COST LEADERSHIP STRATEGY AND ORGANISATIONAL PERFORMANCE: A CASE OF INSURANCE COMPANIES IN NYERI COUNTY, KENYA

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ABSTRACT

This study sought to determine the effect of cost leadership strategy on the performance of insurance firms in Nyeri County, Kenya. It was anchored on Porter's Five Forces Model and the Dynamic Capabilities Theory. A census study approach was used to subject all the twenty (25) insurance companies operating in the county to study. Purposive sampling was used to identify the respondents who included branch managers, finance officers, marketing managers, claims managers and actuaries of all the insurance firms being studied. This procedure led to a total of 125 respondents. The study assessed non-financial performance of the insurance companies for 5 financial years 2014-2018. Primary data was collected through questionnaires while secondary data was gathered using a document review guide to review financial statements, management reports and other key publications in the company. Both descriptive and inferential statistics were used in the analysis. The Pearson correlation analysis results established that cost leadership ($r=0.791$, $p= 0.01$) has a very strong and positive correlation with organisational performance. Similarly, the results of the multiple linear regression analysis showed that cost leadership ($\beta=880$, $p=0.004$) has a positive effect on organisational performance. Thus, a conclusion was made that pursuit of cost leadership strategies delivers positive results to the organisation. The study recommends that insurance companies work on improvement of the adoption of proprietary technology and innovative distribution channels for products which were found to be only moderately entrenched. This could be limiting their efficiency in effectively controlling the operating and distribution costs.

Key Words: *cost leadership strategy, competitive strategies, organisational performance, insurance firms*

INTRODUCTION

Over the past one decade, the general performance of the insurance industry has been wanting especially with regard to inability to sustain the momentum of insurance penetration and density. The Kenyan insurance penetration stands lower than the regional figures being at 2.8 percent compared to an average of 3.5 percent in Africa (Cytonn Investments, 2017). The ability of the insurance firms to attract and retain their customers and generate superior revenue has been a challenging task, a factor attributed to stiff competition in the sector. According to the annual report by the Insurance Regulatory Authority (2016) indicates that a contraction in insurance penetration in 2015 and 2016 ascribed to the detail that the national GDP grew faster than the insurance premiums did in the 2015 and 2016 fiscal years. The gross domestic product (constant prices) expanded by 5.8 percent in 2016 compared to a growth in gross direct premium of 6.4 percent (real terms). Concerns have been raised over rising levels of inefficiency in the operations in Kenya's insurance sector which has adversely affected their growth.

Nevertheless, the insurance industry makes a significant contribution to the economy through savings mobilisation and investments in government securities, deposits, capital markets and the real estate sector (Ward & Zurbruegg, 2000). Notwithstanding the declining trend in insurance density and penetration, the insurance industry has continued to grow significantly and making worthy contribution to economic growth. The gross premium income for the year 2016 was KES 196.64 billion, representing a thirteen (13) per cent from KES 174.06 billion reported in the year 2015. Regarding the industry's asset base, a growth of 10.4 percent was observed from KES 478.75 billion in 2015 to KES 528.75 billion in 2016 with a significant portion of those assets (80.4 percent) being held in income generating investments (IRA, 2016). The low level of insurance uptake in Kenya stands at a mere 12 percent of the population according to a report by the Association of Kenya Insurers (AKI, 2016). This demonstrates a big opportunity that can be tapped by the industry players to turn around their performance and make significant contribution to the economy. The pursuit of competitive strategies by insurance firms has received wide attention. This is occasioned by the high escalation of rivalry as more firms enter the already highly crowded market (Gitau, 2013).

According to Folan and Browne (2005), organizational performance is the process of analysing a company's achievements against some pre-set objectives and goals. It encompasses the real results or outputs compared against the desired outputs as spelt in the organisational plans. Market performance evaluates the performance of the firm or product in the marketplace (Arnold, 2014). Market performance seeks to assess the success of the firm in achieving competitive advantage over rivals as signposted by market share. Best (2009) asserts that market based measures can be approached in three scopes namely; market standing, market profitability and market orientation. Market standing uses market performance metrics which are in essence external measures of market performance. Marketing profitability on the other hand attempts to relate profitability to specific marketing strategies pursued by the organisation. The current study makes use of market based measures of performance including market share and customer outreach which are largely applicable to the highly competitive insurance industry. Efficiency indicators are utilised to indicate the efficiency with which shareholders' funds are being utilised to generate sales.

