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Cost-Leadership Strategy and Perceived Financial Performance of Selected Commercial Banks in Uganda

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Abstract

The objective of this study was to examine the effect of cost leadership strategy on perceived financial performance of commercial banks in Uganda. To achieve this objective, the study tested the following hypothesis: cost leadership strategy significantly affects perceived financial performance of commercial banks in Uganda. The study employed a cross-sectional correlational design, in which primary data was collected using self-completed questionnaires from a population comprising of Senior Managers of the 10 best ranked commercial banks in the country over the period 2015 – 2019. The data was analyzed descriptively using frequencies and percentages as well as inferentially using structural equation modelling. The results of hypothesis testing indicated a positive and statistically significant relationship between cost leadership strategy and perceived financial performance in terms of ROI ($\beta = 0.410$, $\varrho<0.05$). The conclusion of the study is that cost-leadership strategy is an important factor of perceived financial performance in Uganda. Therefore, in order to enhance perceived financial performance, commercial banks in Uganda should pursue cost leadership strategy, which is characterized by charging relatively low prices for products and services, purchasing inputs in bulk, regularly training employees in efficient resource utilization, adopting a lean approach in banking processes and operations, and regularly evaluating banking operations to ensure efficiency.

Keywords: Cost-leadership, Financial performance, Commercial banks, Uganda

1. Introduction

Competition in the banking industry is important for a couple of reasons. It influences the level of research and innovation (Cornaggia et al., 2015; Xia & Liu, 2021), efficiency of production of financial services (Tan & Floros, 2018), the quality of financial products (Huang et al., 2018), access to financial services by households and firms (Pham et al., 2019), and overall economic growth and development of countries (Jayakumar et al., 2018). Unprecedented competition has characterized the banking industry over the past two decades largely driven by financial market deregulation policies in most countries (Gao et al., 2019); increase in supply of bank services providers; proliferation of non-bank financial service providers such as insurance companies, telecom companies, building societies and estate agents; technological developments, and changing consumer tastes, preferences and demands (Aramonte et al., 2021; Dauda & Lee, 2015; Ghosh, 2018; Pousttchi & Dehnert, 2018; Sonono & Ortstad, 2017). Studies indicate that failure to manage competition can compromise bank performance (Sarpong-Kumankoma et al., 2018; Yuanita, 2019). Therefore, in the pursuit of performance maximization, banks are constantly pre-occupied with adopting and implementing competition management strategies.

Cost leadership is one of the competitive strategies widely used by commercial banks to enhance performance. Under this strategy, banks would strive to maximize performance through lowering costs of production to offer quality products and/or services but at low prices (Lepădatu, 2018). Effective implementation of cost leadership necessitates firms to emphasize efficiency at every step of their value chain including production, manufacturing, sales and customer service (Akan et al., 2006; Porter, 1985). The reduction in operational costs reduces the overall prices without reducing the profit margin, and eventually leads to prices that are, on average, lower than those charged by competitors (Doyran, 2020). Proponents of cost-leadership believe that having the lowest cost of operation in the industry may discourage new entrants in the industry and increase in market share through attracting particularly price-sensitive customers, ultimately leading to increase in firm revenue and profitability (Xin et al., 2017). However, opponents of the strategy doubt its effectiveness in achieving competitive advantage and optimal performance on account that it can cause cost reductions in critical value chain areas which may harm product quality, it undermines the importance of critical customer feedback, it can easily be replicated by competitors and compromise its essence, and it can only be applied to a limited spectrum of products or services (Baack & Boggs, 2008; Santalova et al., 2020).

Uganda is an underdeveloped country with a growing commercial banking sector. The decade following the country's independence in 1969 witnessed a rise in the country's commercial banking activity. However, owing to political instabilities that rocked the country in the 1970s and 1980s, the banking sector like all other economic sectors collapsed. With the coming of the post-conflict National Resistance Movement (NRM) Government in 1985, Structural Adjustment Programs (SAPs) were adopted, leading to the liberalization of the financial sector in the early 1990s. As a result, the country's banking sector has progressively expanded. Currently, the sector comprises of 25 commercial banks providing a multitude of similar products and the competition therein is very intensive given the country's relatively small and inelastic customer base. All commercial banks apparently employ different competitive strategies such as cost leadership in managing competition and enhancing their financial performance. However, in the recent past (2015 – 2019), there are particularly some 10 commercial banks in Uganda that are consistently perceived to be performing better than others in terms of revenue, profitability, return on assets, return on investment, and net profit after tax. Yet, it is not known empirically whether cost leadership strategy has a bearing on the superior performance of the selected commercial banks in Uganda. Therefore, the purpose of the study was to examine the effect of cost leadership strategy on perceived financial performance of selected commercial banks in Uganda.

