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Abstract

The insurance uptake in Kenya is estimated to be at 6.8% of population and is served by 50 insurance companies who are members of the Association of Kenya Insurance. Evidently, the competition within the industry must be steep for any insurance firm seeking to make substantial gains in market share. Creating cost advantages and leveraging on them can significantly improve the performance prospects of the insurance firms and enable them to remain competitive in the active markets and break new ground in potential markets. However, the aspect of cost leadership has not been explored in detail in regards to the competitiveness of insurance firms in Kenya. The objective of the study, therefore, was to determine the effect of cost leadership strategy on performance of insurance companies in Nairobi, Kenya. The study was guided by the Resource Based View strategies. Descriptive survey design was adopted for the study that also targeted 1443 top, middle and lower level managers in 43 insurance companies registered in Nairobi. From these 54 managers were selected for the study using systematic random sampling. Data was collected using pretested copies of a structured questionnaire developed by the researcher. Data was analyzed using both descriptive and inferential statistical methods. The findings revealed that the cost leadership strategy employed by the insurance firms moderately affected their performance. The study recommended that insurance firms should embrace and invest in cost leadership strategies most especially forming linkages with service providers, suppliers and other supplementary institutions.

Keywords: *Cost leadership Strategy, Generic Strategies, Performance*

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INTRODUCTION

Competition is so high in today's business environment, and this is bound to increase as businesses seek to tap into new markets, innovate new products and services and generally expand. Evolving customer needs and tastes, changes in technology and government regulations also inform the competition in the business world. Among the business sectors significantly affected by these changes is the insurance industry. The competition is especially intense in Sub Sahara Africa where insurance penetration is the lowest globally and firms have to compete for the small market that at best registers marginal growth. For example, the insurance uptake in Kenya is estimated to be at 6.8% of population (IMF, 2017) and is served by 50 insurance companies who are members of the Association of Kenya Insurance (AKI, 2018). Evidently, the competition within the industry must be steep for any insurance firm seeking to make substantial gains in market share. The increasing competitive pressure, therefore, requires organization to engage in activities that will generate high performance and a competitive advantage (Jones & Linderman, 2014).

Having a competitive advantage makes a business to create higher value for its market and excellent revenues for itself (Huang, Dyerson, & Harindranath, 2015). Competitive advantage is in turn actualized by competitive strategies. Competitive strategies encompass all the actions and tactics that an organization has and is utilizing in attracting customers, survive competition pressure and improve their market position the popular ones in literature being those advanced by Porter (1980); Differentiation, Cost Leadership and Market Niche strategies. While several insurance companies have well differentiated products and focus markets, the issue of premium costs still largely remains unaddressed. For the economies of Sub-Sahara Africa, the costs of premiums are still considered high and this coupled with other factors make uptake of insurance slow and the growth of the industry marginal. For instance, South Africa registered a growth of 12.9% in insurance uptake in 2016 while Kenya in 2016 posted a 2.84% increase in the same year which was a marginal increase compared to the 2.63% posted in 2015. This, therefore, makes it imperative for the insurance firms to re-examine their costing methods relative to the market demands and build their strategies around these in order to obtain competitive advantage. One notable strategy in this regard is the cost leadership strategy proposed by Porter 1980). However, the extent to which cost leadership strategies affect performance of insurance firms in Nairobi, Kenya is not known.

Problem Statement

In Kenya, the present operational set up of the insurance industry is a dynamic one characterized with intense competition due to the presence of numerous insurance organizations. In 2016 Kenya was ranked as one of Africa's most mature insurance markets, with growth forecast at 6% a year. Despite its promise the growth in the industry is still small compared to other peer markets such as South Africa. Therefore, the industry players have to share out the small active market among themselves. Further, in 2018, of the 37 companies that were licensed by the Insurance Regulatory Authority (IRA) to conduct short term business, 7 posted losses before taxes while one did not file. Long term business saw 5 insurers make losses from 26 that are licensed. Although Short Term Business saw a 35.9% increase in profit before tax (PBT), Long Term Business PBT plunged 42.1% due to a 24.1% increase in benefit payout. Creating cost advantages and leveraging on them can significantly improve the performance prospects of the insurance firms and enable them to remain competitive in the active markets and break new ground in potential markets. However, the aspect of cost leadership has not been explored in detail in regards to the competitiveness of insurance firms in Kenya. There is limited research in this field and specifically relating to cost leadership as a competitive strategy used by insurance industry in Kenya. This research was meant to fill this gap by establishing the effect of differentiation strategy on performance of insurance companies in Nairobi, Kenya.

Objective of the Study

The objective of the study was to determine the effect of cost leadership strategy on performance of insurance companies in Nairobi.

