



STRATEGIC PRODUCT DIVERSIFICATION AND PERFORMANCE IN TIER 2 COMMERCIAL BANKS

Dr. Eunice Gacheri Thiankolu¹, Dr. Ninah Makena Muriuki²

¹School of Business and Management, Kiriri Women's University of Science and Technology

²School of Business and Management, Kiriri Women's University of Science and Technology

Article DOI: <https://doi.org/10.36713/epra25337>

DOI No: 10.36713/epra25337

ABSTRACT

Strategic product diversification has emerged as a critical competitive strategy for commercial banks operating in increasingly dynamic and technology-driven financial environments. This study examined the influence of strategic product diversification on the performance of Tier 2 commercial banks in Kenya, focusing on how diversified product offerings contribute to profitability, customer satisfaction, market share, and overall financial performance. Grounded in the Diffusion of Innovation Theory, the study adopted a descriptive research design targeting management and leadership teams, customer relationship officers, and operations staff drawn from Tier 2 commercial banks in Nairobi. Stratified random sampling was used to select a sample of 296 respondents, of whom 229 participated, yielding a response rate of 77.6%. Primary data were collected using structured questionnaires and analysed using SPSS version 25. Descriptive statistics revealed high levels of agreement that Tier 2 banks offer a wide and innovative range of products, including digital banking solutions, varied loan products, savings plans, and investment services. Correlation analysis indicated a very strong positive relationship between product diversification and performance ($r = 0.886, p < 0.001$). Regression results further confirmed that product diversification had a positive and statistically significant effect on bank performance ($\beta = 0.176, p < 0.001$). The findings demonstrate that expanding product portfolios enhances market competitiveness, customer satisfaction, and financial outcomes. The study concludes that strategic product diversification is a key driver of performance in Tier 2 commercial banks and recommends continuous innovation, customer-focused product development, and alignment of diversification strategies with institutional capabilities to sustain growth and competitiveness.

KEYWORDS: Product Diversification; Bank Performance; Tier 2 Commercial Banks; Non-Interest Income; Strategic Management

BACKGROUND OF THE STUDY

Product diversification affects the performance of commercial banks by expanding the range of products and income sources beyond traditional lending and deposit services, enabling banks to stabilize earnings and enhance profitability through wider revenue streams. For instance, diversification into non-interest income activities such as transaction fees, service charges, digital financial services, and other fee-based offerings has been shown to positively correlate with financial performance, increasing return on assets and strengthening competitiveness in changing markets (Zhao et al., 2025). Empirical evidence also indicates that diversified income structures can improve resilience against interest rate volatility and market fluctuations, though the magnitude of the effect may vary by bank size, capital adequacy, and competitive environment, with smaller or more agile banks often deriving greater relative performance benefits from product diversification strategies.

Globally, commercial banking in the 2020s is being reshaped by intense competition, digital disruption, regulatory tightening, and rapid shifts in customer preferences. Banks across advanced economies such as the United States, the United Kingdom, and the European Union have increasingly diversified their product

portfolios beyond traditional lending. They now rely more on fee-based services, digital financial products, and cross-sector offerings to stabilize income streams and mitigate volatility in interest-based revenues. Global studies in 2025 show that product diversification into digital payments, wealth management, insurance distribution, and platform-based financial services has become a core strategic lever for improving performance and achieving sustainable revenue growth in highly competitive markets (Zhao, 2025).

At the international level, emerging economies in Asia, Latin America, and the Middle East are experiencing similar pressures. Banks in these regions face rapidly expanding customer bases seeking convenience, digital access, and integrated financial solutions. Strategic product diversification has therefore become essential as banks introduce bundled financial products, agency banking networks, micro-insurance, and fintech partnerships to enhance both market reach and service delivery. Empirical research from 2025 indicates that such diversification can improve operational efficiency, reduce earnings volatility, and enhance customer retention—especially in markets where competition from fintechs is strong and customer expectations are rapidly evolving (Akinyemi, 2025). Yet, international evidence



consistently warns that diversification is not universally beneficial. It requires strong managerial capabilities, robust risk management systems, and supportive governance structures to avoid complexity, misalignment, and operational strain.