2. Literature Review

The efficacy of cost leadership strategy remains a subject of intense empirical debate. Whereas it is theoretically assumed that cost leadership strategy can affect firm performance through lowering costs of production to offer quality products and/or services but at low prices (Lepădatu, 2018), recent empirical studies have found significant variation regarding the relationship between these constructs. For instance, in Kenya, researchers collected primary data from systematic random sample of 95 SMEs in Nairobi County using structured and unstructured questionnaires, analyzed it inferentially using correlation and regression techniques, and concluded that cost leadership strategy was a significant predictor of business performance of SMEs (Chelanga et al., 2017). In Pakistan, researchers drew on data collected from a sample of banking, insurance and invested firms listed on the Karachi Stock Exchange, analyzed it inferentially, and concluded that cost leadership strategy was a significant factor in the financial performance of firms in the country's service sector (Hunjra et al., 2017). In Turkey, using a data set comprising of 449 questionnaires generated from managers of 142 big firms, researchers found that besides total quality management, cost leadership strategy was a significant factor in firm's financial performance (Ilyas et al.,

2018). There are also other recent studies indicating a positive and significant effect of cost leadership on firm performance (Acquaah & Agyapong, 2017; Chepchirchir et al., 2018; Gorondutse & Hilman, 2018; Hossain et al., 2019; Mahfod et al., 2017). The studies reviewed above suggest that cost leadership strategy is an important factor of firm performance.

However, there are also studies that report no significant relationship between cost leadership strategy and firm performance. For instance, a survey was conducted in India to examine the impact of cost leadership strategy on firm performance and the mediating role of quality management practices in the context of micro, small and medium enterprises (Kharub et al., 2018). The study showed there was no direct relationship between cost leadership strategy and firm performance although quality management practices mediated the relationship. In Ghana, a survey was conducted to assess the relationship between competitive strategies and firm performance in micro and small businesses and whether managerial and marketing capabilities moderate this relationship (Acquaah & Agyapong, 2017). The findings revealed no significant relationship between cost leadership strategy and firm performance although managerial and marketing capabilities moderated this relationship. In Nigeria, a study was conducted to examine the effect of business level strategy on the performance of hotels, and it was found that the strategy of cost leadership did not have a significant bearing on the performance of hotels (Gorondutse & Hilman, 2019). In Turkey, data was collected through telephone interviewing to examine the relationship between competitive strategies, innovation, and firm performance within the manufacturing sector (Bayraktar et al., 2017). The study findings revealed an insignificant relationship between competitive strategy of cost leadership and firm performance in the manufacturing sector.

From the review, it is clear that research on whether cost leadership strategy affects firm performance shows mixed results, signifying an inconclusive debate. Such a debate can only be clarified through conducting additional research. Therefore, this study was motivated by the desire to contribute knowledge that could help in clarifying the debate. Besides, the review revealed that research focusing on the effect of cost leadership strategy on the perceived financial performance of commercial banks remains limited (Ndung'u et al., 2016); more so, in Uganda. Therefore, in order to contribute to knowledge, this study sought to examine the effect of cost leadership strategy on perceived financial performance of selected commercial banks in Uganda. The following hypothesis was developed for testing: there is no significant relationship between cost leadership strategy and perceived financial performance of selected commercial banks in Uganda.

3. Methodology

The study employed a cross-sectional correlational design to test the study hypothesis. The design was chosen because it effectively enables researchers to describe phenomena, and to examine relationships among variables, and besides, the design is often recommended for studying phenomenon in their natural environment without manipulation of variables (Spector, 2019). The unit of analysis in the study was commercial banks; however, data was collected from a population comprised of Senior Managers of the 10 best ranked commercial banks in Uganda over the period 2015 – 2019 (Corporate Finance Institute, 2019) all sitting at the banks' Headquarters in the country's capital-Kampala. These were 210 in total.