The study was guided by the following hypothesis;

H01: Cost leadership strategy does not significantly affect performance of insurance companies in Nairobi

LITERATURE REVIEW

Resource Based View

The original idea of viewing a firm as a bundle of resources can be traced back to Kor and Mahoney (2004), who argues that it is the heterogeneity, not the homogeneity, of the productive services available from its resources that give each company its unique character. The view of the firm's resources heterogeneity is the basis of the resource based view (RBV) and was advanced by Wernerfelt (1984), suggesting that the evaluation of companies in terms of their disposable resources could lead to different insights from traditional perspectives that view competitive advantage as a rather external paradigm and argue that the alignment of a firm to its external environment is the main determining factor for a firm's profitability. Barney (2007) developed a framework for the identification of the properties of firm resources needed for the generation of a sustainable competitive advantage. The properties include whether resources are valuable, rare among a firm's current and potential competitors, imitable, and non-substitutable. If resources have these characteristics they can be seen as strategic assets. Subsequently, this notion has been adopted by many researchers and expanded to include the properties of resource durability, non-tradability, and idiosyncratic nature of resources.

The RBV can be depicted as an "inside out" process of strategy formulation. Resources are the specific physical, human, and organizational assets that can be used to implement value-creating strategies. Capabilities present the capacity for a team of resources to perform a task or activity (Grant, 2002). In other words, capabilities present complex bundles of accumulated knowledge and skills that are exercised through organizational processes, which enable companies to coordinate their activities and make use of their assets. According to Collis (1994), capabilities are always vulnerable to be competed away by a competitor's higher order capability amongst other limitations such as erosion or substitution.

A central thrust of the RBV is the contribution of core competencies as strategic assets, which continues to source new products and services through whatever future developments may take place in the market, which by their nature, are not known. The emphasis of the RBV approach to strategic management decision-making is on the strategic capabilities as basis for superiority of the firm rather than attempting to constantly ensure a perfect environmental fit. Whereas traditional strategy models focus on the organization's external competitive environment, the RBV accentuates the need for a fit between the external market context in which a firm operates and its internal capabilities. From this perspective the internal environment of an organization, in terms of its resources and capabilities, is the critical factor for the determination of strategic action. In other words, the central premise of RBV addresses the fundamental question of how firms achieve and sustain competitive advantage by deploying their resources. Maximal resource deployment can be a significant approach to achieve cost leadership in the firm as the firm looks into its internal capabilities especially its productive

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capabilities and leverages on them to lower production and distribution costs and, thus, enabling it to deliver its products to the market at affordable prices.

Cost leadership strategy and firm performance

Cost leadership strategy main emphasis is the firm getting competitive edge through having the lowest industrial cost. Literature discusses the interrelations between cost leadership and firm's strategic choice. Organization that engages the use of cost leadership is likely to achieve more gains from the utilization of leverage in form of increased managerial efficiency. As explained by Porter (1985), cost leadership entities are required to control cost tightly, desist from more expenditure on innovation or marketing and reduction of prices of commodities. Two chief ways proposed by Jensen (1986) for attaining better performance with cost leadership strategy; Increment of profits through cost reduction, and increment in market share by reducing prices. Further, there are many factors that help in achieving cost leadership which include technology, mass production and distribution, economies of scale, services as well as products design, input cost and exploitation of resources to capacity.

Cost leadership strategies are affected by unique skills of the entity to attain and sustain low cost position within the industry they are operating in. This approach can provide significant competitive advantage to insurance firms when well applied as insurance being a product purchased on a long term basis is sensitive to macroeconomic conditions chief among them inflation which affects the purchasing power of the consumer and the present value of the premiums. Therefore, the insurance firms could gain significantly like other industries by applying cost leadership to reduce their operational costs and at the same time offer inexpensive premiums to the market. However, the extent to which cost leadership strategies affect performance of insurance firms in Nairobi, Kenya is not known.

