

EFFECTS OF COST LEADERSHIP STRATEGY ON PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN NIGERIA

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ABSTRACT

Sustainable superior performance is achieved when managers understand the process of positioning their firms in the face of competition through decreasing internal efficiency into lower input cost for customers. However, this has received less direct emphasis in the SMEs sector. This study analysed cost leadership and performance nexus in SMEs as a way out for resolving this deficiency. Data was obtained using a 7-point Likert scale measuring instrument. A total sample of 978 useful responses was obtained out of 2075 participants that were approached through a multistage sampling technique. Data collected was tested through multivariate analysis of structural equation modeling. The results show that the entire constructs of cost leadership strategy exert significant and positive influence on performance of firms. It specifically revealed that the ability to reduce costs of administration, having access to low-cost materials than rivals, and vigorously pursuing cost reduction have significant effect on performance of SMEs in the study area. This indicates that if firm can deliver value at low cost while not mortgaging the delivery of unique services, it may position itself in the market place relative to competitors.

Keywords: Cost leadership; SMEs, Balanced score card, Performance, Structural equation modelling.

INTRODUCTION

Every business organisation is set up and put into operation with the goal of making decisions that will allow it to achieve a certain level of profitability in order to ensure that the wealth of its shareholders is increased. Although this is possible, it may be difficult to achieve if the firm operates below its bottom line results. As a result, firms are under increasing pressure to strengthen their market position in order to gain a competitive advantage as the economy grows. It is argued that in order to run efficiently and thrive, particularly in this era of globalisation where enterprises are competing and jockeying for customers, it is necessary to be more customer-centric (Teece, 2010, as well as to build a value-creating strategy. Organisations can attain optimal business performance, according to Satiawan (2016) and Hilman and Mohamad (2011), not only through continual reinvention, but also through a series of strategic behaviours that are used and chosen in an appropriate manner by the organisations.

Researchers in the field of strategic management have actually conceptualised these value-creating strategies in terms of a concept known as strategic posture, which was coined by

Hofer and Schendel (1978) and Williams, D'Souza, Rosenfeldt and Kassae (1995) and represents how firms can position themselves in the marketplace relative to competitors. While Barney (1991) advocates for the development of organisational resources, Porter (1985) advocates for the formulation and implementation of a well-executed competitive strategy, as well as the reconfiguration of the value chain as a means of ensuring that enterprises run successfully.

Organisational managers use strategy to respond to the demands of the environment in order to achieve greater performance in comparison to their competitors. According to Sarker and Palit (2015), strategy is a tool that can be used to create new opportunities and improve performance. This is because it aspires to achieve greater performance that exceeds that of competitors. Because of this, organisations must establish a business strategy that will enable them to increase their level of profitability in the face of increased competition. A firm's business model is its set of tactics for operating profitably in the marketplace. Essentially, strategy is concerned with adding value to consumers' experiences that distinguish the firm from its competitors by making the firm stand out from them. In comparison to competitors, a high-performing organization has a high-level plan that allows it to meet client needs at a competitive price and at a sustainable cost.

Porter (2010) proposed a competitive strategy theory that is concerned with doing business operations in a different and better manner than competitors, with the goal of assisting the firm in remaining viable. The theory has been widely employed in previous studies (Andrews et al., 2006) since it aids in the exercise of determining which path a firm should go in the future. The theory is divided into three parts: cost leadership, differentiation, and focusing strategies. These three parts can be employed individually or in combination to attain a large share of the market (Danbauchi, Ishaku & Yemen, 2020).

When it comes to cost leadership, as emphasized by Porter (2010), it simply means employing less expensive inputs than competitors in order to reduce costs in value chain activities (Porter, 1985). It entails being efficiently driven, with significant research and development and value chain optimization. If properly implemented, cost leadership can assist a company in achieving a favorable and significant economic performance in the face of competition. It leads to increased average asset performance, competitive advantage, and enhanced company performance (Dess & Davis, 1984; Allen & Helms, 2006). Firms that pursue cost-conscious tactics cater to a market that places little value on brand recognition but is highly sensitive to pricing (Hilman et al., 2009).