According to Porter (2007), competitive strategies are essentially the long term plans of a firm as it seeks to build sustainable competitive advantage over its competitors in the industry. Pursuit of competitive strategies aims at building a defensive position in an industry and generating a superior return on investment. They concern the specifics of management's game plan for competing successfully and attaining a competitive edge over competitors (Akan et al., 2006). The competitive strategies pursued by firms include cost leadership strategy, differentiation strategy, focus cost strategy and focus differentiation strategy. The line of distinction between these competitive strategies are drawn on two major considerations. These are; whether a company's market target is broad or narrow and whether the company is pursuing a competitive advantage linked to low costs or product differentiation (Johnson, 2016). Under cost leadership strategy, the firm seeks or aims at positioning as the lowest cost producer in the industry (Porter, 2007). This is realised by producing in large scale which brings in the benefits of economies of scale. Other ways for low cost positioning include, increased capacity utilization, cost control, distribution efficiency, network establishments and high technology implementation.

The insurance industry in Kenya is governed by the insurance Act, chapter 487 of the laws of Kenya. The act empowers the Insurance Regulatory Authority (IRA) to regulate and coordinate insurance practice in Kenya. The Association of Kenya Insurers (AKI) further monitors and guides the industry acting as a consultancy and advisory agency with a view to enhance the awareness of insurance products and promote professionalism. The insurance sector has a number of players who include the insurance companies, licenced intermediaries and service providers (Mose & Kuloba, 2013). The insurance intermediaries comprise of insurance agents, bancassurance agents, insurance brokers, and medical insurance providers. The service providers include motor assessors, insurance investigators, loss adjusters, claims settling agents, insurance surveyors and risk managers (IRA, 2017). There are currently 52 insurance companies licensed to operate in Kenya. The insurers are classified into three major categories which include general, long-term and composite insurers. There are twenty six (26) firms under the general insurer's category, fifteen (15) under the long term insurers (category) and eleven (11) under composite insurer's classification (IRA, 2017).

STATEMENT OF THE PROBLEM

The Kenyan insurance sector has been faced with inability to sustain the momentum of insurance penetration. According to Cytonn Investments (2017), compared to regional figures, the penetration of the Kenyan insurance sector stands at a low of 2.8 percent compared to an average of 3.5 percent in Africa. This has seen the insurance sector struggling to not only attract more customers but also retain their existing clients, a factor which has continued to hurt the sector turnovers. A report by IRA (2016) indicates that a contraction in insurance penetration in 2015 and 2016 ascribed to the detail that the national GDP grew faster than the insurance premiums did in the 2015 and 2016 fiscal years. There have also been concerns from stakeholders including the Insurance Regulatory Authority and the Association of Kenya Insurers (AKI) over rising levels of inefficiency in the operations of Kenya's insurance sector, a factor that has adversely hurt not only their ability to generate revenue but has also hindered their momentum of growth. Kamau (2013) singles out poor organisational strategies for the inability of insurance firms to enhance their competitiveness and exploit the market opportunities optimally. While Gitau (2013) observes that the pursuit of competitive strategies has been on the rise for the insurance sector, it is still unclear on whether they are delivering the intended objective of enhancing performance. Muriira (2014) studied competitive strategies adopted by insurance companies in Kenya. Specifically, the study sought to determine the different competitive strategies utilized by the insurance firms to remain profitable. Findings indicated that most companies applied the market focus strategies either on basis of cost and differentiation. The study presents empirical gaps on the need to cover a wide range of competitive strategies and establish the link with performance. From the ongoing, discussion, it is clear that there still exists a lot of unresolved issues on studies regarding competitive strategies and organisational performance. As such, to fill the gaps outlined and to provide a reliable guide for strategic direction by companies in a bid to enhance their performance, the current study focused on the effect of cost leadership strategies on performance of insurance firms in Nyeri County, Kenya.

