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ABSTRACT

This study sought to investigate the effect of cost leadership strategy on performance of manufacturing firms in Kenya. A survey questionnaire and an interview guide was used to collect data from 131 firms drawn from 12 key industrial subsectors located within Nairobi and its environs. The study adopted two tools of analysis namely; Pearson's correlation to indicate positive correlation between the input and the output variable and regression analysis to explain the nature of relationship between the input and output variable. F-statistics was also used to determine the validity of the model while R-squared was used to help determine the model goodness of fit. The study adopted descriptive and explanatory research design. The findings revealed that performance of manufacturing firms are significantly influenced by cost leadership strategy. Arising from the findings, the study concludes that the managers of manufacturing firms adopt cost leadership strategy to increase their competitiveness and performance.

Keywords: Strategy, Cost-leadership strategy, Firm performance

INTRODUCTION

In this highly dynamic and uncertain environment, competitiveness is inevitable. As a result, organizations wishing to remain ahead of competition should therefore pursue suitable strategies. Business strategies have been found to have direct influence on firm's competitiveness and growth Sandlberg (1986). Porter (1985), posit that three competitive strategies namely; cost leadership strategy, differentiation and focus strategies are key to achieving competitive advantage and improving organizational performance. The focus of this paper is cost leadership strategy as it is one of the commonly used strategy dimensions in the literature.

Cost leadership strategy is an integrated set of action taken to produce goods or services with features that are acceptable to customers at the lowest cost, relative to that of competitors (Ireland, et. al, 2011). Cost Leadership also tends to be more competitor oriented rather than customer oriented (Frambach, et. al, 2003). Porter (1980), posit that a firm that successfully pursues cost leadership strategy emphasizes vigorous pursuit of cost reduction, tight cost and overhead control, research and development and advertisement among others to achieve a low cost position.

STATEMENT OF THE PROBLEM

Manufacturing firms in Kenya like in other parts of the world have been experiencing challenges of having to cope with competitiveness in this dynamic business environment. The sector contribution to GDP worsened from 9.6 per cent in 2011 to 9.2 per cent in 2012 while the growth rate deteriorated from 3.4 per cent in 2011 to 3.1 per cent in 2012 (KIPPRA, 2013). These firms are however expected to play a critical role in propelling the country's economy to a 10 per cent growth rate, in line with the aspirations of vision 2030 and in supporting the country's social development agenda through the creation of jobs, the generation of foreign exchange and by attracting foreign direct investment. This is an indication that there is a large potential to improve Kenya's competitiveness in the region. Findings from other parts of the world indicate that formulating appropriate strategy yields superior performance (Porter, 1980; Campbell-Hunt, 2000, Dess & Devis, 1984). This study therefore sought to establish the effect of cost leadership strategy on performance of manufacturing firms in Kenya as an intervention to remain competitive in the global economy.

RESEARCH QUESTION

The study sought to answer one key question:

To what extent does cost leadership strategy affect performance of manufacturing firms in Kenya?

LITERATURE REVIEW

The study was founded in Porter's competitive business strategy typology which argues that three generic strategies namely; low cost, differentiation and focus helps create defendable position that contribute to a competitive advantage. This is based on available literature that states that Porter's (1980) typology seem to be the most popular paradigm and has received much more research attention than any other typologies (Kumar, Subramanian & Strandholm, 2001). It is further acknowledged that Porter's framework of generic strategies is also inherently tied to firm performance (Powell, 1995).

According to Porter (1985), firms pursuing any of the three generic strategies namely; cost leadership strategy, differentiation and focus strategy could achieve better organizational performance and competitive advantage. He further posits that low-cost position gives a

firm defense against rivalry from competitors, because its lower costs means that it can still earn returns after its competitors have competed away their profits through rivalry. Firms adopting cost leadership strategy try to be the low-cost producers in the markets.

Sources of cost advantage depend on industry structure. Cost advantages may come from economies of scale, economies of scope, propriety technology, and preferential access to materials among other factors. With cost advantages, firms are able to have above-average return or can command price. Grant (2005) argues that common to the success of Japanese companies in consumer goods industries such as cars, motorcycles, consumer electronics, and musical instruments has been the ability to reconcile low cost with high quality and technological progressiveness.