In Africa, and particularly within Sub-Saharan regions, banks operate in environments characterized by high competition, fluctuating economic conditions, and rising demand for digital financial services. The continent has witnessed accelerated uptake of non-interest income activities such as mobile money integration, agency banking, bancassurance, and integrated digital lending. Recent African studies reveal that while diversification may reduce funding costs and improve margins, the magnitude of these benefits varies significantly depending on regulatory frameworks, competitive intensity, and bank size. Medium-sized institutions—similar to tier-2 banks—tend to benefit more from nimble diversification into digital and agency-based channels, whereas large banks often face bureaucratic constraints that slow innovation (Ngware, 2025).

Locally, the Kenyan banking industry has undergone significant transformation driven by technological innovation, regulatory reforms by the Central Bank of Kenya, and changing customer expectations influenced by mobile money and fintech penetration. Kenyan commercial banks have increasingly diversified into bancassurance, digital credit platforms, agency banking networks, and value-added mobile-based financial services. These shifts are particularly relevant to tier-2 commercial banks, which operate in highly competitive niches and often rely on diversification to attract new customer segments, enhance revenue stability, and expand market presence. However, studies in Kenya indicate that diversification outcomes are not uniform. While some banks achieve improvements in profitability and operational efficiency, others incur increased operational costs, diluted strategic focus, or suboptimal returns when diversification lacks clear alignment with core competencies (Kimani, Sang & Kinyanjui, 2025).

Although the global, international, and local literature highlights the strategic importance of product diversification in enhancing banking performance, significant empirical gaps remain regarding how such diversification affects tier-2 commercial banks specifically. Much of the current research aggregates banks into broad samples or focuses on large, well-capitalized institutions whose structures and capabilities do not mirror those of mid-sized banks. Tier-2 commercial banks in Kenya face unique constraints limited capital buffers, narrower customer bases, heightened competition, and greater vulnerability to market fluctuations which may influence both the form and effectiveness of diversification strategies. Existing studies (Mutinda, 2025) call for more granular, tier-specific evidence to guide managerial decision-making, particularly concerning which diversification strategies yield the highest returns, under what conditions they succeed, and how they shape financial and operational performance.

The banking sector in emerging economies is therefore undergoing rapid structural change driven by digitalization, increased competition, and shifting customer expectations. Commercial banks are under pressure to broaden their product portfolios in order to stabilize revenues, attract new clients, and remain competitive in increasingly fragmented financial markets. While evidence shows that strategic diversification into non-interest income products can enhance profitability and strengthen customer retention (Zhao, 2025), diversification outcomes remain inconsistent and are influenced by organizational capabilities, market conditions, and bank size (Akinyemi, 2025). Mid-sized, tier-2 commercial banks operate under tighter resource constraints and greater competitive pressures than large banks, making diversification outcomes less predictable and sometimes more costly. Furthermore, findings from Kenya reveal that diversification benefits differ across bank tiers, with some tier-2 banks gaining improved margins while others face diluted focus or elevated costs (Ngware, 2025; Kimani, Sang & Kinyanjui, 2025). Despite global, regional, and local evidence emphasizing the potential of diversification, a substantial empirical gap persists on how strategic product diversification influences the performance of tier-2 commercial banks. As a result, decision-makers lack clear guidance on which diversification strategies yield optimal performance, under what conditions they are effective, and how they can be aligned with the unique operational realities of mid-sized banks. This study therefore seeks to fill this gap by examining the nature, scope, and performance implications of strategic product diversification in tier-2 commercial banks.

REVIEWED EMPIRICAL LITERATURE OVERVIEW

The reviewed literature demonstrates that product and income diversification play a significant role in shaping the performance trajectory of Tier 2 commercial banks. Zhang, Hartarska, and Malikov (2021) show that deregulation enhances complementarities between geographic and product diversification, resulting in long-term performance gains. Similarly, Zouaoui and Zoghلامي (2020) find a bidirectional relationship between income diversification and market power, highlighting strategic trade-offs banks must consider when expanding non-traditional activities. Evidence from Ashraf and Nazir (2023) further supports the positive effect of income diversification on risk-adjusted returns, although some non-interest income sources introduce instability.