GENERAL OBJECTIVE

The study sought to establish the effect of cost leadership strategy on performance of insurance firms in Nyeri County, Kenya.

LITERATURE REVIEW

Porter's Five Forces Model

The five forces model was first proposed by Porter (1980) as a useful theory for evaluating a firms industry structure in strategic processes. The basic premise of the framework is that organizational strategy should be informed by an assessment of the threats and opportunities facing the organization. The five competitive forces that define each industry and market include; threat of new entrants, threat of substitutes, bargaining power of suppliers, bargaining power of customers and competitive rivalry among existing players. A viable organizational strategy aims at modifying these forces in a manner that enhances the competitive situation of the firm (Chesbrough & Appleyard, 2007).

Grundy (2006) postulates that analysis of the five forces is key in understanding the strength of a firm's current competitive position and the strength of a position that the firm aims at. The five forces framework helps in establishing the attractiveness of an industry in addition to provision of insights on viability. It therefore informs choices on whether to enter or exit a given industry or a market segment. Strategic analysts apply the framework to explain the potential viability of new products and services. Chesbrough and Appleyard (2007) argues that the framework elucidates the dynamics likely to influence profitability of individual firms in a specific industry. Management of firms is therefore equipped to make informed decisions on whether to enter a new market, create new products or increase capacity in a given industry.

Dynamic Capabilities Theory

The Dynamic Capabilities Theory was proposed by Teece, Pisano and Shuen (1997) on the foundational premise that organizations should constantly reshape their internal resources in order to achieve sustainable performance in an atmosphere defined with unending change and intense competition. It concerns the effectiveness and efficiency with which an entity integrates, builds, and reconfigures internal and external proficiencies to withstand rapidly changing environments (Helfat & Peteraf, 2009).Zahra, Sapienza and Davidsson (2006) argues that the dynamic capabilities is about obtaining and sustaining a firm's competitive advantage.

While operational capabilities is about the current organisational processes, dynamic capabilities entails the ability of an entity to continually create, extend, or modify their resource base to win long-term competitive advantage (Helfat & Peteraf, 2009). The approach therefore concerns modification of short-term competitive situations into long-term competitive advantage. In the context of generic strategies, the theory supports constant market feedback to guide enhancement of products and services through either differentiation or cost as the sure route to superior performance. According to Zahra, Sapienza, and Davidsson (2006), assimilation of customer feedback in the firm guides the transformation of strategic assets to fit the new strategic directions.

Teece (2007) outlines that a company should be in a position to profile opportunities and threats and work towards repositioning the firm to take advantage of the prospects and control the pressures in order to build competitive advantage. Hence, enhancement of organisational competitiveness requires continuous augmentation of both tangible and intangible assets through combination, protection and reconfiguration of those resources (Helfat & Peteraf, 2009). The competitive strategies pursued by the firm is informed by need to enhance dynamic capabilities of the firm. The theory was applicable to the current study as it proposes that cost leadership strategy would positively influence the performance of a firm which is the subject matter of the assessment.

EMPIRICAL LITERATURE REVIEW

Several studies have tried to demystify the effect of cost leadership strategy on organization performance, albeit not exhaustively. Tavitiyaman, Qiu Zhang, and Qu (2012) examined cost leadership strategy and hotel performance in the United States of America. A combination of descriptive and causal research designs were used. The target population was made up of US hotel owners and general and executive managers. A census approach was employed. Cost leadership strategy was found to have a positive impact on hotel's financial performance. Gaps emerge on need to expand knowledge by considering an assessment of the effect of cost leadership strategy on non-financial dimensions of performance. Gaps also further arise on need to consider a local empirical analysis.

