THE EFFECT OF COST LEADERSHIP STRATEGY ON PERFORMANCE OF COMMERCIAL BANKS IN NAIROBI COUNTY, KENYA

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ABSTRACT

Performance of commercial banks is important because provision of finance is crucial for all sectors in the society comprising of companies, households and governments. However, the dynamic business environment has continued to exert a great impact on performance of all organizations globally. The purpose of this study was to determine the effect of competitive strategies on the performance of commercial banks in Nairobi County, Kenya. The specific objectives were to establish the effects of cost leadership strategy, focus strategy, differentiation strategy and innovation strategy on performance of commercial banks in Nairobi County, Kenya. The theories underpinning this study were Porter's Generic Competitive strategies, Resource Based View (RBV) This study employed a descriptive research design and survey design. Since the listed banks are 40 in number, this study adopted a census survey where the entire population will be included in the study. The study adopted purposive sampling to select the senior managers as respondents in the study. A questionnaire consisting of both open and close-ended questions developed by the researcher in line with the objectives of the study was used to collect primary data. Quantitative data analysis was done with the help of SPSS version 25 software and included descriptive and inferential analysis. Inferential analysis involved multiple regression analysis to determine the relationship between competitive strategies on performance of commercial banks. From 120 questionnaires that were dispatched for data collection, 103 questionnaires were returned completely filled, representing a response rate of 85.8% which is very good for generalizability of the research findings to a wider population. Both descriptive and inferential statistics showed that cost leadership strategy, significantly influenced performance of commercial banks in Nairobi County, Kenya. The study concluded that one cost leadership strategy significantly influences performance of commercial banks in Nairobi County; in terms of effective use of cost leadership approaches such as low interest, low operating costs and competitive pricing can enhance performance of commercial banks. The study recommends that relevant management team of commercial banks should craft viable cost reduction strategies to reduce bank operation costs so as to enhance the banks' financial and non-financial performance. For further research, a longitudinal study can be done, using time series data for a span of 5 years to assess commercial banks' performance after adoption of selected competitive strategies.

Keywords: **Performance, Competitive strategies, Resource Based View, cost leadership, competitive pricing, low interest.**

INTRODUCTION

Background of the Study

The dynamic business environment has continued to exert a great impact on performance of all organizations globally. As competition increases, it has become imperative for organizations to adopt strategies that will enable them to remain competitive and profitable (Pearce & Robinson, 2007). Therefore, the performance of commercial banks in Kenya affects the economy at large because it influences the financial position of the nation (Thumbi & Ragui, 2019). The intense competition from other banks, microfinance institutions and SACCOs threatens the performance of commercial banks in Kenya (Thumbi & Ragui, 2019). Over a period of five years, the number of commercial banks has fallen from a total of 43 banks to stand currently at 40.

On the global landscape, instability and volatility has been witnessed in performance of financial institutions. Although the financial crisis of 2007-09 had a major impact on banking institutions in both the USA and Europe, significant improvement has been seen in the USA as compared to the latter (Schildbach et al., 2013). Marked differences in performance in the European Banking System are evident, and the main factors contributing to this are bad debt handling, operational costs, finding alternative sources of income and interbank liquidity (Lazarides, 2017). Other challenges include low-interest rates, intense pricing competition for commercial and mortgage loans and higher operating costs, particularly related to regulatory compliance, and technology (Neves, Gouveia & Proença, 2020).

The COVID-19 pandemic will probably cause the severest negative impact to financial institutions (PWC, 2020). In the recent past, the passing of mitigation strategies by governments based on social distancing, national quarantines, and shutdown of non-essential businesses has led to more losses in the financial sector than in other financial institutions (Demirgic-Kunt, Pedraza & Ruiz-Ortega, 2020). The financial sector has been one of the most affected by instability and high volatility in global capital markets which depressed stock markets hence devaluation of banks globally (KPMG Report, 2020). Additionally, bank systems have experienced a great deal of pressure in their role as lending agents thus leading to underperformance of bank stocks in various domestic markets and other non-bank financial firms (Demirgic-Kunt, Pedraza & Ruiz-Ortega, 2020).

