory is a trans/interdisciplinary theory that underlies studies of complex systems in nature, society, organizations, and science and is therefore a theoretical framework by which elements that act in concert to produce some result are studied (Yawson, 2012). Another core tenet of system theory is the distinction between open, closed and isolated systems. In open systems there are exchanges of energy, matter, people, and information with the external environment. In closed systems there are no exchanges of information. System theory is applied in management and marketing as well as to the concept of service systems engineering, the focus being, knowledge, value, quality, environment, relationships, adaptation, and complexity (Mele, Pels & Polese, 2010).

Mele, Pels and Polese (2010) explain that a firm is seen as a learning system and as having a set of skills and competencies that enables it to produce its own knowledge. The firm is then a cognitive system that establishes its existence, creating information and activating skills in order to produce knowledge through continuous learning processes. A firm is also seen as a holistic system, characterized by a high degree of integration between the factors intervening in the process of value creation. In the systems theory the decision maker, by analyzing the structure of the system and the structure of supra-systems; employs attenuating and amplifying actions of the kind needed for survival, thus modifying the borders between the system and the individual supra-systems. A competitive firm behavior is strictly linked to the ability to identify and manage functions and relationships, thereby establishing communication channels, organizing information flow, and rationalizing and harmonizing a firm's development aligned with all external relationships.

In critiquing the systems theory, several scholars have pointed out that the systems model neither specifies when and how collaboration within the organization needs to take place, nor what to do when the analysis suggests that there are existing or potential conflicts between the organizational environment, work environment, work, and the structure of the organization. The systems concept assumes that the boundaries between the organization and its environment are distinct. In a rapidly changing environment where tasks and group compositions become intermingled, open-systems theory does not provide

immediate answers to how organizations need to address such complex situations. System theory fails to guide on which aspects of the systems of interest should be manipulated to achieve policy objectives. It also does not provide a way forward when constituents of a system are very ill matched in terms of power and resources (Amagoh, 2008).

### 3. LITERATURE REVIEW

#### *Porter's Generic Strategies*

Porter introduced three generic strategies: cost leadership; differentiation and focus. In cost leadership strategy, the firm should acquire, strong technology and knowledge, effectively manage resources, strong production, marketing and sales knowledge and good delivery system. In differentiation strategy, the firm should possess: strong brand, innovation, high skills and knowledge capability, design unique products or services and have decentralized organization structure that follows strategy. In focus strategy, the firm needs to have: either low cost position or high differentiation needs to capture a small market segment or specific geographic region and provide them with a specific need that requires high specialty skills (Ouk, 2014). This study applied the Porter's generic strategies as they are relevant in coping with the competitive forces in the cement industry.

#### *The Balanced Scorecard*

The Balanced scorecard (BSC) is the most popular and widely used in organization performance measure (Hilman, 2014). Kaplan and Norton (1992) introduced the BSC on the realization that firm executives understood that the traditional financial accounting measures like return-on-investment (ROI) and earnings per share (EPS) can give misleading signals for continuous improvement and innovation. Kaplan (2005) affirms that managers need a balanced presentation of both financial and operational measures.

Mackay (2004) explains that BSC's guiding concept is to move managers away from focusing purely on financial outcomes and to consider a more balanced portfolio of multiple financial and non-financial measures closely linked to strategic objectives. Mackay alluded that no single performance indicator can succinctly capture the complexity of how an entire organization is performing. The Scorecard encourages managers not to rely solely on historical measures, but emphasizes the need for 'lead' indicators that point to the future direction of the organization. The generic Balanced Scorecard proposed by Kaplan and Norton in 1996 consists of four interrelated perspectives, namely: Financial, Customer, Internal Processes, Learning and Growth. The scope of these perspectives is designed to cover the whole of the organization's activities both internally and externally, both current and in the future.