Nisar et al. (2018) reinforce this complexity by showing that not all diversification categories enhance profitability, calling for selective adoption of diversification strategies. Studies from African contexts echo these findings: Amahalu et al. (2023) reveal that diversified investment portfolios enhance returns, while King'ori (2023) finds a significant positive link between diversification and market performance among SACCOs. Kitolo (2020) underscores the interconnectedness of diversification with other financial determinants, suggesting that diverse products strengthen overall bank health. However, Ndungu and Muturi



(2019) caution that product diversification may sometimes negatively impact financial performance, emphasizing the need for strategic alignment and careful execution within Tier 2 commercial banks.

THEORY AND HYPOTHESIS

Diffusion of Innovation Theory

Proposed by Everett Rogers in 1962, the Diffusion of Innovation (DOI) theory explains how new ideas, products, or technologies spread within a population. The theory identifies five adopter categories: innovators, early adopters, early majority, late majority, and laggards, and outlines factors influencing adoption, such as relative advantage, compatibility, complexity, trialability, and observability.

In the context of the objective "To evaluate the relationship between product diversification on performance in Tier 2 commercial banks in Kenya", the DOI theory is relevant to understanding how diversified products gain acceptance among customers. For instance, offering innovative financial products like digital wallets or specialized loans attracts innovators and early adopters, who drive initial market acceptance. The relative advantage of diverse products enhances market share growth as banks cater to varying customer needs (Rogers, 1962).

Additionally, DOI theory highlights the role of compatibility in product diversification. Banks that align new products with customers' preferences and cultural values increase adoption rates, expanding their customer base. Observability, another key element of the DOI theory, suggests that visible benefits of diversified products, such as better financial management tools, encourage widespread adoption among the early majority and late majority, ultimately contributing to bank performance (Bass, 2004).

Hypothesis: *H0: There is no relationship between product diversification and performance in Tier 2 commercial banks in Kenya*

DATA METHODS

A descriptive research design was utilized, as it is suitable for systematically describing the relationships between independent variables (product diversification) and the dependent variable (performance of Tier 2 commercial banks). This design facilitates

the collection of data that reflects the current practices and outcomes within the banking sector. The target population was the Tier 2 commercial banks in Kenya while the unit of observation comprised of management and leadership staff, customer relationship officers, and operations Staff in Tier 2 commercial banks in Nairobi.

This study employed stratified random sampling to ensure that all key population categories; Management and Leadership, Customer Relationship Officers, and Operations Staff are adequately represented. The population is first divided into these distinct strata based on their roles within the banks. From each stratum, simple random sampling is applied to select respondents proportionally, reflecting their contribution to the total population. This technique ensures a fair and unbiased representation while maintaining the relevance of the sample to the study objectives.

The desired sample size was determined using the Yamane formula". This formula is used to calculate a sample size n, for finite population (Yamane, 1967). This formula ensures that the selected sample size is representative of the entire population, minimizing sampling error and enhancing the reliability of the findings.

$$n = \frac{N}{(1+Ne^2)}$$

Where; n = sample size, N = population size, and e = "desired margin of error."

For most normal distributions, Z= A standard normal deviation at the required confidence level (given as 1.96 for 95% Confidence level), the degree of accuracy (acceptable error margin) = 0.05 which is equivalent to e, therefore, e= 0.05

Thus $n = \frac{1138}{(1+1138(0.05)^2)} = 296$ respondents

Table 1 provides a sample distribution table based on the calculated sample size of 286, with a breakdown according to the categories of board members, senior management staff, and key stakeholders. The distribution is done proportionally based on the target population in each category.

Table 1: Sample Distribution Matrix

Category	Target Population	Proportion	Sample Size (n)
Management and Leadership teams	141	12.4%	37
Customer Relationship Officers	505	44.4%	131
Operations Staff	492	43.2%	128
Total	1138	100.0%	296

Source: Human Resource Staffing Records of Tier 2 Commercial Banks (2025)

Data was collected using structured questionnaires for quantitative data. The questionnaires utilized a five-point Likert scale (1-Strongly Disagree to 5-Strongly Agree) to capture perceptions on various aspects. A pre-test was conducted to ensure the reliability and validity of the instruments, achieving a

Cronbach's alpha coefficient of above 0.70 for acceptable reliability.



