

Competitive Strategy and Performance of the Nepalese Banking Industry

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Abstract: *The Nepalese banking industry has been characterized by strong competition with the continual increase in the number of banks. After the entry of joint venture banks and then the burgeoning of Nepalese private banks with the new definition of and approach to banking, the whole banking industry in general, and the erstwhile monopolist state-owned banks in particular are under the pressure to sustain their competitive position. This situation has, therefore, entailed the Nepalese banks to design and redesign their competitive strategies in a manner to attain higher performance. This paper has sought to empirically look into the strategy--performance relationship in the Nepalese banks. The findings of this study have suggested that there exists a positive relationship between competitive strategies pursued by the banks and their organizational performance. The highest performance seemed to be correlated with cost leadership (cost reduction, operating efficiency and offering competitive prices) strategy, followed by differentiation (in particular through unique and wider range of services offered) strategy, and market-focus strategy respectively. It is further observed that banks have preferred more to pursue the combination of cost-leadership and differentiation strategies than the market-focus strategy to attain their higher performance.*

I. INTRODUCTION

Banking industries all over the world are facing a turbulent and complex environment where efficiency and competitiveness hold the key to survival. The Nepalese banking industry cannot remain an exception to this. In recent years, therefore, the commercial banking sector of Nepal has gone through what many observers would like it to term "quantum change", and such a change has adversely affected the industry in terms of its performance and profitability. The industry is facing hyper competition from within and foreign counterparts. Rapid innovation, increasing consumer demands and expectations, and information explosion have significantly changed the way in which

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the commercial banks conduct their business and reach out to their customers. As the banking environment becoming increasingly turbulent and competitive, the commercial banking sector has no other option than to resort to pursuing such strategies that may help attaining competitive advantage. Attaining competitive advantage is truly at the heart of competitive strategy (Delvin and Ennew, 1997).

In order to adapt to the changing environment and to ensure survival, banking firms are emphasizing on understanding the drivers of success such as better utilization of their resources (e.g., technology, infrastructure and employees) and the process of delivering quality service to their customers. This study has been designed to examine the prevailing practices of the leading commercial banks of Nepal on the application of competitive (generic) strategies as the basic source of competitive advantage and the impact of generic strategies - cost leadership, differentiation and market focus, on banking performance. To underpin the associations among strategies and performance primarily focused to explore suitability of the strategies to get sustainable growth and better performance.

II. REVIEW OF THE BUSINESS STRATEGY-PERFORMANCE RELATIONSHIP

From the past few decades, the strategy literature and empirical research present evidence that a firm's strategic orientation is a significant indicator of its performance. Porter (1980) presents a framework describing three generic strategies that a firm can use to achieve competitive advantage: cost leadership, differentiation and market focus. Firms adopting the cost leadership strategy aim to increase market share based on creating a low-cost position relative to their peers through operational efficiencies, performing similar activities better and more efficiently than rivals (Porter, 1996). The second strategy of differentiation requires that the firm create something that is unique in the industry, thus permitting the firm to command higher than average prices. The third is a focus strategy that is concerned with market positioning strategy in which a firm concentrates on a particular group of customers, geographic markets, or product line segments.

Competitiveness has been linked to cost leadership, differentiation and focus strategies [Porter, M.E., 1980]. Empirical research on Porter's strategies has mainly focused on the performance implications of these strategic types (Hambrick, 1983; Dess and Davis, 1984). There is a general consensus in the literature that failure to develop either low-cost or differentiation strategy leads to inferior performance [Porter, 1980].

Miller and Friesen [1986] examining Porter's [1980] generic strategies in consumer durable industries found that the cluster of business units that show distinct competencies in the areas of differentiation, cost leadership and focus dramatically outperform all other competitors. Yamin et al. [1999] found that companies utilizing both cost-leadership and differentiation strategies are effectively more likely to enhance their financial performance and financial management.

The present study attempts to examine strategic-performance relationship in the context of banking industry of Nepal. Existing strategic initiations and practices of the banks and their relative associations with the financial performance obtained by them are the main focus of the study.

