

Cost Leadership Strategy and Financial Performance: Empirical Evidence from Textile Sector Listed Companies of Pakistan

MUHAMMAD ILYAS

*Lecturer (Finance) Institute of Business Studies and Leadership
Abdul Wali Khan University Mardan
milyas_85@awkum.edu.pk*

IHTESHAM KHAN

*Assistant Professor (Finance) Institute of Business Studies and Leadership
Abdul Wali Khan University Mardan
ihishamkhan@awkum.edu.pk*

MUHAMMAD NISAR KHAN

*Lecturer (Finance) Bacha Khan University Charsadda
nisarmgnt@bkuc.edu.pk*

Abstract

Organizations concentrate to maximize their value. Therefore, their management are interested in their financial performance. However, management is also interested in minimization of the operational cost. This study examines the cost leadership strategy (CLS) and financial performance in a sample of 132 textile sector firms listed on the Pakistan stock exchange (PSX) during 2008-2016. For analyses used panel data random effect model and the results demonstrate that CLS significantly and positively affect the financial performance of textile sector listed firms of Pakistan. Moreover, control variables such as leverage and dividend payout ratio are significantly affect organizational performance. Finally reveals that study supports the theoretical association of return on assets with independent and control variables. Hence, recommended to follow the CLS to reduce operational costs further and to perform efficiently in the competitive market.

Keywords: *Cost Leadership Strategy, Financial Performance, Textile Sector of Pakistan.*

1. Introduction

In today uncertain and dynamic environment the competition is unavoidable for firm managers. Therefore, organizations adopted and pursued suitable strategies to keep their businesses ahead against their competitors (Atikiya, Mukulu, Kihoro & Waiganjo, 2015). Among different strategies cost leadership (CLS), focus and differentiation are the generic strategies. Firms pursued these strategies and further add that due to persuasion of such strategies firms achieve better competitive advantages and organizational performance. Moreover, firms adopted CLS and control cost tightly, therefore firms do not bear too much expenses of marketing and innovation. CLS follower firms also cut their prices for products (Porter, 1985). Consequently, sales increase and firm financial performance are improving. Moreover, reported that CLS is not only important and

fruitful for firms but it also helps customers of the concern firm. Firms which adopted cost leadership strategy provide products to customers at competitive prices because these firms produce high volume and standard products at low possible cost (Aulakh, Rotate, & Teegen 2000). The same approach of CLS from customer point of view also observed in another study that CLS is also important in customer views because prices of products are lower in emerging economies and affordable for the lower income people at their disposable income (Caroline, 2008).

Firms at low cost operations have advantages over others firms because such firms have the ability to get return more or achieve the position of command prices (Atikiya et al., 2015). In addition, low cost leader firm get protection from their rivalry firms because these firm earn even if their competitor cut their firm profit through rivalry. In market observed the low cost producer are those firms which adopted strategy of cost leadership (Porter, 1985). The main purpose of the cost leadership strategy to offer the products at low cost in the industry. Firm get the cost leadership strategy through production facility investment, experiences and total operating cost careful monitoring and conservation approaches (Valipour, Birjandi & Honarbakhsh, 2012). Reduction in cost are depend on different factors. Cost advantage sources are depending on the structure of the industry. Sources of cost advantages are economies of scale and scope, economical assess to raw material and propriety technology (Atikiya et al., 2015).

It is generally observed phenomenon that if the firms adopt the cost leadership strategy the performance of firms would improve. If cost leader firms operate in the industry, then the firm provide high quality of products at lower possible cost. Further, observed that sometimes from the cost leadership strategy firms get low level of profit because such firms have low margin of profit (Palepu & Healy, 2008). On the basis of previous literature reveals that cost leadership strategy is one of the important strategy for any business. Researchers in this scenario conduct this study to investigate the cost leadership strategy effect on the financial performance of listed firms of textile sector of Pakistan, because this sector more contribute to Pakistani economy. Moreover, manufacturing sector listed firms of Pakistan Stock Exchange are selected to investigate because highest number of listed firms are from manufacturing sector. Therefore, take into consideration the importance of this sector. The manufacturing sector of economy are facing a number of challenges to survive in the business dynamic environment (Atikiya et al., 2015). Therefore, the aim of this study is to investigate the cost leadership strategy and performance of textile sector listed firms of Pakistan stock exchange.