Consequently, Girancourt et al. (2020) predict a decline in African banking revenues by 23 to 33 percent during the COVID-19 pandemic. So far, some East African banks have reported either flat or reduced profit in the first quarter, an indication of slowed performance as the pandemic restricts economic activity (Anyanzwa, 2020). The non-performing loans (NPL) coverage increased in the first quarter from 57.4 percent in 2020 compared to 54.5 percent in 2019 (Cytonn Report, 2020). This has been attributed to measures put in place by the Central Bank of Kenya to mitigate the effects of COVID-19. In the first quarter, Equity Bank, Standard Chartered

Bank, Stanbic Bank Kenya and I & M holdings posted a decline in profits, while Absa Bank and Co-operative Bank announced flat profits; and KCB and Trust Bank Limited posted single-digit increase in net earnings (Anyanzwa, 2020).

Statement of the Problem

The banking industry is important in the economy of the country because provision of finance is pertinent for all parts of the society comprising of companies, households and governments (Schildbach et al., 2013). However, due to intense competition experienced in the sector, the performance has been unstable (Thumbi & Ragui, 2020). Additionally, the dynamic business environment has a major impact on organizational performance. Consequently, it is becoming increasingly important for organizations to pursue strategies that will enable them to achieve survival, profitability and expansion in market share (Islami, Mustafa & Latkovikj, 2020).

Many studies have been done on the effect of competitive strategies on organizational performance (Kurt & Zehir, 2016; Kahingo & Waithaka, 2018; Kharub, Mor & Sharma, 2018; Islami, Mustafa & Latkovikj, 2020; Nyachwaya & Rugami, 2020). However, these studies have not provided conclusive findings on the relationship between competitive strategies and organizational performance. Some studies have adopted a case study design thus limiting the generalizability of the findings (Ndung'u, Otieno & Rotich, 2016). Some of the studies have examined the effect of competitive strategies on organizational performance under relatively stable environmental conditions (Kahingo & Waithaka, 2018). Nevertheless, the outbreak of COVID-19 has had a profound impact on the banking industry, particularly after the implementation of health protocols to avert its spread. Consequently, there is a paucity of research on the effect of competitive strategies on organizational performance under conditions of financial crisis in developing countries. Those studies that have examined organizational performance under conditions of environmental uncertainty have been based in developed countries that are different in context from the developing countries (Demirguc-Kunt, Pedraza & Ruiz, 2020). There exists a paucity of studies on the effect of competitive strategies on performance of commercial banks in developing countries under conditions of environmental instability. In view of this, the general objective of this study was to conduct an empirical study on the effect of competitive strategies on performance of commercial banks in Nairobi County, Kenya. This article only focuses on the effect of cost leadership strategy on performance of commercial banks.

Objective

The main objective of this study was to examine the effect of cost leadership strategy on performance of commercial banks in Nairobi County, Kenya.

THEORETICAL FRAMEWORK

Porter's Generic Competitive strategies

Porter's (1980) generic competitive framework has been widely studied in strategic management. The author argues that the adoption of the generic strategies in competitive industries produce superior performance than competitors. These three strategies are cost leadership, differentiation and focus strategies. Firms that adopt cost leadership strategy do not necessarily charge the lowest prices and then plough back the extra profits into the business (Lynch, 2003). However, in pursuing such a strategy, organizations strive to realize above-average profits over rivals through low prices that accrue from the alignment of all activities towards reducing costs. Nyachweya and Rugami (2010) argue that competitive banks which pursue a cost leadership strategy realized superior performance than those that pursue broad differentiation, customer service differentiation and focus strategies.