METHODOLOGY

Descriptive survey design was adopted for the study. This research design fitted the study since it is an efficient method for systematically collecting data from a broad spectrum of individuals making it possible to collect a large amount of data on the study problem with minimum effort. The population of interest for this study comprised of all the 43 insurance companies registered in Nairobi as of December 2017. The accessible population was the management of the insurance firms because they were the ones involved in strategy formulation and implementation. Data from the human resource management of the various firms put the total number of managers, that is, lower level, middle level and top level at 1443 persons. Since the population of interest to the study was sufficiently large to warrant probability sampling, the actual sample size was obtained using the method recommended by Nassiuma (2000);

$$n = \frac{Nc^2}{c^2 + (N-1)e^2}$$

Where n = sample size, N = population size, c = coefficient of variation (≤ 30%), and e = error margin (≤ 5%). In this study c was taken as 30%, *e* to be 4% and N = 1443, therefore, fitting this into the formula:

$$n = \frac{1443 * (0.3)^2}{(0.3)^2 + (1443 - 1) * (0.04)^2} = 54.18 \approx 54$$

Therefore, 54 managers were selected for the study. Systematic random sampling was used to select the respondents using predetermined sampling intervals to ensure every firm was involved in the study. This method ensures that large populations can be analyzed with every member of the population having an equal chance of being included, therefore, minimizing bias (Kombo & Tromp, 2009). Copies of a structured questionnaire developed by the researcher were used to collect data. The questionnaires were preferred in this study because respondents of the study were literate and quite able to answer questions asked adequately. The questionnaire was carefully designed and tested with among a pilot group of seven respondents from selected insurance firms. This was done in order to enhance its validity and reliability for accuracy of data to be collected for the study. The validity of the instrument was determined through content validity. This was done by subjecting the questionnaire to scrutiny and review by the researcher's supervisors at the University to ensure that all the items used in the questionnaires were consistent and valid. Some items were, however, rephrased and modified to avoid ambiguity before being used for data collection. In this study reliability test was done on all the variables of the questionnaire. Cronbach's Alpha coefficient was used as a test for the reliability of the instrument. Data was analyzed using both descriptive and inferential statistical methods. Descriptive statistical analysis was done using, frequencies and percentages to describe the basic characteristics of the data. Inferential data analysis was done using the Pearson's Product-Moment Correlation Coefficient. Correlation analyses was used to measure the relationship between variables. The importance of this was that the results of the analysis can be generalized to the larger population.

FINDINGS

A total of 54 instruments were administered to staff in the 9 selected insurance firms in Nairobi, Kenya. All the questionnaires were dully filled and returned hence the response rate was 100%.

Cost leadership and Performance of Insurance Firms in Nairobi County

The respondents were asked to indicate the extent to which cost leadership affect performance in their organization. A Likert scale of 1 to 5 was used with 1 representing not at all and 5 representing very great extent. Correspondingly; 1 = Not at all; 2 = Little extent; 3 = Moderate extent; 4 = Great extent; 5 = Very great extent. The results were summarized in Table 1.

Table 1: Extent to Which Aspects of Cost Leadership Affect Performance

Statement (n=54)	5 F(%)	4 F(%)	3 F(%)	2 F(%)	1 F(%)	Mean	Std. Dev.
We use economies of scale to reduce costs of our products	34(63.0%)	18(33.3%)	2(3.7%)	0(0.0%)	0.0(0%)	4.59	0.567
Capacity utilization of resources	34(63.0%)	20(37.0%)	0(0.0%)	0(0.0%)	0(0.0%)	4.63	0.487
Reduction in operations time and costs	24(44.4%)	28(51.9%)	2(3.7%)	0(0.0%)	0(0.0%)	4.41	0.567
Efficiency and cost control	27(50.0%)	26(48.1%)	1(1.9%)	0(0.0%)	0(0.0%)	4.48	0.540
Forming linkages with service providers, suppliers and other supplementary institutions	39(72.2%)	10(18.5%)	5(9.3%)	0(0.0%)	0(0.0%)	4.63	0.653

From the findings, in the table above, majority (63%) of the respondents were of the opinion that economies of scale and capacity utilization of resources affect performance to a very great extent. This is further supported by a mean of 4.59. A majority (51.9%) of respondents were of the opinion that reduction in operations time and cost affects performance to a great extent as also evidenced by mean of 4.636. Again, a majority (50% and 72.2%) of the respondents had a feeling that efficiency and cost control and forming linkages with service providers, suppliers and other supplementary institutions respectively affect performance to a very great extent. None of the respondents rated the aspects as affecting performance to a little extent and not at all. This was a clear indication that all the indicators of cost leadership under consideration affect performance to some extent. The results were in agreement with those obtained by Atikiya (2015) in the study on the effects of competitive strategies on the performance of manufacturing firms in Kenya. In their study majority of the respondents agreed that the indicators of cost leadership that they considered affected the firm's performance. They also established that cost leadership had a significant positive effect on the firm's performance.

Performance of Insurance Firms

The study also sought to establish the performance of insurance firms in Nairobi County. A Likert scale of 1 to 5 was used with 1 representing not at all and 5 representing very great extent. Correspondingly; 1 = Greatly Decreased; 2 = Decreasing; 3 = Constant; 4 = Improved; 5 = Greatly Improved. The findings were presented in Table 2.