2. Literature Review

Cost leadership strategy significantly affect the future performance of firms. Birjandi, Jahromi, Darabi and Birjandi (2014) investigate the effect of CLS on financial performance of 45 firms listed on the Tehran Security Exchange during 2009-2013. They demonstrate that the cost leadership strategy positively and significantly affects firms' performance. Similarly, Valipour et al. (2012) examined the relationship of cost leadership strategy, product differentiation strategy and firm financial performance. They also select sample of 45 listed firms on Tehran Security Exchange during 2003-2010. They report that cost leadership strategy is positively associated with financial performance. Others examine the effect of cost leadership strategy on financial performance in Kenya. From 131 firms of 12 industries collect data through interview

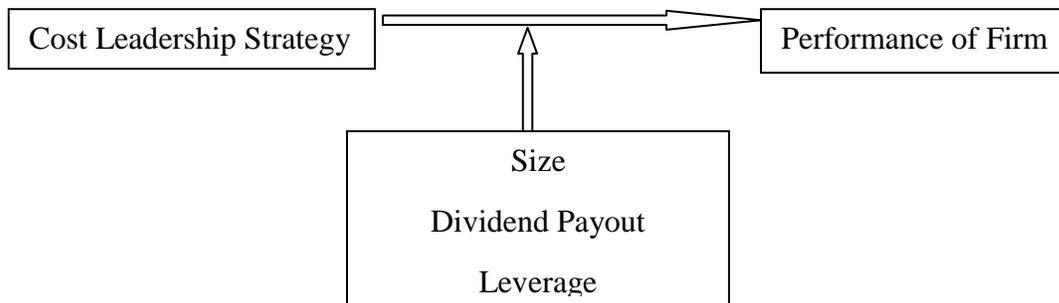
and questionnaire survey methods. They reveal that the cost leadership strategy significantly affects the firm performance. Further, they recommended to management to increase their firm level performance and competitiveness. Moreover, observed that cost leader firms operating in the competitive environment have high financial performance as compare to other firms because such firms do not focus on the acquisition of new customers and markets (Atikiya et al., 2015). In the similar vein, reported that cost leadership strategy in emerging economies (China, Brazil, India, etc.,) increase the financial performance of firms. Moreover, added that the lower cost advantages are due to lower cost of manufacturing and labors (Aulakh, Rotate, & Teegen, 2000). However, find that cost leadership and product differentiation strategies are negatively related with firm performance. Furthermore, demonstrates that this relationship become more negative if firms adopt product differentiation strategy instead of cost leadership strategy (Jermias, 2008).

2. Research Methodology

Performance of firms are observed on the basis of two concepts such as archival data and firm performance. When use secondary data and measure performance of firms is considering the archival data concept. However, on the basis of manager’s perception when measure the firm performance this is consider perceived performance of firm (Rauch, Johan, Lumpkin & Michael, 2009). In this study used the archival data (secondary data base concept). The accounting based approach of firm performance is often used for performance of firm measurement because managers can easily manipulate it and it is controllable for management ((Valipour et al., 2012). Population of this study is total firms of textile sector listed on Pakistan Stock Exchange. however, in this study select a sample of 132 firms listed on Pakistan Stock Exchange during 2008-2016. Sample size is selected on the basis of availability of data of firms during the selected period. Data are collected from State Bank of Pakistan website (financial statement analysis of non-financial companies). The data is panel in nature, therefore used the panel data approaches for analyses.

3.1 Conceptual Framework of the Study

on the basis of previous literature, the following conceptual model is developed.



3.2 Variables of the Study

3.2.1 Dependent Variable

Firm performance in this study is the dependent variable. It is measure through Return on Assets (ROA). ROA is measure through the ratio of net income divided by total assets of firm (Birjandi et al., 2014; Valipour, Birjandi, & Honarbakhsh, 2012).

3.3 Independent variable

Cost leadership strategy is the independent variable of this study. Measure by the proxy of sales to assets ratio (Valipour, Birjandi, & Honarbakhsh, 2012).

3.3.1 Control variables

Size, leverage and dividend payout ratios are used as control variables in this study. Size is measure as log of total assets of firms. Leverage is calculated as ratio of total debts to total assets of firms and dividend payout ratio is calculated as total amount of dividend divided by total number of outstanding equity shares (Valipour, Birjandi & Honarbakhsh, 2012).

3.3.2 Model of the Study

Regression model is use for the analysis purpose of this study. The same approach is also used for the same nature of study (Atikiya et al., 2015; Birjandi et al., 2014; Valipour et al., 2012).

$$ROA_{i,t} = \alpha + \beta_1 CLS_{i,t} + \beta_2 SIZE_{i,t} + \beta_3 LGE_{i,t} + \beta_4 DPO_{i,t} + \varepsilon_{it}$$

Here:

$ROA_{i,t}$ is the return on assets of firm i at time t .

$CLS_{i,t}$ is the cost leadership strategy of firm i at time t .