From the population of 210, a sample of 137 individuals was selected to participate in this study, and this figure was calculated using Yamane's (1967) mathematical formula (Israel, 1992) given as follows:

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

Where, n is the desired sample size; N is the study population size, and e is the level of significance (which is 5% in this case).

The technique of stratified proportionate random sampling was used in selecting sample subjects, and it entailed dividing the Senior Managers into 10 mutually exclusive groups based on the selected commercial banks, and drawing a random sample from each group (commercial bank) which was proportional to the size of the entire population of respondents from the selected commercial banks.

A structured self-completed questionnaire was used in collecting primary data on socio-demographics, execution of cost leadership strategy, and perceived financial performance. Cost leadership strategy implementation and perceived financial performance were operationalized using items borrowed from previous studies (Amit, 1986; Chepchirchir et al., 2018; Doyran, 2020; Hunjra et al., 2017; Mahfod et al., 2017), and these were modified to suit the current study. Respondents were asked to indicate the extent to which they were satisfied/dissatisfied with items measuring execution of cost leadership strategy, or the extent to which they agreed/disagreed with the items measuring perceived financial performance. The responses were rated on a 5-poinnt likert scale ranging from 1=very dissatisfied to 5=very satisfied or from 1=strongly disagree to 5=strongly agree.

Validity measures the extent to which the instrument accurately measures a concept, while reliability measures the extent to an instrument consistently measures a concept it is supposed to measure

(Louangrath & Sutanapong, 2018). A number of measures were undertaken to ascertain the content validity and reliability of the study instrument. For validity, a common methods bias test was conducted, and the Hamman's one factor test generated 28 factors, accounting for 80.25% of variance. The first factor accounted for 10.68% and its variance did not exceed 50%, meaning the data lacked problems of common methods bias (Fuller et al., 2016). The reliability of items in the questionnaire was established using the Cronbach's Alpha coefficient, and theory suggests that values close to 0.70 and above are generally acceptable (Mohamad et al., 2015).

The study hypothesis was tested using structural equation modeling (SEM). SEM is a multivariate statistical analysis technique that uses a combination of factor analysis and multiple regression to analyze structural relationships between variables and latent constructs (Kelloway, 1995). While there are two statistical methods that can be employed in estimating structural equation models including covariance based SEM (CB-SEM) and partial least squares SEM (PLS-SEM) (Kelloway, 1995), this study adopted PLS-SEM, which allows for estimation of complex cause-effect relationships in path models with latent variables (Kelloway, 1995). The technique was chosen because: it is less stringent when working with non-normal data, it can be utilized with relatively much smaller sample sizes, and it has in-built capability for handling formative indicators (Hair Jr et al., 2014), all of which apply to this study. The execution of PLS-SEM was based on a two-step approach that involved first, evaluating the measurement model followed by an evaluation of the structural model as recommended and indicated in literature (Anderson, 1988). The former entailed establishing internal consistency, construct validity, discriminant validity, and collinearity among indicators. The latter entailed establishing structural model path coefficients and testing hypotheses. Overall, the data analysis was facilitated using two statistical tools—Statistical Package for Social Scientists (SPSS) and SmartPLS.

4. Results

4.1. Respondents' Socio-Demographics

A total of 137 questionnaires were distributed to Senior Managers in 10 selected commercial Banks sitting at their Headquarters in Kampala City. Of these, 135 were considered fully completed, representing a response rate of 98.5%. Table 1 presents a summary of respondents' socio-demographics.

Table 1. Respondents' socio-demographics

Construct	Category	Frequency (n = 135)	Percentage
Gender	Male	79	58.6
	Female	56	41.4
Age (years)	Less than 30 years	0	0
	30 – 39	25	18.2
	40 - 49	88	65.3
	50 and above	22	16.5
Employment duration (years)	Less 5	20	14.8
	5 – 10	92	67.8
	11 - 15	21	15.7
	16 and above	2	1.7

The findings summarized in Table 1 show that out of 135 respondents who were successfully surveyed, most of them (58.6%) were male, aged between 0 – 49 years (65.3%), and had worked for their organizations for a period ranging 5 to 10 years (67.8%).