Extensive academic researchers have acknowledged the necessity for greater understanding of the indirect effect of cost leadership strategy on performance (Kharub, Mor, & Sharma, 2019; Kurt & Zehir, 2016; Hilman & Kaliappen, 2014; Teeratasirikool et al., 2013); and more recently, a direct influence with conflicting outcomes (Ngugi & Wathaika, 2020; Ndung'u, et al., 2020; Kimiti et al., 2020; Demba et al., 2019; Gakuya & Mbugua, 2018) in many single firms with less focus on SMEs sector in low income nations. For instance, Teeratasirikool et al., (2013) and Kharub et al., (2018) found that the cost leadership that firms adopt does not directly influence the performance of firms but rather does so indirectly. The inconsistency in the literature reveals there are ambiguities in competitive strategy theory regarding whether it is delivering the intended objective of boosting the performance of firms Gitau, (2013) coupled with insufficient study as well as whether it is a universal phenomenon. This indicates that much empirical study is still expected to be conducted, particularly in emerging economies and in the small and medium enterprises sector, whose performances have been made worse by COVID-19

disruption. Scientifically, it is the communication of knowledge from the results of many studies that matters, as a single or small sample of studies will neither resolve a major nor minor issue.

It is hoped that the SMEs sector's growth through the adoption of the cost leadership component of the competitive strategy will no doubt lay a key criterion for achieving sustainable performance and attract the attention of opportunity-seeking entrepreneurs for a rapid level of industrialisation in nations. Therefore, the aim of this study is to contribute to the existing literature that shows that using a cost leadership strategy alone will help small firms improve and sustain performance. To this end, the central objective of this research is to assess the effects of using cost leadership as a component of competitive strategy on the performance of SMEs in the southwest geo-political zone of Nigeria.

MATERIAL AND METHODS

The study employs quantitative research approach. The study targeted owner/manager of small and medium enterprises sector in the six states that make up the Southwest geopolitical zone in Nigeria. The zone represents a homogenous section with a dominant cultural characteristic. These states are Lagos, Ogun, Ondo, Oyo, Osun and Ekiti States. The owners/managers were targeted because they were believed to have a clear conception of the operation of their business process and as such are in position to give accurate response. The total population of the study was 23,290 SMEs owners/managers comprising of 570 medium businesses and 22,720 small firms. This figure actually represents one-third or 31.86% of SMEs out of the total 73,081 (71, 288 SEs and 1,793 entities in SMEs) in the entire 36 states of the federation. A multi-stage sampling technique was used to select a total of 2075 owners/managers. The research instrument was designed using 7-point Likert scale to obtain categorical data for the latent constructs. The researcher considered the Covid-19 situation and thus, chose the delivery and collection approach. Cost leadership strategy measured of Porter, (1985) was adapted and it contains fourteen items. The dependent variable was measured through Balanced Score Card which comprises both financial and non-financial measures (Kaplan & Norton, 2008). Data collected were subjected to analysis using descriptive and inferential statistical techniques.

RESULTS AND DISCUSSION

Influence of Cost Leadership on Performance of SMEs

The influence of cost leadership on performance of SMEs is estimated through the maximum likelihood approach. Each component of cost leadership measure is presented to indicate the contribution of each construct to the aggregate effect of cost leadership on SMEs. As a component of competitive strategy, cost leadership is measured by a number of constructs. Table 1 indicates that eight out of the fourteen indicated constructs significantly ($P < 0.05$) represent cost leadership. These constructs are represented as CL1 (price), CL2 (sales promotion), CL3 (labour input), CL4 (supply source), CL5 (cost reduction), CL6 (administrative activities), CL7 (materials) and CL8 (administrative cost).

Results in Table 2 show the regression weights of each of the significant cost leadership constructs leading to the estimation of their influence on SMEs. Out of the significant constructs of cost leadership, the results show that charging lower price than competitors (CL1), carries the lowest weight (0.157), while the activities of SMEs to reduce cost in administrative activities

(CL6) carries the highest regression weight of 0.835. The weight of ‘access to low-cost materials than our competitors’ (CL7), is also high at 0.830. The activities of SMEs to vigorously pursue cost reduction attract a regression weight of 0.756. The estimated influence of the entire constructs of cost leadership on SMEs performance is 0.227 representing approximately 23% of performance outcome of SMEs. The path analysis of the influence is illustrated in Figure 1.

Table 1
MAXIMUM LIKELIHOOD ESTIMATES OF THE COST LEADERSHIP MODEL AND SMES PERFORMANCE

			Estimate	S.E.	C.R.	P
CL1	<---	Cost leadership	1.000			
CL2	<---	Cost leadership	2.454	.451	5.444	***
CL3	<---	Cost leadership	2.102	.391	5.372	***
CL4	<---	Cost leadership	1.928	.357	5.403	***
CL5	<---	Cost leadership	3.438	.564	6.101	***
CL6	<---	Cost leadership	3.646	.591	6.167	***
CL7	<---	Cost leadership	3.915	.635	6.163	***
CL8	<---	Cost leadership	1.940	.369	5.252	***
CL9	<---	Cost leadership	.593	.374	1.584	.113
CL10	<---	Cost leadership	.915	.352	2.598	.009
CL11	<---	Cost leadership	.120	.343	.351	.726
CL12	<---	Cost leadership	.000	.326	.001	.999
CL13	<---	Cost leadership	.232	.362	.640	.522
CL14	<---	Cost leadership	.485	.354	1.370	.171
PERFORM	<---	Cost leadership	1.000			

