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# EFFECTS OF COST LEADERSHIP STRATEGY ON CUSTOMER LOYALTY AMONG PHARMACEUTICAL COMPANIES IN NAIROBI COUNTY, KENYA

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**Abstract:**
Pharmaceutical firms need to come up with innovative strategies to achieve competitive advantage in a market with many manufacturers of generic products. Kenya is currently the largest producer of pharmaceutical products in the Common Market for Eastern and Southern Africa region. Customer loyalty is developed over a period of time from a consistent record of meeting, and sometimes even exceeding customer expectations. Customer loyalty is very difficult to be achieved with more and more unique ways being adopted to meet the ever changing nature of the pharmaceutical industry. Cost leadership involves becoming the low cost firm in an activity and can be operationalized as low input costs, economies of scale, experience, products, process design and low pricing. The study objective was to determine the effect of cost leadership strategy on customer loyalty among Pharmaceutical companies in Nairobi County. The research was carried out using descriptive survey design where 119 pharmaceutical firms targeted in Nairobi County, dealing with manufacturing and distribution of drugs as listed in the Kenya medical directory. The sample size was computed using 30% of the target population which gives a sample size of 35 pharmaceutical companies. These 35 were randomly selected from the list of 119 pharmaceutical companies. The study used questionnaires as an instrument of collecting data. Inferential statistics was used to determine the effect of the independent variable on the dependent variable. The findings reveal that, cost leadership strategy had a positive effect on customer loyalty in pharmaceutical firms, with a good indication that increase in cost leadership strategies improves the customer loyalty among pharmaceutical firms in Nairobi County. It was recommended that since cost leadership was found to be a key determinant in customer loyalty, the stakeholders

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should allocate adequate resources to the cost reduction implementation strategy plans among pharmaceutical firms in Nairobi County.

**Key word:** effect, cost leadership, strategy, customer loyalty, pharmaceuticals

## 1. Background Information

Academic research on customer loyalty has received considerable attention; it has largely focused on measurement issues and correlates of loyalty with consumer characteristics in a segmentation context (Homburg, 2012). Implicit in this research is the notion that competitive strategies play a special role on customer loyalty, (Smith, 2011). Customer loyalty is viewed as the strength of the relationship between an individual's relative attitude and repeat patronage. The relationship is seen as mediated by social norms and situational factors. The central thrust of the marketing activities of a firm is often viewed in terms of development, maintenance, or enhancement of customers' loyalty toward its products or services, (Christensen 2010). Marketing research on loyalty has focused on frequently purchased package goods. The customer loyalty concept is also important for industrial goods, services and retail establishments. Indeed, customer loyalty constitutes an underlying objective for strategic market planning. (Homburg, 2012), and represents an important basis for developing a sustainable competitive advantage, an advantage that can be realized through marketing efforts. In the present environment of increasing global competition with rapid market entry of innovative products, maturity conditions in certain product markets, and the task of managing customer loyalty has emerged as a focal managerial challenge.

Studies were conducted in China by Pan in an attempt to understand customer loyalty of mobile services customers. These studies emphasize that customer loyalty and analysis of factors affecting it are important for the success of mobile services firms, (Pan 2011). Globalization and deregulations have increased competition within the retail pharmacy sector in South Africa pharmacy chains, (Toit 2013). The most important strategy for a pharmacy chain is to obtain customer loyalty. In Kenya Customers appreciate efforts made by banks to offer them the best service under strained circumstances and remain loyal to them Karuku, (2010). One of the key challenges of Pharmaceutical firms has been on starting and maintaining customer loyalty. They have been experiencing high degree of customer switching from one Pharmaceutical firm to another thus a noticeable lack of customer loyalty even among delighted and satisfied customers. Pharmaceutical firms need to come up with innovative strategies to achieve competitive advantage in a market with many manufacturers of generic products. Kenya is currently the largest producer of pharmaceutical products in the Common Market for Eastern and Southern Africa (COMESA) region, supplying about 50% of the regions' market. Out of the regions' estimate of 50 recognized pharmaceutical manufacturers, approximately 30 are based in

Kenya. (M.O.H, 2008). It is approximated that about 9,000 pharmaceutical products have been registered for sale in Kenya. (Export Processing Zone, 2015, Pharmacy and Poisons Board, 2015).

## 2. Statement of the Problem

Increased competition exerts pressure on firms to be proactive and to formulate successful strategies that facilitate proactive response to anticipated and actual changes in the environment (Malburg, 2000). According to Porter (2010), competitive strategy is about being different. This means deliberately performing activities differently and in better ways than competitors.