RESULTS AND DISCUSSIONS

Data analysis was conducted using SPSS version 25, a robust statistical software widely used in research for its efficiency and reliability in handling large datasets. Descriptive statistical techniques will be applied to summarize the collected data, providing insights into trends, frequencies, and patterns within the dataset. This will include measures such as means, percentages, and standard deviations, which will help in understanding the general characteristics of the study variables.

Inferential statistical techniques, particularly regression analysis, will be utilized to examine the relationships between the independent variables (customer relationship management, loyalty renewal programs, quality service, and product diversification) and the dependent variable (performance in Tier 2 commercial banks). Regression analysis will help to determine the strength, direction, and significance of these relationships. The results will be presented in tables and charts for enhanced clarity, allowing for a clear visual representation and easier interpretation of the findings. This approach ensures comprehensive and accurate data analysis that aligns with the study objectives.

The following regression model guided the analysis:

$$Y = \beta_0 + \beta_1 X_1 + \epsilon$$

Response Rate

The findings indicate that out of the targeted 296 respondents, 229 participated, representing an overall response rate of 77.6%. Among the groups, management and leadership teams recorded the highest response rate at 78.4%, followed closely by customer relationship officers (77.9%) and operations staff (76.6%). This distribution demonstrates balanced participation across the three categories, ensuring diverse perspectives were included in the study. The overall response rate exceeds the 70% benchmark considered adequate for survey-based research. According to Mugenda and Mugenda (2003) and Babbie (2010), a response rate of 70% or more is sufficient for drawing valid conclusions, which suggests that this study achieved an acceptable and credible level of participation.

Descriptive Statistics for Product Diversification

This section explores employee perceptions of how product diversification contributes to competitiveness and customer satisfaction in Tier 2 commercial banks in Kenya. Six statements measured variety of products, market share, customer base expansion, introduction of new offerings, competitiveness, and customer satisfaction.

Table 2: Descriptive Statistics for Product Diversification

Statement	SD F (%)	D F (%)	N F (%)	A F (%)	SA F (%)	Mean	Std. Dev.
1. The bank offers a variety of products to meet different customer needs.	5 (2.1)	4 (1.7)	22 (9.2)	25 (10.5)	183 (76.6)	4.58	0.88
2. Product diversification has led to an increase in market share.	5 (2.1)	12 (5.0)	29 (12.1)	157 (65.7)	36 (15.1)	3.87	0.80
3. The bank has successfully expanded its customer base through diversification.	1 (0.4)	8 (3.3)	21 (8.8)	120 (50.2)	89 (37.2)	4.21	0.77
4. New product offerings are introduced to the market regularly.	1 (0.4)	11 (4.6)	29 (12.1)	87 (36.4)	111 (46.4)	4.24	0.87
5. Product diversification has helped the bank remain competitive in the market.	3 (1.3)	9 (3.8)	22 (9.2)	148 (61.9)	57 (23.8)	4.03	0.77
6. Customers are satisfied with the variety of products available at the bank.	1 (0.4)	12 (5.0)	30 (12.6)	104 (43.5)	92 (38.5)	4.15	0.85

Source: Research Data, (2025)

The results show strong agreement that Tier 2 banks offer a wide range of products, with most respondents affirming product variety (mean = 4.58). Product diversification is viewed as enhancing market share, competitiveness, and customer base expansion, with all related statements scoring high means (3.87–4.24). Respondents also agreed that new products are introduced regularly and customers are satisfied with available options, confirming diversification as a key driver of performance.

Descriptive Statistics for Performance of Tier 2 Commercial Banks

This section evaluates employees' perceptions of the financial and operational performance of Tier 2 commercial banks in Kenya. Six statements measured profitability, customer retention, customer satisfaction, sales growth, achievement of financial targets, and the influence of loyalty initiatives.

