Journal of
**Strategic Management**
*(JSM)*

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AJP

Journal of Strategic Management
ISSN 2520-0461 (Online)
Vol.7, Issue 1, pp 52 -63, 2022


# Cost Reduction Strategies and Performance of Commercial Banks in Kenya

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**Abstract**

**Purpose:** The purpose of the study was to establish the influence of cost reduction strategies on performance of commercial banks.
**Methodology**: The study used census approach and targeted all the 41 commercial banks in Kenya. This is because the population is small. Senior finance and operations managers working in the headquarters of the commercial banks were targeted. This was therefore a total of 82 respondents. The research adopted cross-sectional survey. The study used both primary and secondary data. Primary data was collected using questionnaires while Secondary information was acquired from the commercial banks' audited financial statements.
**Findings:** Both primary and secondary data regression results showed that cost reduction strategies had a positive and significant effect on performance of commercial banks. From the study findings, the study concluded that that cost reduction strategies had a positive and significant effect on performance of commercial banks in Kenya.
**Recommendation:** The study recommended that bank management should establish measures that reduce overhead costs as well as operational costs so as they can boost their performance.

**Key Words:** *cost reduction strategies, performance, commercial bank*

## 1.0 INTRODUCTION

### 1.1Background of the Study

Cost reduction strategies are strategies that reduce resource wastage to increase organizational efficiency and effectiveness (Ngumi, 2014). The first thing that the bank should reduce is cost. Cost reduction strategies are operative values for growing processes efficiency. Cost reduction strategies can decrease functional costs while growing productivity, permitting for planned rearrangement of resources. These cost reduction strategies deliver extra assistances that swell throughout the business by eradicating waste, hastening processes, and exploiting resources effectively (Ngumi, 2014).

Banks should also work towards reducing their overhead costs. Overhead costs are costs that are associated with a firm's daily operation. In an economic recession in business, overhead cost reduction is important. Overhead expenditure is autonomous of income and must always be billed whether the company is in a position of gains or losses. Expenses resulting from the development of goods are not included in overhead. Fixed monthly or yearly costs (such as leases, insurance or salaries) or costs which fluctuate from month to month as a result of levels of business activities (such as sales special offers or maintenance) can be covered by overhead costs (Dal Colle, 2018).

Due to its firmness during the financial crisis, the Canadian banking industry is detained in great favor by its global complements (Canadian Banks, 2016). However, Canada's banks, which gained admiration around the world for their performance throughout the financial catastrophe of 2008, are not insusceptible to these forces. Through their resilient capital ranks and track record through the financial catastrophe, banks in Canada are well situated within the worldwide financial services municipal (Canadian Banks, 2016). In addition, there has been long lasting commitment to the financial innovation strategies through in house initiatives and partnerships in innovation and technology programs. There has also been increasing active role of the Canadian banking industry management in supporting cost reducing strategies (Canadian Banks, 2016).

In India, most banks put more emphasis on investment in value creation strategies so as to enhance their performance. Internet banks are bigger, extra lucrative, have advanced asset value, inferior managerial expenditures, and are more effective than non-internet banks in India (Pooja & Singh, 2009). Menon (2015) conducts research on Indian software as a service business and suggests industry companies to expand their services. His study contributes a great deal to the country's other businesses. Motley (2015) applies blue ocean strategy to the banking industry and finds that by entering different market segments without competitors they reduce operating costs and increase profits.

In Kenya, the banks that have excelled in origination, servicing, distribution or making markets have been considered to have first succeeded in implementing value creation strategies. The unique resources held by a firm in Kenyan banks helped in value creation for the customers. In addition, bog banks were able to minimize the costly programs and invest on cost friendly programs. They were also able to invest more in innovation and thus enabling them to perform better (Oloko, 2012). Sia, Soh and Weill (2016) further added that for banks to gain the value creation, they will have to transform the way they bank their processes and the way they operate.

### 1.2 Statement of the Problem

World Bank (2017) reported a steady decline in banks' financial results over the ages as reflected in their profit margins (ROE) from 23.10 percent in 2011 to 21.99 percent in 2012, 20.94 percent in 2013, then to 20.88 percent in 2014 and further decline to 17.39 percent in 2015. The ROE of Kenya's commercial banks too far decreased in 2016, essentially attributable to Kenya's implemented capping bill of 2016. Likewise, in its 2017 Cooperative Bank reported a downturn in revenue by 10.4 percent from the previous year. Similarly, in the year 2018, Diamond Trust Bank posted a decline of 10.1% in full year 2017 profit after tax to Kshs 6.4 Billion. From the earnings report, there was a steep increase in gross non-performing loans by a massive 97% to Kshs 14.8 Billion (CBK, 2017). This is a clear indication of poor performance of most commercial banks in Kenya.