Customer loyalty is developed over a period of time from a consistent record of meeting, and sometimes even exceeding customer expectations. Mayer et al. (2013) claims that the cost of attracting a new customer may be five times the cost of keeping a current customer happy. Customer loyalty is very difficult to be achieved with more and more unique ways being adopted to meet the ever changing nature of the pharmaceutical industry. Cost leadership involves becoming the low cost firm in an activity and can be operationalized as low input costs, economies of scale, experience, products, process design and low pricing (Johnson et al., 2011). A study done by Patterson (2008) also indicated that product's price plays a vital role that may influence customer loyalty in all purchasing situations since customers tend to prefer cost as an important factor that need to put into consideration before making any purchase decision. Additionally, Punniyamoorthy & Raj (2007) declared product’s price as an imperative indicator that affects customer loyalty. In this strength, the study focused on establishing the effect of cost leadership strategy on customer loyalty among pharmaceutical companies in Nairobi County.

### 2.1 Research Objective

To determine the effect of cost leadership strategy on customer loyalty among Pharmaceutical companies in Nairobi County.

### 2.2 Research Questions

What is the effect of cost leadership strategy on customer loyalty among Pharmaceutical companies in Nairobi County?

### 2.3 Scope of the study

The study targeted 35 pharmaceutical firms in Nairobi County, dealing with manufacturing and distribution of drugs as listed in the Kenya medical directory. This research was limited to the study of pharmaceutical companies in Nairobi County. The limit in scope has provided for future studies that encompass a larger geographical area.

### 2.4 Limitation

Some respondents were reluctant to respond to some questions and to complete the questionnaires promptly, while some even failed to return the questionnaire and also the Kenya medical directory having not been updated. However, the researcher made efforts to assure the respondents that the information was used duly for academic purposes.

### 2.5 Theoretical Framework

#### 2.5.1 Porters Theory of Competitive Advantage

According to Porter (1985), competitive advantage grows fundamentally out of value a firm is able to create for its buyers that exceeds the firm's cost of creating it. Value is what buyers are willing to pay, and superior value stems from offering lower prices than competitors for equivalent benefits, or providing unique benefits that more than offset a higher price. Porter developed three generic strategies that, he argues, can be used singly or in combination to create a defendable position and to outperform competitors, whether they are within an industry or across nations. Porter states that the strategies are generic because they are applicable to a large variety of situations and contexts. The strategies are overall cost leadership; differentiation; and focus on a particular market niche. An institution's relative position within its industry determines whether an industry's profitability is above or below the industry average.

The fundamental basis of above average profitability in the long run is sustainable competitive advantage. It provides a framework for the competitive strategies that are quite fundamental in competition. In Porter's view, the notion underlying the concept of generic strategies is that competitive advantage is the heart of any strategy and achieving competitive advantage requires a firm to make a choice (Porter, 1985).

According to Porter, a firm's relative position within its industry determines whether a firm's profitability is above or below the industry average. There are two basic types of competitive advantage a firm can possess: low cost or differentiation. The two basic types of competitive advantage combined with the scope of activities for which a firm seeks to achieve them, lead to three generic strategies: cost leadership, differentiation, and focus. (Porter 1980, 1985, & 1998).

#### 2.5.2 Empirical Literature

Cost leadership strategy is usually developed around organization-wide efficiency. The organization must be willing to discontinue any activities which do not have a cost advantage and should consider outsourcing activities to other organizations with a cost advantage (Malburg, 2000). Besides, Biswas et al. (2002) have proved that price of a product directly affect the customer's buying intention and customer's value awareness. Price can be considered as the important factor that influences customer loyalty among the various offerings in the different category of products (Romaniuk & Dawes, 2005). Due to increasing competitive industries such as the pharmaceutical retail industry, the key of success lies in increasing and preserving loyal customers Bay, Petrizzi and Gill (2008). This is not the matter of winning customers but retains or maintains current customers who are loyal. Loyal customers refuse to accept competitors' lower price offer but yet continue to purchase from the particular brand of pharmaceutical firm. Lower costs and cost advantages result from process innovations, learning curve benefits, and economics of scale, product designs reducing manufacturing time and costs, and reengineering activities.

According to Hoskisson (2004), a company pursuing this strategy must have core competencies in the following primary activities, inbound logistic as materials handling, warehousing and inventory control and outbound logistics as collecting, storing and distributing products to customers. These activities often account for significant portions of the total cost to produce goods. Thus, cost leaders seeking competitively valuable ways to reduce costs may want to concentrate on the primary activities of inbound logistics and outbound logistics. According to porter (1980) to achieve substantial rewards from this strategy, the company/firm must be the cost leader and unchallenged in this position. There is room or only one; and if there is competition for market leadership based on this strategy there will be price competition.