Table 2: Trend of Various Aspects in the organization for the Last Five Years

Statement	5 F(%)	4 F(%)	3 F(%)	2 F(%)	1 F(%)	Mean	Std. Dev.
Revenue has increased in the last five years	0(0.0%)	20(37.0%)	34(63.0%)	0(0.0%)	0(0.0%)	3.01	0.662
We have improved on the quality of the service	0(0.0%)	32(59.3%)	16(29.6%)	6(11.1%)	0(0.0%)	3.33	0.763
We have been able to increase our product portfolio	1(1.9%)	19(35.2%)	33(61.1%)	1(1.9%)	0(0.0%)	3.38	0.86
We have been increasing our numbers of new customers in the last five years	21(38.9%)	6(11.1%)	27(50.0%)	0(0.0%)	0(0.0%)	3.11	0.705
Investors are showing considerable interest in partnering with us	0(0.0%)	26(48.1%)	2(3.7%)	26(48.1%)	0(0.0%)	3.14	0.841
Our branches are able become profitable within the first one year after inception	0(0.0%)	11(20.4%)	2(3.7%)	41(75.9%)	0(0.0%)	2.91	1.125
Our growth strategies have led to good returns on investment	0(0.0%)	15(27.8%)	38(70.4%)	1(1.9%)	0(0.0%)	2.98	1.055

From the findings, it was evident that revenue had been constant in most firms for the last five years as expressed by 63.0% of the respondents. However, majority (59.3%) of the respondents were of the view that quality of service had greatly improved in the last five years though their product portfolio had also remained constant (61.1%) and the numbers of customers had remained constant (50.0%). The firms were, however, split on whether investors were showing considerable interest in partnering with them (48.1%). Most disagreed that their branches had been able become profitable within the first one year after inception (75.9%). In majority of the firms, there was uncertainty on whether their growth strategies had led to good returns on investment. These findings imply that generally the performance of the insurance firms in the area was low as indicated by the measures. This agrees with OBG (2018), that the sector is experiencing lackluster performance as a result of slow growth amid issues with fraudulent claims, particularly in the medical and motor segments. Kenyan insurers are also struggling to expand coverage among a large informal economy and income-sensitive population.

Hypothesis Testing

Correlation analyses was used to measure the relationship between differentiation strategy and the performance of the insurance firms in the area. Table 3 gave the correlation analysis results.

Table 3: Correlation results between differentiation and performance

	Variable	Correlation	Sign
Independent Variable			
	Performance of Insurance Firms		
Dependent Variable			
	Cost leadership	0.292	0.001
	N = 54		

From the results in Table 3, it was established that there was a significant moderate and positive relationship between performance and cost leadership as indicated by the correlation coefficient of 0.292 and a p value of 0.000 < 0.005. This led to the rejection of the null hypothesis;

H01: Cost leadership strategy does not significantly affect performance of insurance companies in Nairobi

The implication of the above results was that the dependent variable, that is, performance of the insurance firms had been moderately affected by cost leadership strategies and was bound to improve when the firms put more emphasis on cost leadership. The moderate reflection of the cost leadership strategy on firm performance could be explained by the observation of Porter (1996) that the firm must have a high market share that generates high sales volume in order to successfully develop and implement the cost leadership strategy. It was observed that the firms had marginal growth of customers and corresponding marginal growth in sales volumes implying that they were not implementing the cost leadership strategy as expected.

CONCLUSIONS AND RECOMMENDATIONS

The study looked at the effect of cost leadership strategy and differentiation strategy on performance of organizations. The study revealed that majority of the firms were utilizing the economies of scale and capacity utilization of resources to attain cost leadership in the market. Further, most of the firms were pursuing reduction in operations time and cost and this was having an important impact on organizational performance. In addition, efficiency and cost control and forming linkages with service providers, suppliers and other supplementary institutions respectively were linked to firm performance. It was also established that there was a significant moderate and positive relationship between performance and cost leadership as indicated by the correlation coefficient of 0.292 and a p value of 0.000 < 0.005. This led to the conclusion that the performance of the insurance firms had been moderately affected by cost leadership strategies and was bound to improve when the firms put more emphasis on cost leadership.

The study recommended that insurance firms should embrace and invest in cost leadership strategies most especially forming linkages with service providers, suppliers and other supplementary institutions since it will enable them achieve competitive advantage as compared to other organizations that are not investing in these strategies.

Suggestions for Future Research

The study recommended that future research should be done on the differentiation strategies being employed by insurance firms in Kenya. Also, studies should be done on the effects of bancassurance strategies on performance of insurance firms in Kenya.

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