III. RESEARCH METHODOLOGY

Sample

To obtain a representative set of commercial banks for the study, a sample of the banks which have already published 3 years complete financial statements was drawn from the Bank Supervision Report 2007 published by Nepal Rastra Bank,. The banks are: Nepal Bank limited, Rastriya Banijya Bank, Nepal Investment Bank Limited, Standard Chartered Bank of Nepal Limited, Himalayan Bank Limited, Nepal SBI Bank Limited, Nepal Bangladesh Bank Limited, Everest Bank Limited, Bank of Kathmandu Limited, Nepal Credit and Commerce Bank Limited, Nepal Industrial and Commercial Bank Limited, Lumbini Bank Limited, Machhapuchhre Bank Limited, NABIL Bank Limited, Kumari Bank Limited, Laxmi Bank Limited, Siddhartha Bank Limited and Agricultural Development Bank, Nepal

Nature and sources of data

The study has been based on the primary data obtained from a survey of the sample commercial banks. A questionnaire survey was conducted in 18 'A' listed commercial banks located in Kathmandu valley in July 2007. The structured questionnaire contained 46 close-ended questions regarding generic strategies and perceived performance, which were grouped into 5 sections including personal profile, cost leadership, differentiation, focus and perceived performance. The survey was conducted by administering 200 sets of questionnaire to the respondents that included the board of directors and higher level managers of the respective sample banks, which formulated and implemented strategies for responses. However, only 76 usable responses were received.

Measurement of generic strategies

Based on the activities associated with low cost, differentiation and focus strategies, Narver and Slater (1990) developed scales to measure the extent to which an organization uses these three strategies. This study used a modified (to suit the banking environment) version of this scale. Cost advantage strategy was measured using a four item, five point scale that asked respondents to indicate the extent to which their institution engaged in competitive activities involving: aim for cost reduction, striving to achieve operating efficiency, achievement of operating efficiency, and achievement of competitive prices. To measure the strategy differentiation, respondents were asked to indicate on a five point scale the extent to which their institution engaged in the following four activities: having strong differential advantage than competitors, unique services difference, reputation difference, and wide service range.

Similarly another focus strategy was measured using a four item, five point scale that asked respondents to indicate the extent to which their institution engaged in focus related activities involving: clear segmentation and positioning, meeting niche market need, undertaking extensive market research, and applying competitor analysis. The scale constructed and validated by Miles and Snow (1978) requires respondents to "rate the characteristics or behaviors of various sectors on the degree of their predictability" using a five point scale with 1 = strongly disagree and 5 = strongly agree.

Measurement of perceived performance

Dess and Robinson (1984) concluded that it is appropriate to use subjective measures where objective measures are inappropriate or unavailable. Previous studies using both approaches have found that the measures of the subjective approach were closely correlated with objective measures (Pearce and Robbins, 1987). In this study, performance has been measured using five subjective items including Increasing Revenue, Improving return on Capital, Improving Profit Margin, Success of New Service, Ability to fund future growth, Success in retaining customers and Success in controlling expenses. The respondents were asked to judge performance. The respondents were first asked to indicate on a 5 point Likert-type scale, where 1 = strongly disagree and 5 = strongly agree, the importance their organization attaches to various performance criteria.

Hypotheses

Since the basic aim of this study has been to empirically examine the impact of generic strategy components - cost leadership, differentiation and focus on performance, the following hypothesis prepositions have been postulated;

H1: The cost leadership strategy has significant impact on banking performance.

H2: The differentiation strategy has significant impact on banking performance.

H3: The focus strategy has significant impact on banking performance.

The hypothesis prepositions formulated above appraise whether these strategies yield significant impact on banking performance or not. The hypothesis testing aims to assess strength of the strategies and their relative robustness in yielding significant impact on performances.

IV. RESULTS AND DISCUSSIONS

This section is divided into two major parts. The first part deals with the results regarding strategies followed by the banks. The descriptive statistics of the survey have been presented and analyzed for cost leadership, differentiation, focus strategies and perceived performances of the banks. Similarly the second section explores mutual associations of 3 generic strategies with performance through correlation analysis and importantly hypothesis testing included within the analysis.