The Financial perspective acts as the focal point of all the three perspectives and can readily accommodate both operational and shareholder derived measures. The customer perspective is crucial in today's competitive markets as the key emphasis for most executives is the customer. Many firms focus on customer satisfaction, identifying customer needs and re-engineering their business capabilities from the customer interface. The internal business processes perspective, focus on the operational aspects of an organization's activity and measures the organizational skills, competencies, and processes that are most critical for the strategy to be effectively executed (Kaplan, 2005).

Non-financial measures commonly used for monitoring operational processes include; quality, timeliness and output volumes. The learning and growth perspective, focus on enabling the organization and deals with the cultivation of an infrastructure for future development and organizational learning. These objectives deal with the strategic investment in people, processes, information systems and organizational culture (Mackay, 2004).

The BSC's most obvious benefit arises when managers use it to design a customized reporting and performance management system, that enables management reports to focus on measures specifically selected to represent the organization's strategy. The BSC also influences other organizational systems when managers use it to align their planning, budgeting, and resource allocation systems, and their incentive and reward systems to strategy (Kaplan, 2005).

The balanced scorecard has problems with some of its key assumptions and relationships. For instance, there is no causal relationship, but rather a logical one among the areas analyzed. For example, customer satisfaction does not necessarily yield good financial results. Assessing the financial consequences of increased customer satisfaction or quality improvements requires a financial calculus. Therefore, the balanced scorecard makes invalid assumptions, which may lead to the anticipation of performance indicators which are faulty, resulting in sub-optimal performance. In addition, the

balanced scorecard is not a valid strategic management tool, mainly because it does not ensure any organizational rooting, but also because it has problems ensuring environmental rooting. Consequently, a gap must be expected between the strategy expressed in the actions actually undertaken and the strategy planned (Norreklit, 2000).

### ***Firm Performance***

Machuki and Aosa (2012) explain that firm performance refers to the achievement of an enterprise with respect to some criterion (or criteria). They pointed out that a substantial disagreement exists concerning the measurement of performance; as they observed that performance is a multidimensional construct and thus, any single index may not be able to provide a comprehensive understanding of the performance relationship relative to the constructs of interest and therefore, it is important to look at multiple indicators.

Firm performance (Chorn, 2007) lacks a common measure and is applied differently by various stakeholders to include: profitability, market share, good value for money products and stable employers. Drivers of firm performance and effectiveness include competitive situations, strategies and styles capable of consistently producing good performance. Specific firm cultures and leadership styles are only appropriate in given strategic situations. This firm performance principle is understood and makes sense, but is difficult to operationalize and apply. The management of a complex firm requires managers to measure performance and analyze the impact of different performance dimensions of firm excellence (Kit & Antony, 2005). Kaplan and Norton (2005) created the balanced scorecard that allows managers to look at the business and measure its performance on the basis of four perspective areas: financial, customer, internal business and learning and growth perspectives.

### ***Firm System***

Tracy and Blood (2012) define System as the mechanisms used to manage organizational processes and procedures such as: financial planning, internal controls, staffing, and information technology. Nguyen (2015) pointed out that a system is the process and procedures that support routine activities for organizations.

Holcim's global standards, but local management approach needed a balance between a strong and consistent management behavior and local market needs. Therefore, the firm used ISO management system standards across all corporate, regional and local sections. High standards of corporate governance had been developed in order to ensure sound strategic actions, and management behavior geared to long-term economic success and reputation of the company. The company also underlined the importance of an internal Audit section as an independent body which monitors the results and the effectiveness and efficiency of the internal management and control systems (Ryf, 2011). In King Toys, the flow of information within the company was unsatisfactory due to lack of computerization. Salespeople were not informed of overall company performance and only top management administered most of the information existing in the company (Tsalidis, 2010).