Baraza (2017) considered the influence of cost leadership strategy on performance of East Africa Breweries (Kenya) Limited. The study used a descriptive research approach. Information was gathered from top management who were considered well versed with the details. Descriptive statistics and inferential statistics were used in the analysis. The regression analysis was a key inferential analysis tool. The study concluded that cost leadership strategy positively influences firm performance. Gaps emerge on the need to consider more firms to enhance comparison of results. Kago, Gichunge, and Baimwera (2018) analyzed cost leadership strategy and performance of Kenyan petroleum companies. The specific objectives of the study was; to determine the effect of cost leadership strategy, differentiation strategy and focus strategy on performance. A descriptive survey approach was applied on a population of fifty nine petroleum companies in Kenya. Analysis was done by way of content analysis and descriptive statistics. Results demonstrated that cost leadership strategy was useful in positively driving organizational performance.

Kampire (2012) studied cost leadership strategy adopted by insurance companies in Rwanda. The study sought to establish the type of competitive strategies implemented by Rwandan insurance companies in an environment characterized by hyper competition. Cost leadership strategy characterized by price wars was the most common approach implemented by insurance companies. Firms set up high switching costs to discourage customers from moving to competitors. Ouma (2016) assessed cost leadership strategy and performance of the insurance companies in Kenya. The study was informed by the fact that the Kenyan insurance sector was largely crowded with forty nine companies competing for a relatively small market characterized by penetration standing at a low of 2.93 percent. Findings indicated that strategic alliances was the most dominant strategy for insurance firm players. Results further indicated that cost leadership strategy had a positive effect on both financial and non-financial performance of insurance firms in the Kenyan market.

RESEARCH METHODOLOGY

The study applied a descriptive survey research design as it allows description of existing state of research phenomena. The descriptive survey research approach further allows individuals to present their experience, values and perception of the study subjects. According to Mugenda and Mugenda (2003), a descriptive survey research design involves the discovery of already existing links and relationships regarding variables and does no attempt to alter anything in the environment. The target population comprised of twenty five (25) insurance companies actively operating in Nyeri County, Kenya. The target respondents included branch managers, finance officers, marketing managers, claims managers and actuaries of all the insurance firms being studied. Therefore the study targeted 125 respondents. The respondents were purposively selected as they are well versed with information sought regarding competitive strategies and performance of the insurance firms. A census approach was considered as the population was relatively small. According to Oso and Onen (2005), a census approach entails the is the systematic acquisition and recording of data from all elements, units or participants in a given population. The participants threshold meets the minimum size of thirty (30) as recommended by Mugenda and Mugenda (2003) for normal approximations. The study used a semi-structured questionnaire as the choice instrument in data collection. The questionnaire was semi structured to objectively deal with the subject matter of the study; competitive strategies and performance of insurance companies. The instruments were tested for reliability and validity to ensure consistency and usefulness of information collecting in answering the research questions. The study collected both quantitative and qualitative data. Content analysis method was used in analysing qualitative data. On the other hand, quantitative data was analysed through descriptive statistics and inferential statistics. The descriptive statistics included means and standard deviations. On the other hand, the inferential analysis involved the multiple regression analysis and Pearson correlation analysis. The statistical package for social sciences SPSS was the choice analytical tool for generating the output. A multiple regression model was adopted as follows:

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

Where: Y = Organisational Performance, X_1 = Cost Leadership Strategy, ε = Error term

The results were presented in the form of tables and figures.

RESEARCH RESULTS

Organizational Performance for Insurance Firms

On average, the companies had introduced 2 new products over the past five years. The company with the highest number of new products within this period had three while the lowest had one product. Results agreed with Muriira (2014) who also found that innovation performance of the insurance companies in Kenya was fairly good. On innovative distribution and promotional channels, the insurance companies had entrenched among others, social media marketing and mobile marketing.

Research results on the ratings of different dimensions of organizational performance for insurance firms in Nyeri County, indicated that the average market share of the insurance firms in Nyeri County over the past five years was good (mean 2.81, SD 0.88). The same applied to innovation as a performance indicator which was also reported to be good (mean 3.25, SD 0.96). The insurance firms performed above average with regard to customer outreach which was found to be very good (mean 3.8, SD 1.26). In conclusion, the general performance of the insurance firms was good. The results agree with Kampire (2012) and Ouma (2016) who also established that the performance of the insurance industry was good.