Section-1: Results from responses regarding strategy and performance variables *Cost leadership strategy*

For the response of question as to what extent their banks aim to reduce costs, most of the bank managers agree that cost reduction being a main strategic thrust to achieve competitive cost advantage. Almost all of the managers have strong desire to achieve operating efficiency and have put their higher intention to achieve competitive prices and achievement of economies of scale as well. The result shows clearly that cost leadership strategy is a major strategy preferred by the banks even though some of the respondents disagree with their strong alignment with cost reduction as well as competitive prices for their services and achievement of operating efficiency and economies of scale.

Table: 1- This table reports the summary of opinions of the respondents regarding cost leadership strategy scales and descriptive statistics. The opinions have been scaled from strongly agreed-5 to strongly disagreed-1.

Variables	Strongly agree 5	Agree 4	Undecided 3	Disagree 2	Strongly disagree 1	Mean	Standard deviation
Aim for cost reduction	29	38	4	4	1	4.18	.85962
Strive to achieve operating efficiency	42	28	4	2	0	4.45	.71916
Try to achieve economies of scale	19	43	13	1	0	4.05	.69079
Strive to achieve competitive prices	30	39	6	1	0	4.29	.66964

* These estimates are based on 76 responses.

Source: Survey, 2007

From the result, the manager of the banks are highly interested to achieve operating efficiency by the way of using of their resources in effective way and to achieve competitive prices is their second basic concern to get significant share in the market. The managers also want to reduce their unproductive cost strongly and finally they prefer to get economies of scale. Therefore, cost leadership strategy is the main strategy favored by Nepalese bank managers.

Differentiation strategy

Table: 2- This table reports the summary of opinions of the respondents regarding the various scales of differentiation strategy and mean as well as standard deviations.

Variables	Strongly agree 5	Agree 4	Undecided 3	Disagree 2	Strongly disagree 1	Mean	Standard deviation
having strong differential advantage relative to competitors	22	45	8	1	0	4.16	.65427
unique banking service	19	42	10	5	0	3.99	.80818
Better reputation of bank	23	34	12	7	0	3.96	.91565
Presence of wide service range	31	36	6	3	0	4.25	.76811

* These estimates are based on 76 responses.

Source: Survey 2007

From the responses received the differentiation strategy is the second primary strategy applied and essential to the banks. Among four items of differentiation strategy, most managers support presence of wide service range is their prime source to get differential advantage. They also have strong believed that they have differential advantage than of their competitors in some means. They provide good support to have unique banking service and bank's reputation as another means to get the advantage. Even though significant portion of the respondents are not sure having these two key elements within their banks, it indicates clearly that the importance of differentiation strategy is basic for their successful operation and better performances.

Focus strategy

Table: 3 - This table reports the summary of the opinions of the respondents relating to focus strategy practiced by them and their respective mean and standard deviation values have been presented.

Variables	Strongly agree	Agree	Undecided	Disagree	Strongly disagree	Mean	Standard deviation
	5	4	3	2	1		
Use of market segmentation	17	42	19	4	0	3.95	.78136
Having segmentation and positioning strategies	13	37	18	8	0	3.72	.87329
Attempt to meet niche market needs	13	37	21	5	0	3.77	.81435
undertaking extensive market research	7	32	23	12	2	3.39	.95330
applying competitor analysis	15	32	21	5	1	3.74	.92906

* These estimates are based on 76 responses.

Source: Survey 2007

Among 5 scales of focus strategy asked as to the respondents to measure the extent of focus strategy has been applied by the banks, most of them believe that the banks are using market segmentation basically to gain focus advantage. evenly they have responded that the banks are attempting well to meet niche market need even though a major portion of them are not sure about this. Thirdly they believe having segmentation and positioning strategies to gain better market share. Most of the respondents agree that their banks are applying competitor analysis even though one third of them do not believe of this impact. Finally, there is clear lack seen in the banks having lack of extensive market research. Only about half of the respondents are positive for this statement.