The poor performance of commercial banks is been associated with the stiff competition that the Kenyan banking industry is experiencing from new entrants like mobile phone companies and international banks (CBK, 2015). In addition, the increasing number of SACCOs in the country has shifted customer focus from the commercial banks. This could be due to the fact that SACCOs have friendlier services which are less costly. The dominant mobile service provider, Safaricom and Airtel are also a threat to the banking industry. Many people consider saving money with these telecommunication firms as opposed to banks.

### 1.3 Objectives of the Study

To establish the influence of cost reduction strategies on performance of commercial Banks

## 2.0 LITERATURE REVIEW

### 2.1 Theoretical Review

#### 2.1.1 Value Innovation Theory

This theory was proposed by Kim and Mauborgne (2005). It proposes that the central tenet of the Blue Ocean Strategy (BOS) is value advancement according to which institutions continue to concentrate on taking customer value up while at the same time pulling down the company's expenses, as opposed to solely benchmarking toward rivalry and existing industrial norms. Kim and Mauborgne (2005) formed the Four Actions Paradigm to enhance value development which lowers administrative expenses whereas taking customer value up. This batch of four basic probes helps guide the emergence of a new trajectory of value that is dissimilar from the existing business model. The quadruple probes are: what variables ought to be obliterated inside the company; which aspects ought to be lowered; what aspects should be raised; and what aspects should be created in an attempt to minimize expenses while at the same time increasing the value of the buyer.

Consequently, the firm achieves meaningful input on how to handle its cost aspects relative to its competitors by advancing the first two core issues of significant decrease and eradication. And accordingly the final probes about development and boosting some business aspects improve alternative sources of worth for customers and new markets (Kim & Mauborgne, 2005).

Zott and Amit (2010) asserted that worth advancement is crucial to the creation and appropriation of wealth, especially during economic evolvement. Consequently, a certain element of technology entails developing an adapted or fresh orientation scheme focused on creating profit for an organization, its associates, distributors and, most crucially, consumers. The firm should always evaluate various interrelationships between its business operations then shape such interaction programs to create integrative worth in its environment (Amit & Zott, 2010). The theory explained the four aspects that enhance value development which lowers administrative expenses whereas taking customer value. The theory therefore informed the value creation strategies variable.

**2.2 Empirical Review of Literature**

Miano (2013) carried out a survey on the key drivers of the blue ocean strategy's implementation. As of June 30, 2013, the population of the research project was 43 banks licensed by Kenya's Central Bank and were all profiled and out of which 25 banks were eventually involved. The study revealed that long queues, running expenses and overheads, and indirect costs had all been considerable factors which must be lowered. The survey also discovered that a range of factors have been held for granted by banks and that expensive operation and initiatives should be removed. It was additionally discovered that respondents felt that factors such as customer satisfaction, new and quality products, improvement of customer service should be brought up above benchmark of the banking industry.

During the recession period, Adeniyi and Egbunike (2017) analyzed cost saving strategy and company revenue growth with an emphasis placed on Nigerian banking experience. The study showed the impact on bank profit margins of reducing staff size and reducing staff salary. The specific target was to determine the impact of staff layoffs and staff wage decrease on equity return. A methodology of linear regression was utilized to estimate the model's parameter. The study showed that there was a pessimistic association between staff downsizing, staff wage reduction, and profit margins. During the time that the banks minimized their workers, it was realized that bank efficiency was very low. The survey advised that banks should be able to lower the wage of their workers instead of dismissing them. Then, when the profitability improves, salary increases can be made.

Siyanbola and Raji (2016) established that cost cutting has a favorable impact on the cash flow of businesses. Hamed, Bowra, Aleem, and Hussain (2016) conducted an analytical layoffs inquiry in Pakistan's banking sector. The study found that decreasing the complete number of workers to reduce wage costs sometimes does not result in increased profitability of banks.