In a differentiation strategy, organizations endeavor to distinguish their products and services from those of competing firms (Wesulah, 2016). When organizations offer products and services that are perceived by the buyers as being essentially different on many dimensions from those of their competitors, they may charge a premium price for this uniqueness (Svatopluk & Ljuba, 2006). The distinguishing dimensions may include the design, brand image, technology, product features, dealers, network or customer service (Tanwar, 2013). This translates into higher profits for the organization thus superior performance. The adoption of differentiation strategy by commercial banks has a positive effect on performance (Atikiya, 2015).

Organizations that adopt a focus strategy elect to concentrate their efforts in a niche market with the least competition (Porter, 1980). In most cases organizations will choose a narrow competitive scope within an industry that large firms tend to overlook (Obasi et al, 2006). Within this selected niche, the firm may choose to pursue either a cost leadership or differentiation strategy. The focus strategy whether anchored in a low-cost base or differentiation base attempts to attend to the needs of a particular market segment (Pearce & Robinson, 1997). Firms pursuing this strategy target isolated geographic areas, satisfy needs of customers with special financing, inventory or servicing problems or even to tailor the products to somewhat unique demands of the small to medium-sized customers (Odunayo, 2018).

This theory underpins this study because it outlines the three independent variables in the study. These are cost leadership, differentiation and focus strategies. Under cost leadership strategy, this study will examine the effect of low interest, low operating costs and competitive pricing on the performance of commercial banks. Under differentiation strategy, this study will examine the effect of unique products, new products/services and brand loyalty on the performance of commercial banks. Under focus strategy, this study will examine the effect of targeting specific customers, specific markets and specific products/services on the performance of commercial banks.

Resource Based View (RBV) Theory

The foundations for the resource based view can be found in the seminal work by Penrose (1959) in which the idea that organizations can perceived as bundles of resources and capabilities was advanced. Resources are tangible and intangible inputs needed by an organization in its operations to produce outputs. They may include machinery and equipment, financial capital, human capital, management team, management systems, technology and knowledge, and intangible assets like reputation and brand (Oswago, 2018). Through the RBV the firm examines and identifies its strategic advantages that accrue from its unique combination of assets, skills, capabilities, and intangibles as an organization (Pearce and Robinson, 2010). Firms use resources to create positions that can, either directly or indirectly, deny competitors a chance to compete with them (Wernefelt, 1984).

These views were further developed into the resource based view by Barney (1991) who postulated that a firm gains a competitive advantage from its firm-specific resources that are valuable, rare, imitable, and non-substitutable. Valuable resources are those that play a key role in the organization's operations by enabling it to take advantage of opportunities and neutralize threats from the environment. Rare resources are unique because they are possessed by only few players in the industry. This is the key characteristic of strategic resources identified by Wernerfelt (1984) as resource heterogeneity. Imitable and non-substitutable resources cannot be easily imitated or substituted by competitors because they have been developed within the unique context of the organization, thus carry huge cost investments that are a deterrent to competitors.

The relevancy of this theory to this study is drawn from the argument that an organization with a competent management team, efficient management systems, and advanced technology and knowledge will most likely outperform its competitors. Management teams and efficient management systems play a crucial part in ensuring that customers' satisfaction with the banks is well maintained. Advanced technology and appropriate knowledge are prerequisites for maintaining and exceeding profitability for the banks. This study will use the dependent variables of profitability, market share and customer satisfaction as measures of performance of commercial banks during COVID-19 pandemic.

Cost leadership Strategy and Organizational Performance

Kurt and Zehir (2016) conducted a study on the relationship between cost leadership strategy, total quality management applications and financial performance in micro, small and medium enterprises found in İstanbul and Gebze, Turkey. The study adopted a survey research design and questionnaires were used to collect data from the target population 600 middle and top level managers and directors of the companies. The findings show that cost leadership has a positive and statistically significant effect on performance but this relationship is mediated by TQM practices.

Kharub, Mor and Sharma (2018) examined the relationship between cost leadership strategy competitive strategy and firm performance of MSMEs situated in the state of Himachal Pradesh in India. The study adopted a survey research design and the target population was 381 respondents, with a response rate of 65.1 percent achieved. The findings indicate there is no direct nor significant relationship between cost leadership competitive strategy and firm performance.