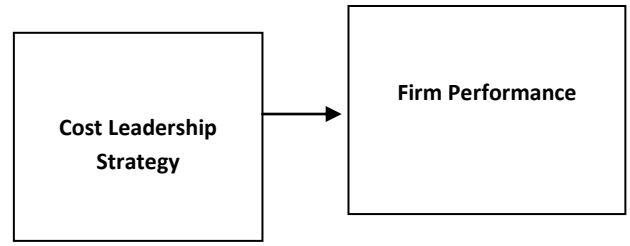
This position is further supplemented by Barney and Hesterley (2006) who affirm that few layers in the reporting structure; simple reporting relationships, small corporate staff, and focus on narrow range of business functions are elements of organizational structure that allow firms to realize the full potential of cost leadership strategies. It is important to note however, that a company might be a cost leader but that does not necessarily imply that the company's products would have a low price. In certain instances, the company can for instance charge an average price while following the low cost leadership strategy and reinvest the extra profits into the business Lynch (2003). The risk of following the cost leadership strategy however, is that the company's focus on reducing costs even sometimes at the expense of other vital factors may become so dominant that the company loses vision of why it embarked on one such strategy in the first place.

Performance is the ability of an object to produce results in a dimension Laitinen (2002). According to Rauch et al.(2009), there are two types of firm performance. They care perceived firm performance and archival data. Archival data involves aspects of firm performance especially related to financial performance measured from secondary sources while perceived performance involves use of perceptions of managers in a firm about the company's performance. This study chose to use perceived indicators to measure firm performance. This is considered to be the most appropriate measure as discussions with managers suggested that in general it was not possible to obtain a wide range of hard measures of performance. This study also seeks to understand how managers initiate certain set of strategy it necessitate a focus on manager perception hence use of perceived indicators. These indicators include managers view on; sales growth rate, sales, profit growth rate, profit, profitability ratio and overall performance

Conceptual Framework

Deriving from the literature review the following depicts the conceptualization of the study:

Fig 1: Conceptual framework



RESEARCH METHODOLOGY

To test the effect of cost leadership strategy on performance of manufacturing firms, the study adopted descriptive and explanatory research design. The data was gathered once over a period of one month from a sample of 131 manufacturing firms in Kenya. The manufacturing sector was chosen since it is

one of the key drivers for realizing a sustained annual GDP growth of 10 per cent and has high potential for employment creation and poverty alleviation. Pearson's correlation was further used to indicate positive correlation between the input and the output variable and further regression analysis to explain the nature of relationship between the dependent and independent variables. F-statistics was also used as a measure of the model goodness of fit.

MEASUREMENT OF VARIABLES

The variables in this study were measured using perceptual indicators. Cost leadership strategy was measured depending on fifteen items namely; we charge lower price than our competitors, we heavily invest in sales promotion, we reduce labour input through automations, we charge higher than our competitors, we source for our supplies from those suppliers who provide discount, we do not emphasize on cost cutting and internal efficiency program, we vigorously pursue cost reduction, our competitors' products are sold at relatively affordable price, we have access to low cost raw materials than our competitors, we strive to reduce cost in administration activities, our major expenditure is on technology based delivery system to lower costs, we outsource functions to control costs, we continuously exercise tight cost control and pay attention to details, we identify underperforming areas in order to cut costs and we focus on product design technique that economize on cost of materials. However, a five point likert type scale ranging from one (Strongly agree) to five (Strongly Disagree) was used. These measures have been adopted from previous research (Dess & Devis 1984). A number of items were however amended for the purpose of clarity. The Cronbach alpha was 0.68 which indicates internal reliability of the scale was satisfactory. According to Bryman and Cramer (1997) reliability as low as 0.70 is normally acceptable for basic research. Based on the coefficient values, the results indicate that the data has a high level of internal consistency. Several parameters were used as a measure of firm performance. These include: sales growth rate, sales, profit growth rate, profit, profitability ratio and overall performance. Five point likert type scale ranging from one (much worse) to five (much better) was used. The Cronbach alpha was 0.9 which indicates satisfactory internal reliability of the scale.

RESEARCH FINDINGS AND DISCUSSIONS

Descriptive analysis for Cost Leadership Strategy

The study findings depicted that majority of the respondents 43.5% agreed that they charge lower price as compared to their competitors. The manufacturing firms are involved in aggressive sales and promotions since majority 49.6% agreed that they imvest heavily in sales promotions. Moreover, most of the manufacturing firms are reducing their labour cost through automation of their production process as accounted for 42.3% who agreed on the same. Majority of the respondents agreed that they charge higer than their competitors as accounted by mean of 3.8 while 3.9% strongly disagreed that they charge higher than their competitors.