Kinyugo (2014) recognized that measures of asset management establish the efficiency of the management and how they use firm asset to make sales. Asset management ratios display how proficiently assets are used to generate revenue competently. In addition, there was a fall in efficiency ratio from 2008 to 2013 in companies indicating that they were making considerably more than they were spending thus depicting a sound fiscal footing. The findings revealed a significant positive relationship between Return on Asset and Efficiency. In conclusion taking into deliberation of the outcomes provided, certain inputs are vital which impact on the level of cost efficiency of these companies.

## 3.0 RESEARCH METHODOLOGY

In Kenya, there are 41 commercial banks which will be targeted by the study. The study used census approach and targeted all the 41 commercial banks in Kenya. This is because the population is small. Senior finance and operations managers working in the headquarters of the commercial banks were targeted. This was therefore a total of 82 respondents. The research adopted cross-sectional survey. The study used both primary and secondary data. Primary data was collected using questionnaires while Secondary information was acquired from the commercial banks' audited financial statements. After quantitative data was obtained through questionnaires, it was prepared in readiness for analysis and keyed into statistical package for social sciences (SPSS) computer software (version 22) for analysis.

## 4.0 RESULTS AND DISCUSSIONS

### 4.1Descriptive Results

#### 4.1.1 Descriptive Results for Primary Data

Descriptive Results for Cost reduction Strategies were shown in Table 1 below:

**Table 1: Descriptive Results for Cost reduction Strategies**

| Statement | Strongly Disagree | Disagree | Neutral | Agree | Strongly Agree | Mean | Std.dev |
|---|---|---|---|---|---|---|---|
| The management has established measures to reduce the overhead costs | 19.70% | 4.20% | 0.00% | 59.20% | 16.90% | 3.49 | 1.37 |
| The bank's management has established measures to reduce the operational costs | 22.50% | 1.50% | 7.00% | 54.90% | 14.10% | 3.37 | 1.39 |
| The bank has adopted social media advertising as a marketing strategy to reduce costs of advertising | 23.90% | 1.50% | 1.40% | 50.70% | 22.50% | 3.46 | 1.48 |
| The management has adopted modern techniques of monitoring staffing and maintenance costs. | 16.90% | 5.60% | 1.40% | 50.70% | 25.40% | 3.62 | 1.38 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| The bank regularly monitors the staffing costs to ensure optimal cost efficiency | 11.30% | 7.00% | 12.70% | 33.80% | 35.20% | 3.75 | 1.32 |
| The bank has adopted an operating model to reduce product management costs | 12.70% | 2.80% | 8.50% | 53.50% | 22.50% | 3.70 | 1.22 |
| **Average** | | | | | | **3.57** | **1.36** |

The results revealed that 76.1% of the respondents agreed with the statement that the management has established measures to reduce the overhead costs (Mean =3.49). However, the answers were varied from the mean with a standard deviation of 1.37. These findings agreed with that of Miano (2013) carried out who indicated that long queues, running expenses and overheads, and indirect costs had all been considerable factors which must be lowered so as to enhance performance of an organization. The results further revealed that 69.0% of the respondents agreed with the statement that the bank's management has established measures to reduce the operational costs (Mean =3.37). However, the answers were varied from the mean with a standard deviation of 1.39. The findings were inconsistent with Hamed, Bowra, Aleem, and Hussain (2016) who found that decreasing the complete number of workers to reduce wage costs sometimes does not result in increased profitability of banks.

The results further revealed that 73.2% of the respondents agreed with the statement that the bank has adopted social media advertising as a marketing strategy to reduce costs of advertising (Mean =3.46). However, the answers were varied from the mean with a standard deviation of 1.48. The results further showed that 76.1% of the respondents agreed with the statement that bank regularly monitors the staffing costs to ensure optimal cost efficiency (Mean =3.75). However, the answers were varied from the mean with a standard deviation of 1.32. The results further showed that 76.0% of the respondents agreed with the statement that the bank has adopted an operating model to reduce product management costs (Mean =3.70). However, the answers were varied from the mean with a standard deviation of 1.22. These findings agreed with Adeniyi and Egbunike (2017) who indicated that banks should be able to lower the wage of their workers instead of dismissing them. Then, when the profitability improves, salary increases can be made.

The results average mean for the cost reduction strategies was 3.57 implying that majority of the respondents agreed with the statements on cost reduction strategies. This is because the mean was above 3.5. However, the answers were varied from the mean with a standard deviation of 1.36.