The primary business and technical systems that drove the council for scientific and industrial research institute (CSIR) were the usual traditional management procedures that thrived largely on paper and less on electronic systems. CSIR lacked efficient and functional management information system capable of transforming internal and external data into information, making it difficult for regular monitoring of market trends, stakeholder needs and expectation. Its finance reporting scalar software was not enabled for activity-based costing and was unable to trace unit costs of products for product and service pricing (Garbrah, 2013). Kenya Airways at its formative years lacked a measurement for its operations, had imprecise financial reporting, lacked accountability, misused technical skills, and had no means to measure productivity, its computer systems weren't sufficient to sustain business. This changed after the commercialization era with new financial control and accountability systems, new budget planning and reporting systems installed; creation of IT department and formulation of new programs to continuously improve operations and reliability (Fleisher & Bensoussan, 2007). Therefore the following hypothesis was proposed.

***H<sub>1</sub>: Firm system does not influence performance of cement firms in Kenya.***

## **4. METHODOLOGY**

### ***Sample***

The study adopted purposive sampling; a non-probability sampling technique. Saunders, Lewis and Thornhill (2009) aver that business and management research projects may dictate usage of non-probability sampling. It provides a range of

alternative techniques to select samples based on researcher’s subjective judgement. This sample would provide the researcher with an information-rich case study and gain theoretical insights. Purposive sampling (Mugenda & Mugenda, 2003) allows a researcher to use cases that are informative and have required characteristics. The respondents in the study were the senior managers who were section heads of business units of the respective cement firms in Kenya. The rationale was that senior managers play a key role in strategic formulation and implementation. They also play crucial role in managing resources, providing information to decision makers, giving emotional support to their subordinates and communicating the strategic intent of executive management throughout the organization (Salih & Doll, 2013). The characteristics of the sample are displayed in Table 1.

**Table 1: Sample sizes**

Departments	Kenya’s Cement Firms						Total
	ARM	BCL	EAPCC	SCC	MCL	NCL	
Production							
Sales and Marketing							
Finance	20	20	20	20	20	20	120
Human Resources							
Supply Chain							

**Pilot Study**

This study undertook pilot testing. Kothari and Garg (2014) explained that pilot testing is the replica and rehearsal of the main survey. It is a survey being conducted by experts and brings to the light the weaknesses (if any) of the questionnaires and also of the survey techniques. Specifically (Saunders, Lewis & Thornhill, 2009) pilot testing is essential in determining the time needed to complete the questionnaire. In this study the pilot survey involved a randomly selected sample of 24 respondents representing 20% of the sample size and as pointed out by Saunders, Lewis and Thornhill (2009), most student questionnaires requires a minimum number of 10 respondents for a pilot.

**Instruments**

Primary data was collected using a questionnaire that measured the influence of the employee’s skills on performance of cement firms in Kenya. Primary data are those which are collected afresh and for the first time, and thus happen to be original in character (Kothari & Garg, 2014). The questionnaire is the most widely used primary data collection technique within the survey strategy in which people are asked to respond to the same set of questions in a predetermined order. It provides an efficient way of collecting responses from a large sample prior to quantitative analysis (Saunders, Lewis and Thornhill, 2009). It is considered as the heart of a survey operation and has the following advantages: it’s a low cost method of data collection and free from the bias of the interviewer. The respondents have adequate time to give well thought out answers and the respondents who are not easily approachable can also be reached conveniently. Larger samples can be made use of and thus the results can be made more dependable and reliable (Kothari & Garg, 2014).

Saunders, Lewis and Thornhill (2009) stated that rating questions in a questionnaire most frequently use the Likert-style scale in which the respondents are asked how strongly they agree or disagree with a statement or series of statements, usually on a four, five, six or seven-point rating scale The Likert-type scale has several advantages in that it is relatively easy to construct and is considered more reliable and provides more information and data than other types of scale (Kothari & Garg, 2014). In this study, a 5 rating Likert scale was applied whereby the respondents selected a statement of their choice and entered the respective number in the provided column.

**5. RESULTS**

Table II provides the correlation analysis under study. The correlation analysis established that firm system was positively and significantly correlated with the firm performance at ( $r=0.576; p=0.000$ ). These findings are corroborated by Alattas, Kang and Sohaib (2016) who found that the perceived usefulness of business system had a significant positive impact at ( $r=0.45, p=0.000$ ) on the success of business system.