In addition, the study findings showed that majoriry 38% agreed that they source their supplies from suppliers who provide a discount while majority 29.2% agreed that they do not emphasize on cost cutting and efficiency. Further, 48.8% agreed that they vigorously perform cost reduction and 30% agreed that their competitors products are sold at relatively affordable price. The major expenditure for manufacturing companies was on technology as accounted for by 44.2% who reported that their major expenditure is on technology based delivery system to lower costs. Moreover, 43.4% of the respondents agreed that they outsource functions so as to control costs and 35.4% agreed that they have cheaper sources of raw materials as compared to their competitors. Further, 50.4% agreed that they strive to reduce cost in administration activities while 46.5%

agreed that they continuously exercise tight cost control and pay attention to details and 48.1% agreed that they strive to identify underperforming areas in order to cut costs. Finally, 50% agreed that they focus on product design technique that economizes on cost of materials. Table 1 presents the descriptive statistic for this factor.

Table 1: Descriptive statistics for Cost Leadership Strategy.

Cost Leadership Strategy	(%) SD	D	N	A	SA	Mean	S.D
We charge lower price than our competitors	4.6	6.1	22.1	43.5	23.7	3.8	1.0
We heavily invest in sales promotion	2.3	7.6	16.8	49.6	23.7	3.8	0.9
We reduce labour input through automations	3.8	13.8	26.2	42.3	13.8	3.5	1.0
We charge higher than our competitors	3.9	6.2	26.4	38	25.6	3.8	1.0
We source for our supplies from those suppliers who provide discount	11.5	7.7	12.3	35.4	33.1	3.7	1.3
We do not emphasize on cost cutting and internal efficiency program	22.3	23.1	20	29.2	5.4	2.7	1.3
We vigorously pursue cost reduction	3.1	6.2	17.1	48.8	24.8	3.9	1.0
Our competitors' products are sold at relatively affordable price	4.6	16.2	35.4	30	13.8	3.3	1.1
We have access to low cost raw materials than our competitors	4.6	17.7	32.3	35.4	10	3.3	1.0
We strive to reduce cost in administration activities	1.6	7	22.5	50.4	18.6	3.8	0.9
Our major expenditure is on technology based delivery system to lower costs	1.6	8.5	21.7	44.2	24	3.8	1.0
We outsource functions to control costs	4.7	22.5	20.2	43.4	9.3	3.3	1.1
We continuously exercise tight cost control and pay attention to details	1.6	10.1	17.8	46.5	24	3.8	1.0
We identify underperforming areas in order to cut costs		8.5	20.9	48.1	22.5	3.8	0.9
We focus on product design technique that economize on cost of materials	0.8	8.6	15.6	50	25	3.9	0.9

n=131

SD=strongly disagree D=Disagree N=Neutral A=Agree SA= Strongly agree S.D=Standard deviation.

Descriptive analysis for firm performance

The study findings showed that majority 45.7% reported that their firm's sales growth rate was better with 54.3% reporting that their sales was better. Secondly, majority 52% of the respondents further reported that their profit growth rate was better, while 59.5% reported that their profit for the last five years was better. 50.4% reported that their profitability ratio was better. On overall majority 56.3% reported that their firms overall performance was better.

Table 2: Descriptive analysis for Firm Performance

	(%) MW	W	I	B	MB	M	S.D
Sales growth rate for the past 5 years	1.6	8.7	15	45.7	29.1	3.9	1.0
Sales for the past 5 years	3.1	2.4	15.7	54.3	24.4	3.9	0.9
Profit growth rate for the past 5 years	2.4	7.1	18.1	52	20.5	3.8	0.9
Profit for the past 5 years	0.8	8.7	14.3	59.5	16.7	3.8	0.8
Profitability ratio for the past 5 years	1.6	7.9	22	50.4	18.1	3.8	0.9
Overall performance for the past 5 years		4	18.3	56.3	21.4	4.0	0.7

n=131

***MW** =Much worse **W** = worse **I** = Indifferent **B**=Better **MB** = Much Better, M=Mean SD= Standard deviation*

Correlation Analysis

The result from correlation analysis shows that there is a significant positive relationship between cost leadership strategy (X= 0.253, p value = 0.004) and firm performance. Therefore an increase in cost leadership strategy leads to an increase in firm performance.