The respondents were further asked to propose a change in cost reduction in their bank. Majority of the respondents indicated that banks should minimize the customer queues as well as remove duplicated services. In addition, banks should eliminate cross-department and coordinate parallel activities for example combined our purchasing power to reduce prices. Other respondents indicated that their banks should minimize or eliminate low value meetings and forums.

Journal of Strategic Management
ISSN 2520-0461 (Online)
Vol.7, Issue 1, pp 52 -63, 2022
www.ajpojournals.org

### 4.1.2 Descriptive Results for Secondary Data

The descriptive results for secondary Data are presented in Table 2 below:

**Table 2: Descriptive Results for Secondary Data**

| | Minimum | Maximum | Mean | Std. Deviation |
|---|---|---|---|---|
| ROA | 4.21 | 22.67 | 12.2277 | 3.02685 |
| Number of new investment introduced | 3 | 89 | 23.99 | 18.425 |

The results showed that the mean of ROA was 12.228 in the commercial banks between the year 2015 and 2019. The minimum ROA was 4.21 while the maximum ROA was 22.67. The results also showed that the ROA was varied from the mean of all banks with a standard deviation of 3.027.

The results showed that the mean number of new investment introduced was 24 in the commercial banks between the year 2015 and 2019. The minimum number of new investment introduced were 3 while the maximum were 89. The results also showed that the numbers of new investment introduced were varied from the mean of all banks with a standard deviation of 18.425.

## 4.2 Correlation Results

### 4.2.1 Correlation Results for Primary Data

Correlation results for the association between the independent variables and the dependent variables were presented in Table 3 below:

**Table 3: Correlation results for Primary Data**

| | | Performance | Cost reduction strategies |
|---|---|---|---|
| Performance | Pearson Correlation | 1 | |
| | Sig. (2-tailed) | | |
| Cost reduction strategies | Pearson Correlation | .716** | 1 |
| | Sig. (2-tailed) | 0.000 | |

The results revealed that cost reduction strategies had a strong positive and significant association with performance of commercial banks (r=0.716, p=0.000). This implied that improvement in cost reduction strategies would lead to an increase in performance.

### 4.2.2 Correlation Results for Secondary Data

Correlation results for the association between the independent variables and the dependent variables were presented in Table 4 below.

**Table 4: Correlation results for Secondary Data**

| | | ROA | Cost reduction strategies |
|---|---|---|---|
| ROA | Pearson Correlation | 1 | |
| | Sig. (2-tailed) | | |
| Cost reduction strategies | Pearson Correlation | .469** | 1 |
| | Sig. (2-tailed) | 0.000 | |

The results revealed that cost reduction strategies had a weak positive and significant association with performance of commercial banks (r=0.469, p=0.000).

## 4.3 Regression Results

### 4.3.1 Influence of Cost Reduction Strategies on Performance of Commercial Banks

The first objective was to establish the influence of cost reduction strategies on performance of commercial Banks. The results are shown in Table 5 below:

**Table 5: Model Summary for Cost Reduction Strategies**

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|---|---|---|---|---|
| 1 | .716[a] | 0.512 | 0.505 | 0.64876 |

The results showed that the R was 0.716 while the R squared was 0.512. This means that cost reduction strategies explain 51.2% of the variations in the dependent variable which is performance. This also implies that 49.8 % of the variation in the dependent variable is attributed to other variables not captured in the model.
The results for ANOVA were presented in Table 6 below:

**Table 6: ANOVA Results for Cost Reduction Strategies**

| | Sum of Squares | df | Mean Square | F | Sig. |
|---|---|---|---|---|---|
| Regression | 30.508 | 1 | 30.508 | 72.484 | .000[b] |
| Residual | 29.041 | 69 | 0.421 | | |
| Total | 59.549 | 70 | | | |

Table 6 showed F statistic of 72.484 and a p value of 0.000. This shows that cost reduction strategies had a significant effect on performance of commercial banks.