4.2. Descriptive Analysis of Perceived Financial Performance of Banks

The dependent variable in this study was perceived financial performance. Accordingly, respondents were asked to indicate the extent to which they were satisfied with the financial performance of their banks in terms of Return on Investment (ROI), Return on Assets (ROA) and Net Profits after Tax over the last five years. Their responses were rated on a 5-point likert scale ranging from 1=very dissatisfied to 5=very satisfied. Table 2 shows a summary of respondents' perceptions on financial performance of selected commercial banks in Uganda.

Table 2. Descriptive analysis of perceived financial performance of commercial banks in Uganda

Perceived financial performance indicators		Percentage				
	n	Very satisfied	Satisfied	Neutral	Dissatisfied	Very dissatisfied
To what extent are you satisfied with your bank's performance in terms of ROI over the last 5 years	135	30.1	47.3	7.6	10.2	4.8
To what extent are you satisfied with your bank's performance in terms of ROA over the last 5 years	135	28.3	49.4	8.2	12.6	1.5
To what extent are you satisfied with your bank's performance in terms of Net Profit after Taxes over the last 5 years	135	26.4	49.2	12.5	8.6	3.3

The findings summarized in Table 2 show that most respondents were generally satisfied with their bank's financial performance in terms of ROI, with 30.1% of them reporting they were very satisfied and 47.3% reporting they were satisfied. The table further shows that most respondents were generally satisfied with their bank's financial performance in terms of ROA, with 28.3% of them reporting they were very satisfied and 49.4% reporting they were satisfied. Finally, the table shows that most respondents were generally satisfied with their bank's financial performance in terms of Net Profits after Tax, with 26.4% of them reporting they were very satisfied and 49.2% reporting they were satisfied. Overall, the findings show that respondents' perceptions about the financial performance of selected commercial banks in Uganda were good. The next section presents findings on perceived implementation of cost leadership strategy by selected commercial banks in Uganda.

4.3. Descriptive Analysis of Perceived Implementation of Cost Leadership Strategy

Cost leadership strategy was the independent variable in this study. Its implementation among selected commercial banks in Uganda was assessed using 10 items. Accordingly, respondents were asked to indicate the extent to which they agree or disagree with the 10 items, and their responses were rated on a 5-point likert scale ranging from 1=strongly disagree to 5=strongly agree. Table 3 presents a summary of findings concerning respondents' perceptions on the implementation of cost leadership strategy in their banks.

Table 3. Perceptions on implementation of cost leadership strategy among banks in Uganda

Perceived implementation of cost leadership strategy	n	Percentage				
		Strongly agree	Agree	Neutral	Disagree	Strongly disagree
My bank prices its products lower than competitors	135	23.4	43.5	2.8	20.2	10.1
Purchasing inputs and raw materials in bulk is a standard practice of my bank	135	25.6	48.2	3.2	11.1	11.9
The attitude of low-cost consciousness is part and parcel of my bank's culture	135	21.2	40.4	3.5	18.2	16.7
My bank strives to make strategic partnerships with its suppliers	135	26.2	43.4	3.8	16.9	9.7
Innovative processes and practices is a foundation of my bank's strategies	135	34.8	29.7	2.6	18.4	14.5
Employees are regularly trained on efficient resources utilization	135	22.8	37.4	4.9	18.3	1.5

My bank has well stipulated rules on resources utilization	135	22.8	37.4	4.9	18.2	16.6
My bank's management practices outsourcing of most of its non-core functions	135	25.6	48.2	3.2	11.1	11.9
My bank strives for lean operations and practices and practices	135	22.4	45.3	4.8	18.2	9.7
My bank's processes are regularly evaluated for purposes of enhancing efficiency	135	21.4	40.5	3.8	17.1	17.2

The results in Table 3 show that the biggest proportion of respondents either agreed or strongly agreed with all items assessing the implementation of cost leadership strategy among the surveyed commercial banks. This means that in pursuit for optimal performance, to a large extent, the surveyed commercial banks practice cost leadership characterized by charging low prices for services, purchasing inputs in bulk, having a low-cost consciousness culture, establishing strategic supplier relationships, striving for innovations, often training employees in effective resource utilization, discouraging resource wastage, out-sourcing none-core functions and having lean processes and practices among others.