***, significant at 1%

Source: Data Analysis, 2023

Table 2
STANDARDIZED REGRESSION WEIGHTS OF COST LEADERSHIP CONSTRUCTS AND PERFORMANCE

			Estimate
CL1	<---	Cost leadership	0.157
CL2	<---	Cost leadership	0.439
CL3	<---	Cost leadership	0.421
CL4	<---	Cost leadership	0.429
CL5	<---	Cost leadership	0.756
CL6	<---	Cost leadership	0.835
CL7	<---	Cost leadership	0.83
CL8	<---	Cost leadership	0.394
CL9	<---	Cost leadership	0.073
CL10	<---	Cost leadership	0.127
CL11	<---	Cost leadership	0.016
CL12	<---	Cost leadership	0
CL13	<---	Cost leadership	0.029
CL14	<---	Cost leadership	0.063
PERFORM	<---	Cost leadership	0.227

Source: Data Analysis, 2023

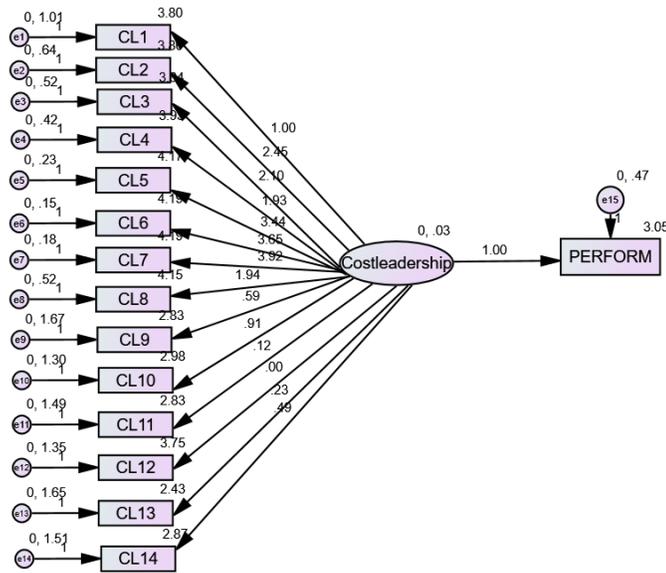


FIGURE 1
PATH ANALYSIS OF THE INFLUENCE OF COST LEADERSHIP ON PERFORMANCE OF SMES

DISCUSSION

The study investigates influence of cost leadership strategy on performance of firms in the small and medium enterprises. The research contributes to knowledge by showing the essence of cost leadership as a business model for which the SMEs can leverage to obtain superior performance. The maximum likelihood approach used estimate the influence of cost leadership strategy revealed that not all the constructs used in measuring cost leadership were significant in affecting performance. However, the overall construct had not too high influence on performance. From the result it is indicative that charging low price than rivals will not improve performance rather, materials will help firm maintain sustained level of profitability. This result appears to support earlier studies which indicate that cost leadership strategy is based on maintaining efficiency in the production of goods and services, as such any firm that pursue it will have a higher return on equity towards achieving performance (Marques et al., 2004). However, the results did not support the study of Demba, Ogal & Muli (2019) which revealed that cost leadership was not statistically and positively significant in affecting firm performance.

CONCLUSION

The major challenge facing business organisations in the business environment today is how to devise means to grow the business and achieve competitive advantage. However, this is possible if firm can deliver value at cost while not mortgaging the delivery of unique services, it may position itself in the market place relative to competitors. In spite, the inconsistency among past researchers on how this may work out among all firms irrespective of climate, and whether small or large call for a continuous research through which value can be created to satisfy

customers and obtain an improved firm performance. Therefore, the study aims at assessing the effect of cost leadership strategy on SMEs performance.

The results revealed that the ability to reduce costs of administration, having access to low-cost materials than rivals, and vigorously pursuing cost reduction have significant effect on performance of SMEs in the study area.

The study recommends firm should pursue efficiency as much as possible by continuously cutting of costs of doing business at all level as this may make it achieve bottom level results.

The limitation of the study is that it used a cross-sectional survey to obtain data on firm performance. Besides, the study collected data on performance using perceptual scale, and that only a sectional part of the country with a homogeneous culture was focused. Since Nigeria is a nation state with three dominant cultures, further research can extend to other geopolitical zones, and can also engage in longitudinal survey for the purpose of generalization of results.

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