The regressions of coefficient results were presented in Table 7 below:

**Table 7: Regression of Coefficient Results for Cost Reduction Strategies**

| | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|---|---|---|---|---|---|
| | **β** | **Std. Error** | **Beta** | | |
| (Constant) | 0.76 | 0.334 | | 2.279 | 0.026 |
| Cost Reduction Strategies | 0.775 | 0.091 | 0.716 | 8.514 | 0.000 |

Table 7 showed that cost reduction strategies have a regression of coefficient of 0.775 and a p value of 0.000. This means that cost reduction strategies had a positive and significant effect on performance of commercial banks. These findings agreed with that of Miano (2013) who indicated that long queues, running expenses and overheads, and indirect costs had all been considerable factors which must be lowered so as to enhance performance of an organization. These findings also agreed with Adeniyi and Egbunike (2017) who indicated that banks should be able to lower the wage of their workers instead of dismissing them. Then, when the profitability improves, salary increases can be made.

$Y= 0.760 + 0.775X_1$

Where Y is performance while $X_1$ is cost reduction strategies

### 4.3.2 Secondary Data Regression Results

The secondary data results are shown in Table 8 below:

**Table 8: Model Summary for Cost Reduction Strategies**

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|---|---|---|---|---|
| 1 | .469 | 0.22 | 0.215 | 2.68127 |

The results showed that the R was 0.469 while the R squared was 0.22. This means that cost reduction strategies explain 22.0% of the variations in the dependent variable which is performance. This also implies that 78.0% of the variation in the dependent variable is attributed to other variables not captured in the model.
The secondary data results for ANOVA were presented in Table 9 below.

**Table 9: ANOVA Results for Cost Reduction Strategies**

| | Sum of Squares | df | Mean Square | F | Sig. |
|---|---|---|---|---|---|
| Regression | 370.145 | 1 | 370.145 | 51.486 | .000[b] |
| Residual | 1315.628 | 183 | 7.189 | | |
| Total | 1685.773 | 184 | | | |

Table 9 showed F statistic of 51.486 and a p value of 0.000. This shows that cost reduction strategies had a significant effect on performance of commercial banks.

The regressions of coefficient secondary data results were presented in Table 10 below:

**Table 10: Regression of Coefficient Results for Cost Reduction Strategies**

| | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|---|---|---|---|---|---|
| | β | Std. Error | Beta | | |
| (Constant) | 6.692 | 0.796 | | 8.405 | 0.000 |
| Cost Reduction Strategies | 1.884 | 0.263 | 0.469 | 7.175 | 0.000 |

Table 10 showed that cost reduction strategies have a regression of coefficient of 1.884 and a p value of 0.000. This means that cost reduction strategies had a positive and significant effect on performance of commercial banks. These findings agreed with Adeniyi and Egbunike (2017) who indicated that banks should be able to lower the wage of their workers instead of dismissing them. Then, when the profitability improves, salary increases can be made. These findings also agreed with that of Miano (2013) carried out who indicated that that long queues, running expenses and overheads, and indirect costs had all been considerable factors which must be lowered so as to enhance performance of an organization.

$Y = 6.692 + 1.884 X_1$

Where Y is performance while $X_1$ is cost reduction strategies

## 4.4 Hypothesis Testing

The hypothesis stated that cost reduction strategies do not have a significant influence on performance of commercial Banks. From the primary data regression results Table 6 the p value was 0.000 which was less than 0.05. Therefore the null hypothesis cost reduction strategies do not have a significant influence on performance of commercial Banks was rejected. From the secondary results Table 9 the p value was 0.000 which was less than 0.05. Therefore the null hypothesis cost reduction strategies do not have a significant influence on performance of commercial Banks was rejected. Therefore, the researcher concluded that cost reduction strategies have a significant influence on performance of commercial Banks. These findings agreed with Adeniyi and Egbunike (2017) who indicated that banks should be able to lower the wage of their workers instead of dismissing them. Then, when the profitability improves, salary increases can be made.

## 5.0 CONCLUSIONS

The study concluded that cost reduction strategies have a positive and significant effect on performance of commercial banks. The study concluded that establishing measures that reduces overhead costs enhances performance of commercial banks. In addition, measures that reduces operational costs also enhances performance of commercial banks. Monitor the staffing costs regularly ensure optimal cost efficiency.

## 6.0 RECOMMENDATIONS

From the study findings, the study concluded that that cost reduction strategies had a positive and significant effect on performance of commercial banks in Kenya. The study therefore recommended that bank management should establish measures that reduce overhead cost as well as operational costs so as they can boost their performance. In addition, commercial banks also ought to minimize long customer queues and also minimize indirect costs so as they enhance their organizational performance. The study also recommends that banks need to adopt an operating model that minimize product management costs. This will boost their operational performance.

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