**Table 3: Descriptive Statistics for Performance of Tier 2 Commercial Banks**

Statement	SD F (%)	D F (%)	N F (%)	A F (%)	SA F (%)	Mean	Std. Dev.
1. The bank has shown an improvement in profitability in recent years.	0 (0.0)	5 (2.1)	12 (5.0)	129 (54.0)	93 (38.9)	4.30	0.66
2. Customer retention has improved significantly in the bank.	0 (0.0)	7 (2.9)	15 (6.3)	78 (32.6)	139 (58.2)	4.46	0.74
3. The bank has high levels of customer satisfaction.	1 (0.4)	3 (1.3)	18 (7.5)	144 (60.3)	73 (30.5)	4.19	0.66
4. The bank's sales volume has increased over the past year.	1 (0.4)	5 (2.1)	26 (10.9)	106 (44.4)	101 (42.3)	4.26	0.77
5. The bank consistently meets its financial performance targets.	1 (0.4)	1 (0.4)	16 (6.7)	49 (20.5)	172 (72.0)	4.63	0.67
6. The performance of the bank is positively impacted by customer loyalty initiatives.	0 (0.0)	4 (1.7)	8 (3.3)	99 (41.4)	128 (53.6)	4.47	0.65

Source: Research Data, (2025)

The findings indicate strong agreement that Tier 2 banks have improved profitability, customer retention, and sales volume, with all items scoring high mean values (4.19–4.63). Respondents affirmed high customer satisfaction and noted that banks consistently meet financial performance targets. Customer loyalty initiatives were also viewed as significantly enhancing performance. Overall, the results show that financial and non-financial performance indicators have improved steadily across the banks.

Correlation Analysis**Correlation between Product Diversification and Performance of Tier 2 Commercial Banks**

Table 4 evaluates the relationship between product diversification and bank performance. The Pearson correlation coefficient is 0.886, significant at $p = 0.000$, with 239 valid responses. This indicates a very strong, positive, and statistically significant correlation between diversification and performance.

Table 4: Correlation between Product Diversification and Performance of Tier 2 Commercial Banks

		Product Diversification	Performance of Tier 2 Commercial Banks
Product Diversification	Pearson Correlation	1	.886**
	Sig. (2-tailed)		.000
	N	239	239
Performance of Tier 2 Commercial Banks	Pearson Correlation	.886**	1
	Sig. (2-tailed)	.000	
	N	239	239

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

The implication is that introducing a variety of innovative products directly contributes to profitability, market share growth, and customer satisfaction. This result is consistent with Ansoff's Growth Matrix highlighted in the literature, which emphasizes product development as a key growth strategy. Langat and Atheru (2023) similarly found that product

diversification strengthens competitiveness and customer loyalty in Kenyan banks. These findings confirm that regular introduction of new products is essential for sustaining market relevance and driving strong financial outcomes in Tier 2 commercial banks.

Regression Analysis**Table 4. 1: Regression Coefficients for Product Diversification**

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	0.2140	.076		2.837	0.005
Product Diversification	0.158	0.035	0.176	4.480	0.000

Source: Research Data, (2025)

The regression results show that product diversification has a positive and statistically significant effect on performance of Tier 2 commercial banks. The unstandardized coefficient ($B = 0.158$)

indicates that a one-unit increase in product diversification leads to a 0.158-unit increase in bank performance, holding other factors constant. The standardized coefficient ($Beta = 0.176$)



shows a moderate positive influence relative to other potential predictors.

The effect is highly significant ($t = 4.480$, $p < .001$), meaning product diversification is a meaningful predictor of performance. The constant value (0.214 , $p = .005$) suggests that even without diversification, banks retain a baseline level of performance. Overall, the model confirms that enhancing product diversification contributes positively and significantly to bank performance.