Cost leadership strategy seeks to achieve above-average returns over competitors through low prices by driving all components of activities towards reducing cost. Low input costs involve locating operations close to materials and cheap lab our; economies of scale require large scale operations and experience is where more experience leads to efficiency (Kimono, 2011). Products/process design influence efficiency by making products from cheap standard materials while low pricing is made possible by having products that are close to competitors in terms of features. The firm can then make small price cuts to compensate the slightly lower quality (Johnson et al., 2011). According to Dulo (2006), manufacturing firms pursuing a cost leadership strategy follow policies of purchasing materials in large volume to get low costs of inputs, mass producing a limited range of products, marketing non branded or privately branded goods or services as to avoid advertising costs, making extensive use of automation to maximize economies of scale, locating any manual production in low-wages areas of the world and aggressive pricing to build and maintain market share.

According to Ko¨seoglu et al., (2013) cost leadership by its nature provides some defense against competition. Customers look for high value or low cost and are less concerned with product uniqueness, and high levels of individualized service. This strategy generally requires a large capital investment, aggressive pricing and state-of-the-art equipment. In this strategic type success is reached in a variety of ways: through seeking low-cost customers, standardizing service setting, reducing the personal element in service delivery, reducing network costs, and sealing off portions of the service to enhance efficiency (Johnson et al., 2011).

## 3. Research Methodology

The research will be carried out through descriptive survey design. This design refers to a set of methods and procedures that describe variables. It involves gathering data that describes events and then organizes, tabulates, depicts and describes the data. This survey method specifies the nature of given phenomena and also involves direct contact with a population or sample (Dada & Idowu, 2006).

The research targeted 119 pharmaceutical firms in Nairobi County, dealing with manufacturing and distribution of drugs as listed in the Kenya medical directory. The sample size was computed using 30% of the target population which gives a sample size of 35. These 35 were randomly selected from the list of 119 pharmaceutical companies.

The study used questionnaires as an instrument of collecting data. The data generated from the administration and adequately filled and retrieved questionnaires was checked, coded and analyzed using the Statistical Package for the Social Sciences (SPSS), so as to obtain descriptive statistics such as frequencies and percentages. The data analysis provided easy, clear and understandable data presentation. Various relationships were discussed using tables, frequencies and percentages since the study was largely descriptive. Finally, the researcher drew conclusions and recommendations from the information obtained from the findings of the study in an attempt to answer the research questions. Inferential statistics was used to determine the effect of the independent variable on the dependent variable. The multiple regression analysis model specification was as follows:

$$\mathbf{Y=\alpha+\beta 1X1 + \varepsilon.}$$

Where:
Y= is the dependent variable, customer loyalty
X1= cost leadership strategies
$\varepsilon$= error term
$\beta$=coefficient of independent variable.
$\alpha$= constant

The data was presented by the means of tables, graphs and pie charts.

### 3.1 Data Analysis

#### 3.1.1 Response Rate

From the study, 33 out of the 35 respondents filled-in and returned the questionnaires making a response rate of 94%. According to Mugenda and Mugenda (2012) a response rate of 50% is adequate for analysis and reporting; a rate of 60% is good and a response rate of 70% and over is excellent; therefore, the response rate obtained in this study was excellent for analysis and reporting.

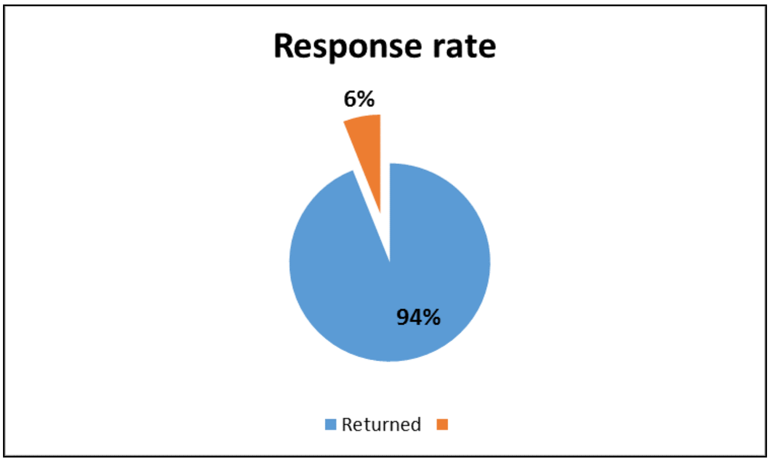


**Figure 1:** Response Rate

### 3.1.2 Effect of cost leadership strategy on customer loyalty

The researcher tried to determine the effect of cost leadership strategy on customer loyalty. The table 1 summarizes the responses given.