**Table II: Correlation Matrix**

		Firm System	Firm Performance
Firm System	Pearson Correlation	1	0.576**
	Sig. (2-tailed)		0.000
	N	98	97
Firm Performance	Pearson Correlation	0.576**	1
	Sig. (2-tailed)	0.000	
	N	97	97

\*\* . Correlation is significant at the 0.01 level (2-tailed).

Regression analysis was performed. The results are shown in Table III. The result showed  $R^2=0.332$  which meant that 33.2 per cent of the variation in firm performance could be explained by firm system. The remaining 66.8 per cent was explained by other variables. The results of regression analysis revealed a significant positive relationship ( $\beta=0.726$ ,  $p=0.000$ ) between firm system and firm performance.  $P$ -value of 0.000 was less than the set level of significance,  $\alpha$  at 0.05. This means that the alpha level is greater than the  $p$ -value. This led to conclusion that the null hypothesis ( $H_0$ ): "Firm system does not influence performance of cement firms in Kenya", should be rejected. Firm system as a hard element of McKinsey 7S framework therefore influences the performance of cement firms in Kenya. This is supported by Alattas, Kang and Sohaib (2016) who regressed the perceived usefulness of business success against business system success and obtained coefficient of determination  $R^2$  of 0.42.

**Table III: Regression Analyses**

Model	R	R Square	Adjusted Square	R Sig.	Unstandardized Coefficients B
1	0.576	0.332	0.325	0.000	0.726

## 6. DISCUSSION

This study examined the influence of firm system on performance of cement firms in Kenya. A regression analysis was used to analyze the 120 surveys. It was found that firm system had a positive relationship with firm performance.

### *Theoretical and practical implications*

The study links important theories and findings, and draws implications and recommendations on how firm system influence performance. The theory and reviewed literature offered a good explanation platform of the findings of this research. The great system theory was primarily concerned with how systems operate, and integrates a broad range of systems by naming and identifying patterns and processes common to all of them. While the Porter's generic strategies were relevant for coping with the competitive forces in the cement industry.

Specifically in the Kenyan cement firms, the study observed relatively less frequent system deviation from stable state, budget and plans. Also noted was the reasonably high level of process and product leadership in the cement firms. Resource allocation was observed not to be a key system problem. Production facilities were standard and procedures for system improvement existed. However firm stability and efficiency was observed not to be a fairly key system's success criterion. Besides, there was fairly lack of incorporation of historical data in extrapolating future performance. The cement firms had invested in systems fairly well except few notable areas of improvement such as ensuring stability and efficiency to be the key system's success criterion. There was need to incorporate both historical information gathering system and extrapolation for future performance measures.

### *Limitations and suggestions for future research*

The study focused on the cement industry in Kenya while there was value in exploring the influence of employee's skills in other industry types and countries where similar conditions prevailed. This infers that other industry types and the cement industry in other countries excluded in this study posed the limitation to the extent on which these results could be generalized across them. Donselaar (2012) argued that the problem of generalization is to infer whether a causal relationship holds over variations in units, treatments, outcomes and settings. Meaning that the causal relationships might only hold for the unit of analysis (in this case the cement firms in Kenya) and not for all other cement firms in the world or other industries. Moreover, the study examined the influence of firm system on performance of all cement firms in Kenya.

However, each firm presents distinctive position with unique resources and capabilities. Some factors could be more relevant when analysis is done on individual case basis. Future research into each of the cement firms on the influence of firm system would provide detailed tailor-made strategic solutions to individual firms.

The other limitation is that the study adopted a cross-sectional research design whereby averages of corporate performance data for a five year period (2009/2013) for cement firms listed on the Nairobi Securities Exchange were used to infer variability and decline in performance for all the cement firms in Kenya. Machuki, Aosa and Letting (2012) explain that information about the subjects gathered in a cross-sectional study represents what is going on at only one point in time. The interpretation of the results of this study was therefore limited to the cross-sectional data obtained for the stated period. This provided an opportunity for replicative studies through either longitudinal or case study research designs.

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