$SIZE_{i,t}$ is size of firm i at time t .

$LGE_{i,t}$ is leverage ratio of firm i at time t .

$DPO_{i,t}$ is the dividend payout ratio of firm i at time t .

4. Results and Discussion

Table 1: Descriptive Statistics

	CLS	ROA	LEV	SIZE	DPO
Mean	1.444	0.080	0.554	6.536	0.800
Median	1.367	0.072	0.569	6.516	0.693
Maximum	3.776	0.264	0.971	7.906	3.555
Minimum	0.064	-0.113	0.030	4.945	-2.733
Std. Dev.	0.681	0.058	0.172	0.512	0.950
Skewness	0.676	-1.529	1.595	0.051	0.132

Table 1 of the study reports the descriptive statistics of the study. Values of mean and median of all variables are close, hence reveal that the dispersion is low. Mean value of CLS shows that on average the cost of listed firms is low because its maximum value is high. Moreover, the mean value of the ROA is positive which show favorable performance of the listed firms of textile sector. Moreover, the values of standard deviation also report low level of dispersion from their means. Results of skewness show that all variables of the study are normally distributed.

Table 2: Correlation Results of the Study

	CLS	ROA	SIZE	LEV	DPO
CLS	1.000				
ROA	0.415	1.000			
SIZE	-0.506	-0.117	1.000		
LEV	0.039	-0.390	-0.018	1.000	
DPO	0.207	0.470	0.124	-0.360	1.000

Table 2 shows that CLS is positively associated with ROA, LEV and DPO. If management control their operational cost, then performance of firm increases. Moreover, the confidence of creditors are increases, therefore the cost of debt on their financing is decreases. The CLS is push the DPO of firms high. However, size and CLS are negatively associated, it means large size firms have low CLS. Further, shows that control variables either positively or negatively associated with each other.

Table 3: Dependent Variable (ROA)

Variable	Coefficient	t-Statistic	P-Value
C	0.021	0.406	0.6846
CLS	0.037	6.720	0.0000
LEV	-0.098	-5.089	0.0000
SIZE	0.007	0.955	0.3402
DPO	0.017	5.089	0.0000
Adjusted R-Squared	37.67%		
Prob (F-Statistic)	0.0000		

Table 3 reports that CLS effect ROA significantly and positively. Positive affect reveals that textile sector listed firms of Pakistan follow the cost leadership strategy and this strategy improve their performance because as compared to their total assets they made more sales. The findings are similar as reported in the other studies (e.g., Birjandi, et al., 2014; Valipour et al., 2012). Further, find that leverage significantly affect ROA of firms but the association is negative. The results are having similarities with the theoretical concept that when the level of debt increase in the capital structure of firms the performance of firms are reduce. This negative association of return on assets and leverage of firms having similarity with the findings of the Jermias (2008) that report that leverage has negative and significant association with firm performance and the relationship become more negative if firms adopt product differentiation strategy instead of cost leadership strategy. In the similar vein, find that dividend payout and firm performance are positively and significantly associated. High performing firms pay more dividends and ultimately the paying dividends firms perform well because the investor confidence on such firms is high. Additionally, the firms which adopt the cost leadership strategy and favorable policy for dividend payment their return on assets are improve. These finding having similarities with the study of Atikiya et al. (2015) that cost leadership strategy increase their firm level performance. Positive and significant relationship of return on assets and dividend payout ratio support the studies of (Birjandi,

et al., 2014; Valipour et al., 2012) that dividend payout positively affects firm performance. However, size of the firm insignificantly and positively affects the ROA. This shows that small and large firms perform in the same way because the growth and expansion opportunities are available for all size of textile sectors listed firms.

Adjusted R-Squared shows that ROA is explained 37.67% through variables used in this study. Moreover, the value of F-statistic shows that the model is valid for the analysis.

Table 4: Hausman Test

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	P-Value
Cross-section random	1.701874	4	0.7904

Table 4 reports that random effect model is the appropriate model of this study as compared to pooled and fixed effect models of panel data analysis.

5. Conclusion

In this research work investigate cost leadership strategy and financial performance of 132 firms from textile sector listed on Pakistan Stock Exchange. used random effect model of panel data approach on the basis of Hausman test decision. The results of the study demonstrate that relationship of return on assets (firm performance) with cost leadership strategy, dividend payout and size of firms are positive. Moreover, reported that values of t-statistics and probability values demonstrate that cost leadership strategy, dividend payout and leverage significantly affect the financial performance of listed firms. However, size of the firm insignificantly effects the financial performance and relationship of return on assets with leverage is negative. The overall results of the study support the theoretical association of these variables.

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