**Table 1:** Descriptive statistics regarding cost leadership

| Opinion Statement | Mean | Std Dev |
|---|---|---|
| Our company produces at a very low cost | 3.9419 | 0.9097 |
| We maintain lower prices than competitors | 3.8823 | 0.8104 |
| We are efficient in production | 3.3731 | 0.8044 |
| We produce in high volumes | 3.6901 | 1.0721 |
| We source directly from suppliers | 3.9334 | 0.8983 |
| We have high technology implementation | 3.5908 | 1.1146 |
| **Average** | 3.7352 | 0.9349 |

From the data presented in above relevant results which show on a scale of 1 to 5 (where 1= strongly disagree and strongly agree=5) for the means and standard deviations, a majority of the respondents with the highest mean of 3.9419 agreed that their company does its production at very low cost. The lowest mean of 3.3731 was observed with the respondents agreeing with the statement that their company was efficient in production. The highest standard deviation was observed as 1.1146, which showed that there was greater viability in the response that the firms have high technology implementation. The respondents further agreed that their company maintained lower price than competitors (mean 3.8823), production was done efficiently (mean 3.3731), company produced in large scale and with high volumes(mean 3.6901), company sourced directly from suppliers (mean 3.9334) and that they have high technology implementation (mean 3.5908). Thus, a majority of the respondent agreed that pharmaceutical companies pursue cost leadership strategy and that cost leadership influences customer loyalty to a great extend with an average mean of 3.7352. The above findings are in line with research by Porter (2008) that the company must be willing to standardize its offerings in order to manage costs, which implies that exceptions requested by prospective customers must be limited or excluded in order to keep costs down. The findings are also in line with a research by Smith ( 2012) who claims that for customers to remain loyal, the company must choose the right distribution channel that ensures customers in different locations can buy the firms products at lower prices than competitors.

### 3.1.3 Regression results

Multiple regression was used to determine the predictive power of the cost leadership strategy in influencing customer loyalty of the pharmaceutical companies in Nairobi County.

**Table 2:** Multiple Regression Results

| **Model** | **Unstandardized Coefficients B** | **Std. Error** | **Standardized Coefficients Beta** | **t** | **Sig.** |
|---|---|---|---|---|---|
| Cost leadership strategy | 0.752 | 0.1032 | 0.152 | 4.223 | 0.0192 |

$Y= 1.147 + 0.752X1 + e$

According to the regression equation above, taking all the competitive strategies of cost leadership, differentiation and focus strategy to be constant, at zero, customer loyalty of the pharmaceutical companies in Nairobi County will be 1.147. The data findings analyzed also show that taking all other independent variables at zero, a unit increase in cost leadership strategy will lead to a 0.752 increase in customer loyalty among the pharmaceutical companies in Nairobi County.

## 4. Summary, Conclusion and Recommendation

From the results, all the measurers of cost leadership were found to have effect on the customer loyalty among pharmaceutical firms in Nairobi County as depicted by the various responses from the respondents that were presented using a table where the responses were in percentages, mean and standard deviations. The constructs were found to be of good reliability that allowed the researcher to proceed to the actual data collection. The cost leadership strategy variable was found to have a positive and a statistically significant effect on customer loyalty. This meant that increase in cost leadership strategy facilitated the increase in customer loyalty in the pharmaceutical firms in Nairobi County.

### 4.1 Conclusion

The findings reveal that, cost leadership strategy had a positive effect on customer loyalty in pharmaceutical firms, with a good indication that increase in cost leadership strategies improves the customer loyalty among pharmaceutical firms in Nairobi County.

This meant that there is need to allocate adequate resources as to reduce costs and attract more loyal customers in the pharmaceutical firms. Thus, it is the responsibility of the key players in industry, to ensure that sure those adequate resources are set aside for cost reduction avenues.

### 4.2 Recommendation

Since cost leadership was found to be a key determinant in customer loyalty, the stakeholders should allocate adequate resources to the cost reduction implementation strategy plans among pharmaceutical firms in Nairobi County. The study found that cost leadership affects customer loyalty, and therefore recommends that the firms should strive towards having a large market, for an effective cost leadership strategy.

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