Cost Leadership Strategy by Insurance Firms

Findings on application of cost leadership strategy among insurance companies in Nyeri County, indicated that the mean of means (3.56), cost leadership strategy was largely applied in the insurance companies in Nyeri County. This is further affirmed by the low average standard deviation (1.10), which shows that observations are closely held close to the mean. The results indicated that the firm enjoyed a system that guaranteed operational efficiency and was largely able to reap from the benefits of economics of scale. The firms largely had well outlined frameworks for cost regulation and control, largely enjoyed well established network with partners which help in cutting costs and widely participated in price wars with rivals in the market.

Nonetheless, as shown by the statistics (mean 3.07, SD 0.84), the distribution channels for products were found to be only moderately entrenched and hence firms may not have been perfectly efficient in reducing associated costs. On the same note, as represented by the results (mean 3.01, SD 1.10), the firms were only moderately found to have an edge with regard to use of proprietary technology in controlling costs. Respondents were asked to also provide other methods applied by the firms in controlling costs. The methods cited included reduction of supply expenses, modernization of marketing efforts such as use of social media and harnessing virtual technology. The findings agree with Muriira (2014) who established that insurance companies had widely applied cost leadership strategy.

Effect of Cost Leadership Strategy on Performance of Insurance Firms

The study used Pearson correlation analysis to assess the nature, strength, and direction of relationships between cost leadership strategy and organisational performance. Table 1 provides the Pearson Correlation Output.

Table 1: Pearson Correlation Analysis

		Organisational Performance
Cost Leadership	Pearson Correlation	.791**
	Sig. (2-tailed)	.001
	N	95

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

The results are indicative that all the independent variables (cost leadership, differentiation, focus cost and focus differentiation strategies) are positively and significantly related with organisational performance. For cost leadership, the Pearson correlation coefficient (0.791) shows that the factor is very strongly and positively related with organisational performance. The relationship is very strong since the co-efficient is above 0.70. In addition, the relationship is statistically significant since the P-value (0.001) is less than 5% level of significance. The results agree with Tavitiyaman, Qiu Zhang, and Qu (2012), Baraza (2017), Kago, Gichunge, and Baimwera (2018), Kampire (2012) and Ouma (2016) who indicated that cost leadership has a positive relationship with organisational performance.

The multiple regression analysis results was also used to determine the effect of cost leadership on organisational performance. Table 2 captures the key results.

Table 2: Coefficients

	Unstandardized Coefficients		**Standardized Coefficients**		
Model	**B**	**Std. Error**	**Beta**	**T**	**Sig.**
1(Constant)	8.084	.501		2.104	.001
Cost Leadership	.880	.314	.884	3.204	.004

The results of the multiple linear regression analysis show that cost leadership strategy has a positive and significant effect on organisational performance. The coefficient for cost leadership (0.880) implies that a unit increase in implementation of cost leadership would lead to a 0.880 unit increase in organisational performance. The effect is statistically significant because the associated P-Value (0.004) is less than 0.05 level of significance. Hence, cost leadership is a useful predictor of organisational performance. The results agree with Tavitiyaman, Qiu Zhang, and Qu (2012), Baraza (2017), Kago, Gichunge, and Baimwera (2018), Kampire (2012) and Ouma (2016) who indicated that cost leadership has a positive effect on organisational performance.

CONCLUSIONS AND RECOMMENDATIONS

The study concluded that the insurance firms registered good performance on the basis of market share, innovation and customer outreach. A conclusion was reached that the insurance industry widely adopted cost leadership as a competitive strategy. The study concluded that the distribution channels for products only moderately entrenched. In addition, the firms were only moderately found to have an edge with regard to use of proprietary technology in controlling costs. A further conclusion was reached based on the Pearson correlation analysis results that cost leadership is positively related with organisational performance. Further, regression analysis informed a conclusion that cost leadership positively influences the level of organisational performance. It was recommended, on account of the conclusions, that insurance firms devote more resources to execution of cost leadership programs as this was established to be a viable strategy. It is recommended that insurance companies work on improvement of the adoption of innovative distribution channels for products which was found to be only moderately entrenched, a factor that could be limiting their efficiency in reducing distribution costs. The study further recommends the enhanced use of proprietary technology which was also moderately implemented.

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