Kahingo and Waithaka (2018) conducted a study on the effect of cost leadership strategy on the sustainability of MFIs in Murang’a County. The study used a descriptive survey design and targeted the senior managers of the MFIs. Most of the respondents agreed that to a great extent cost leadership strategy affects the sustainability of MFIs. The regression analysis showed that cost leadership strategy has a positive and statistically significant relationship with sustainability of MFIs in Murang’a County. Additionally, MFIs offered products/services to broad customer segment, using technology like mobile banking and had a flexible loan repayment schedule.

Nyachwaya and Rugami (2020) examined the effect of competitive strategies on performance of commercial banks in Mombasa County, Kenya. The study utilized a descriptive survey design and the target population was 280 commercial banks staff in Mombasa County. The findings established that there exists a relationship between competitive strategies and performance. The study also indicated that cost leadership strategy recorded the highest mean of 3.19 with a standard deviation of 0.547 followed by differentiation strategy with a mean of 2.85 and a standard deviation of 0.662 and finally focus strategy with a mean of 2.76 with a standard deviation of 0.643. Furthermore, low cost leadership strategy had the strongest significant influence on firm performance.

RESEARCH METHODOLOGY

Methods

This study employed a descriptive research design and survey design. A descriptive research determines and reports the way things are and attempts to describe things as possible behavior, attitudes, values and characteristics (Mugenda & Mugenda, 2003).

The target population of this study was 40 listed commercial banks at their headquarters in Nairobi County. Since this number is small, the study adopted a census study design. The respondents selected by the researcher were those in senior management positions of these banks because they will be able to provide valuable and relevant data on the study objectives. One Chief Financial Officer (CFO), one regional director and one branch manager from each bank were the respondents, therefore, comprising a total of 120 respondents.

The study used a questionnaire developed by the researcher to collect primary data. The questionnaire consisted of close-ended questions (Mugenda and Mugenda (2003) in line with the objectives of the study, while secondary data (on profitability/ROA) was collected by a secondary data collection sheet. A pilot test was done test the instrument's validity and reliability.

Data Analysis and Presentation

After the data has been collected, it will be cleaned to ensure that it is complete for analysis. This will be done by removing any incomplete questionnaires and checking for consistency. Data analysis was based on quantitative analysis, which will be done with the help of SPSS version 25 software and will include descriptive and inferential analysis. Descriptive analysis involved determination of percentages, means, standard deviations and frequencies. Inferential analysis involved multiple regression analysis to determine the relationship between selected competitive strategies on performance of commercial banks. The regression model that was used in the study is:

$Y = \beta0 + \beta1X1 + \beta2X2 + \beta3\ X3 + \beta4\ X4+\varepsilon$

Where:

Y = Performance of commercial banks

$\beta0$ is the constant

$\beta1 \ldots \beta4$ are the coefficients of the independent variables

X1 = Cost leadership strategy

X2 = Focus strategy

X3 = Differentiation strategy

X4 =Innovation strategy

ε is the error term

RESEARCH FINDINGS AND DISCUSSIONS

Descriptive statistics

The descriptive statistics were summated responses on the statements measuring the study's independent variables (cost leadership strategy, and dependent variable (performance of commercial banks) using Likert scale with values ranging from 5 to 1; that is; 5=Strongly Agree, 4=Agree, 3= Neutral, 2=Disagree and 1= Strongly Disagree, and some 1-Very little extent, 2-

little extent, 3-moderate extent, 4-Great extent and 5-Very great extent The results are presented in the table form showing each variable and its corresponding grand mean of responses
The grand mean is 3.502 rounded off to 4 corresponds to ‘great extent’ on the likert scale used meaning that effective use of selected cost leadership strategies (low interest, low operating costs and competitive pricing) to a great extent influences performance of the commercial banks studied. The findings are consistent with Kahingo and Waithaka (2018) study on the effect of cost leadership strategy on the sustainability of MFIs in Murang’a County, where most of the respondents agreed that to a great extent cost leadership strategy affects the sustainability of MFIs.