Table 3: Correlation Analysis

		X	Y
Cost leadership	Pearson Correlation	1	.253* *
	Sig. (2-tailed)		0.004
		13	
	N	1	127

** Significant at 0.01 level (2 tailed), * significant at 0.05 (2 tailed)

Key Y=Firm performance X= Cost leadership strategy.

Regression Analysis

H_{01}: Cost leadership strategy has significant effect on performance of manufacturing firms in Kenya.

Cost Leadership and Manufacturing Firm Performance Model Summary

The coefficient of determination (R squared) of 0.064 shows that 6.4% of manufacturing firm performance can be explained by cost leadership strategy. The adjusted R square of 5.7% depicts that cost leadership strategy in exclusion of the constant variable explained the change in firm performance by 5.7% the remaining percentage can be explained by other factors excluded from the model. The R shows the correlation coefficient of the effects of cost leadership strategy, an R =0.253 shows that there is a positive relationship between cost leadership strategy and manufacturing firm performance. The standard error of estimate (0.70) shows the average deviation of the independent variables from the line of best fit.

Table 4: Cost Leadership and Firm Performance Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.253a	0.064	0.057	0.70124

a Predictors: (Constant), Cost leadership

Cost Leadership Strategy and Manufacturing Firm Performance ANOVA

The F statistics was used as a test for the model goodness of fit, in Table 7.4 (F=8.557, p value =0.00) shows that there is a significant relationship between cost leadership strategy and manufacturing firm performance and at least the slope (β coefficient) is not zero.

Table 5: Cost Leadership Strategy and Manufacturing Firm Performance ANOVA

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	4.208	1	4.208	8.557	.004b
	Residual	61.468	125	0.492		
	Total	65.676	126			

a Dependent Variable: Firm performance

b Predictors: (Constant), Cost leadership

Cost Leadership Strategy and Manufacturing Firm Performance Regression Weights

The study hypothesized that cost leadership strategy has no significant effect on performance of manufacturing firms in Kenya. The study findings depicted that there was a positive significant relationship between cost leadership strategy and manufacturing firm performance (β=0.338 and p value=0.004). Therefore, a unit increase in cost leadership strategy leads to an increase in manufacturing firm performance by 0.338. Since the p value was less than 0.05 the null hypothesis was rejected and the alternative hypothesis accepted. Therefore, we can conclude that cost leadership strategy have a significant influence on manufacturing firm performance in Kenya.

Table 6: Cost Leadership Strategy and Firm Performance Regression Weights

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.648	0.421		6.286	0.000
	Cost leadership	0.338	0.116	0.253	2.925	0.004

a Dependent Variable: Firm performance

DISCUSSION

The finding of the study greatly contradicts the hypothesis that cost leadership strategy has no significant effect on performance of manufacturing firms in Kenya. Result of regression analysis indicated that cost leadership strategy has significant effect on firm performance of manufacturing firm. Firms employing a cost leadership strategy appear to have an average performance compared to all other clusters (but not the lowest). An implication of this finding is the possibility that cost leaders, in a competitive environment, have an average performance because they are not focusing on acquiring new markets or customers. Similar conclusions were drawn by Marques et al (2000), Silva et al. (2000); and Lumpkin & Dess (2006).

SUMMARY AND CONCLUSION

The objective of this paper was to investigate the effect of cost leadership strategy on performance of manufacturing firms in Kenya. The empirical evidence from this study infers that cost leadership has significant effect on performance of manufacturing firm. The results of this study therefore provides a valuable reference for top manufacturing companies in Kenya in terms of implementing cost leadership strategy as this would help them achieve competiveness and sustainable performance.

RECOMMENDATIONS

Based on the findings, the study recommends that the manufacturing firms adopt cost leadership strategy as it has been found to have a positive significant effect on performance. In addition the managers of these firms should consider pursuit of the other strategies namely; differentiation and focus. A focus on more ways of dealing with the challenges is also needed for maximum profitability. Similarly, while the objective of this study was successfully accomplished, several areas remain unclear and require to be addressed by future research. For instance there is need to strengthen this study via a longitudinal study and compare the performance of different levels of businesses i.e. SMEs, ME and Large enterprises over a period of time since this study was conducted on a short span of time and establish whether there is any difference in performance of these businesses. Other studies could use objective measures to verify the findings of the current study as it used perceptual measures. Cluster analysis should be done on the manufacturing firms so as to determine which uses low cost strategy, focus, differentiation, mixed strategy or stuck in the middle.

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