4.4. PLS-SEM Estimation Results

PLS-SEM estimation comprised of two steps including evaluation of the measurement model followed by an evaluation of the structural model. Factor loadings, Cronbach's Alpha, composite reliability (CR), average variance extracted (AVE), and discriminant analysis were computed and used to evaluate the measurement model. Factor loading is a measure of the variance explained by the variable on a particular factor, and as a rule of the thumb, acceptable factor loadings should be above 0.5. Cronbach's Alpha is a measure for assessing the reliability or internal consistency of a set of scale items. The higher the Cronbach's Alpha value, the better, but as a rule of the thumb, this value is expected to be above 0.7. Composite reliability (CR) is a measure of how well assigned items measure a construct. As a rule of the thumb, acceptable CR values should be higher than 0.6. AVE measures the amount of variance that is captured by a construct relative to the amount of variance attributed to a measurement error. As a rule of the thumb, AVE is expected to be above 0.5.

Table 4. Results of evaluation of measurement model

Construct	Item	Loadings	Cronbach's Alpha	CR	AVE
Cost leadership (CL)	CL1	0.610	0.715	0.780	0.504
	CL2	0.748			
	CL6	0.705			
	CL9	0.653			
	CL10	0.690			
Financial performance (FP)	FP1	0.70	0.735	0.802	0.546

From Table 4, 5 items on cost leadership strategy and 2 item on perceived financial performance were deleted because they had low factor loadings which failed to meet the minimum requirements for CR and AVE of 0.7 and 0.5 respectively as theoretically recommended. Otherwise the remaining items posted CR values ranging from 0.705 – 0.822 and AVE values ranging from 0.504 – 0.552, meaning that convergent validity was established.

After assessing the measurement model, the structural model for the study was examined for the purpose of establishing whether the hypothesized relationships among the study constructs exists. Table 5 presents findings corresponding to the path relationships.

Table 5. Path relationship

	Beta	Std. Error	t-value	p-value
H: CL -> FP1	0.4102	0.097	4.288	0.023

The findings in Table 5 show that a positive and statistically significant relationship between cost leadership strategy and financial performance in terms of ROI (β = 0.410, ϱ<0.05). This means that improving the execution of cost leadership strategy by one percentage point leads to an improvement in perceived financial performance in terms of ROI by 41%. Clearly, the hypothesis that there is no significant relationship between cost leadership strategy and perceived financial performance of selected commercial banks in Uganda was rejected, and it was concluded that cost leadership significantly affects perceived financial performance of selected commercial banks in Uganda particularly in terms of ROI.

5. Discussion and Implications

The objective of this study was to examine the effect of cost leadership strategy on perceived financial performance of commercial banks in Uganda. To achieve this objective, the study tested the hypothesis that: there is no significant relationship between cost leadership strategy and perceived financial performance of selected commercial banks in Uganda. Indeed, the results did not support this view since cost leadership strategy was found to be a significant predictor of perceived financial performance of selected commercial banks particularly in terms of ROI. From the study findings, it can be rightly argued that attempts by Managers of the surveyed banks to deepen implementation of cost leadership strategy will be reciprocated with positive financial performance perceptions particularly in terms of ROI. The study and its findings are consistent with earlier research findings that also found a positive and significant relationship between cost leadership strategy and firm performance (Acquaah & Agyapong, 2017; Chelanga et al., 2017; Chepchirchir et al., 2018; Gorondutse & Hilman, 2018; Hossain et al., 2019; Hunjra et al., 2017; Ilyas et al., 2018; Mahfod et al., 2017). This may be because pursuing an effective cost leadership strategy particularly in a low-income country like Uganda where customers are price-sensitive, will likely attract more customers, leading to increased revenue and profit margins (Xin et al., 2017). Overall, implementing a cost leadership strategy is an important factor in the perceived financial performance of commercial banks in Uganda. Accordingly, banks should pursue this strategy by ensuring that they charge relatively low prices for their products, purchase inputs in bulk, regularly train employees in efficient resource utilization, adopt a lean approach in banking processes and operations, and regularly evaluate banking operations to ensure efficiency. However, the generalizability of the study findings may be limited since they are purely based on only data attributed to the 10 best financially performing commercial banks in Uganda. Accordingly, future research involving a wider scope of commercial banks in Uganda and elsewhere may be needed. Otherwise, the study's value lies in providing empirical evidence that validates the usefulness of Porter's Generic Competitive Strategies Framework in theoretically explaining firm performance. In addition, the study findings provide evidence that calls to action managerial efforts to deepen the implementation of cost leadership strategy for enhanced bank performance.

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