Regarding the overall performance of the commercial bank, there were mixed responses, because, while 34 generally agreed that the bank generally improved in performance in terms of profitability, ROA, 29 respondents were neutral and the grand mean of responses is 3.441 which is in between agree and disagree on the likert scale; implying that while commercial may have had an increase in profitability, not all commercial banks may have realized an increase in customer base and market share, or performed better than the industry average due to the outbreak of COVID-19 which has had a profound impact on the banking industry, particularly after the implementation of health protocols to avert its spread.

Descriptive statistics

Variable	5	4	3	2	1	Grand mean
1. Cost leadership strategy	29	40	10	13	11	3.502
2. Performance of commercial banks	16	34	29	19	5	3.441

Valid list wise 103

Inferential analysis

Coefficient analysis showed that Cost leadership strategy had positive significant influence on performance of commercial banks in Nairobi County ($\beta = 0.724$ (0.063); at $p<.01$). This implies that a single improvement in the effective application of cost leadership tactics will lead to 0.724 unit increase in the performance of commercial banks in Nairobi County. Therefore, the linear regression equation is;

(i) $y = 1.204 + 0.724X1$

Where;

y = performance of commercial banks in Nairobi County

X1 = Cost leadership strategy

Multiple regression analysis was computed to assess the multivariate influence of the study’s independent variables (cost leadership, differentiation, focus and innovation strategies) on the dependent variable (performance of commercial banks in Nairobi County).

Table 4.8 Multiple regression analysis

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.914a	.836	.829	.56019	.836	124.666	4	98	.000

ANOVAb

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	156.486	4	39.122	124.666	.000a
	Residual	30.753	98	.314		
	Total	187.240	102			

a. Predictors: (Constant), Innovation Strategy, Differentiation Strategy, Cost Leadership strategy, Focus Strategy

b. Dependent Variable: performance of commercial banks in Nairobi County

The model's R squared (R2) is 0.836 which shows that the study explains 83.6% of variation in performance of commercial banks in Nairobi County, while other factors not in this study's model accounts for 16.4%, hence, it is a good study model.

Unstandardized regression coefficients with standard errors indicated that cost leadership strategy; $\beta = 0.387$ (0.078) at $p<0.05$ significantly influenced performance of commercial banks in Nairobi County.

Discussion

Multiple regression results showed that cost leadership strategy has positive significant effect on performance of commercial banks in Nairobi County (βeta = 0.407 significant; at $p<.05$). This implies that a single improvement in the effective application of cost leadership tactics will lead to 0.407 unit increase in the performance of commercial banks in Nairobi County.

The results are consistent with Kurt and Zehir (2016) study on the relationship between cost leadership strategy and financial performance in micro, small and medium enterprises in İstanbul and Gebze, Turkey, whereby the findings showed that cost leadership has a positive and statistically significant effect on performance. The results also concur with Nyachwaya and Rugami (2020) study that found a significant positive relationship between cost leadership strategy and performance of commercial banks in Mombasa County, Kenya; showed a mean of mean of 3.19 with a standard deviation of 0.547.

However, the results differ with Kharub, Mor and Sharma (2018) who examined the relationship between cost leadership strategy competitive strategy and firm performance of MSMEs situated in the state of Himachal Pradesh in India; where the study findings showed no direct nor significant relationship between cost leadership strategy and firm performance. May be the non-significant relationship could have due to sampling and measurement errors.

CONCLUSION AND RECOMMENDATION

Conclusion

The study concludes that one, cost leadership strategy significantly influences performance of commercial banks in Nairobi County; that is, effective use of cost leadership approaches such as low interest, low operating costs and competitive pricing can enhance performance of commercial banks.

Recommendation

The study recommends that relevant management team of commercial banks should craft viable cost reduction strategies to reduce bank operation costs so as to enhance the banks' financial and non-financial performance.

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