SUMMARY OF THE FINDINGS, CONCLUSION, RECOMMENDATIONS, AREAS OF FURTHER RESEARCH

In summary, Product diversification recorded high mean scores, showing that Tier 2 commercial banks provide a wide and innovative range of products including loan options, savings plans, digital platforms, and investment services to meet diverse customer needs. Respondents valued the flexibility and variety, which enhance satisfaction and strengthen banking relationships. Correlation analysis showed a strong positive relationship with performance ($r = 0.886$, $p = 0.000$), while regression confirmed a significant contribution ($\beta = 0.176$, $p = 0.000$). These results demonstrate that expanding product offerings improves market share and financial outcomes. Overall, strategic practices, including product diversification, jointly explained 93.3% of performance variation ($R^2 = 0.933$), highlighting their critical role in boosting bank performance.

The conclusion from the study was that Product Diversification significantly contributed to the performance of Tier 2 banks. Banks that expanded their range of financial products—such as mobile banking, investment products, and SME financing—were better positioned to attract new customers, manage risk, and enhance profitability. This conclusion supports SDG 1 (No Poverty) and SDG 9 (Industry, Innovation, and Infrastructure) by promoting innovative financial solutions that stimulate entrepreneurship and access to finance. It also aligns with Kenya Vision 2030's Economic Pillar, which encourages innovation and diversification to strengthen competitiveness. Moreover, product diversification directly supports the Bottom-Up Economic Transformation Agenda, which prioritizes access to affordable credit, digital finance, and SME empowerment as engines for inclusive economic growth.

The study confirmed a strong positive effect of product diversification on performance ($r = 0.886$, $p = 0.000$; $\beta = 0.176$, $p = 0.000$). It was recommended that product teams should develop innovative financial products such as digital lending solutions, tailored investment plans, and sector-specific credit facilities to meet evolving customer needs. Regular market research is necessary to identify emerging trends and ensure new offerings align with customer demands and regulatory requirements, thereby strengthening market share and profitability.

Product diversification showed a significant positive relationship with performance ($r = 0.886$, $p = 0.000$; $\beta = 0.176$, $p = 0.000$), yet the study did not evaluate potential risks linked to diversified product portfolios. Further research could assess how diversification affects risk exposure, financial stability, and long-term profitability. Such studies would guide banks in balancing the benefits of offering a wider range of products with the need to manage operational and market risks effectively.

REFERENCES

1. Akinyemi, J. O. (2025). *International diversification strategy, resource intensity, and financial performance*. *Cogent Business & Management*. <https://doi.org/10.1080/23311975.2025.2579664>.
2. Akinyemi, J. O. (2025). *International diversification strategy, resource intensity and financial performance*. *Cogent Business & Management*. <https://doi.org/10.1080/23311975.2025.2579664>
3. Kimani, J. W., Sang, W. K., & Kinyanjui, J. K. (2025). *Competitive intensity as a mediator of revenue diversification and financial performance*. *African Multidisciplinary Journal of Research*. <https://doi.org/10.71064/spu.amjr.1.1.2025.363>
4. Kimani, J. W., Sang, W. K., & Kinyanjui, J. K. (2025). *Mediating role of competitive intensity on revenue diversification and financial performance of commercial banks in Kenya*. *African Multidisciplinary Journal of Research*, 1(1). <https://doi.org/10.71064/spu.amjr.1.1.2025.363>.
5. Mutinda, D. M. (2025). *Portfolio diversification and profitability in Kenyan commercial banks*. *International Academic Journal of Economics & Finance* (2025). (See institutional repository).
6. Ngware, S. G. (2025). *Investment diversification and financial performance of commercial banks in Kenya: Controlling role of bank size*. *International Journal of Accounting, Finance & Risk Management*. <https://doi.org/10.46281/ijafr.v16i1.2512>
7. Ngware, S. G. (2025). *Investment diversification and financial performance of commercial banks in Kenya*. *International Journal of Accounting, Finance & Risk Management*. <https://doi.org/10.46281/ijafr.v16i1.2512>
8. Zhao, Y. (2025). *Bank performance and non-interest income diversification*. *PLOS ONE*. <https://doi.org/10.1371/journal.pone.0321899>.
9. Zhao, Y. (2025). *Bank performance and non-interest income diversification*. *PLOS ONE*. <https://doi.org/10.1371/journal.pone.0321899>