*Performance***Table: 4- This table reports the summary of opinions of the respondents' organizational performance scales and descriptive statistics.**

Variables	Strongly agree 5	Agree 4	Undecided 3	Disagree 2	Strongly disagree 1	Mean	Standard deviation
Increasing Revenue	35	37	4	0	0	4.41	.59279
Improving return on Capital	30	41	4	4	0	4.32	.63688
Improving Profit Margin	35	33	8	0	0	4.36	.66741
Success of New Service	23	42	8	3	0	4.12	.74775
Ability to fund future growth	28	38	8	2	0	4.21	.73604
Success in retaining customers	19	44	10	2	1	3.95	.78271
Success in controlling expenses	17	39	12	7	1	3.84	.92452

* These estimates are based on 76 responses.

Source: Survey 2007

Out of the 7 scales of perceived performances, 76 respondents from 18 banks have provided their mixed responses. Most of the respondents have strong believed that revenues, profit margin and return on capital gradually improving in their banks. They believe that their future growth of the services is very hopeful and new services are being successful. Inspire of better performances, more the respondents believe their banks are getting success to retain customers and controlling customers but significant of them are negative and indifference about these. in sum most of the banks pose satisfactory performance and they are being expected to continue their prevailing success.

Section-2: Correlation between performance and generic strategy components

Generic strategy propounded by Porter is a proven strategic tool to enhance performance by achieving competitive advantage. The 3 strategies of generic strategy-cost leadership, differentiation and focus provide a great aid for achieving competitive advantage. As like previous researches by different scholars, in this study the mutual associations of these strategies with organizational performances have been examined through application of Spearman's correlation analysis. The result and discussion of the analysis are presented below:

Table: 5- This table reports the summary of opinions of the respondents regarding cost leadership strategy scales and descriptive statistics.

Items of the generic strategy	Spearman's correlation	Sig (Two-tailed)
• Cost leadership strategy	.296	.009
• Differentiation strategy	.225	.041
• Focus strategy	.195	.091

* These estimates are based on 76 responses.

Source: Survey 2007

Correlation between Cost leadership strategy and performance

According to past findings, businesses that primarily compete with the low cost approach tend to achieve high market shares through the offering of low prices, made possible by economies of scale (Porter, 1980, 1985). The contemporary Nepalese commercial banking industry has followed cost leadership strategy as the basic means to achieve more market share through economies of scale and setting competitive prices (lower rate of interests). Our first hypothesis to examine impact of cost leadership on performance is:

H1: The cost leadership strategy has significant impact on banking performance.

Applying the Spearman's correlation analysis (using spss-13.00) to reveal their relationship, viz. the impact of cost leadership strategy over performance, the correlation coefficient obtained from the analysis is .296. The result indicates having positive relationship between these two variables. The impact of cost leadership strategy on the performance of Nepalese commercial banks is positive and statistically significant. The test of significance produces high significant value of .009 (two-tailed). From these results we can accept the alternative hypothesis that the cost leadership strategy has significant impact on banking performance. The cost leadership seems to be more effective strategy for banking context since it has strong correlation.

Correlation between differentiation strategy and performance

Enterprises that primarily compete with a differentiation strategy may obtain a competitive advantage, in spite of higher cost positions, since unique product or service offerings allow the alternative of charging higher prices (Wright et al., 1990). In contrast, advantages attained through differentiation are more likely to be sustainable because unique activities or products valued by customers cannot be easily imitated by competitors (Grant, 1991; Porter, 1985). From the results and discussions presented in earlier sections. it is apparent that Nepalese commercial banks have given higher importance to differentiation strategy. To access the impact of the differentiation strategy on performance the second research hypothesis has been postulated as;

H2: The differentiation strategy has significant impact on banking performance.

With the application of Spearman's correlation using spss-13.0, positive relationship between observed between differentiation strategy and banks performance. The correlation coefficient has been .225 and significance (two-tailed) is .041. These outputs justify that there is significant impact of differentiation strategy on banking performance. Therefore, the alternative hypothesis of: the differentiation strategy has significant impact on banking performance is accepted.

The foregoing analysis provides further support for presence of differentiation strategy as basic strategy in the banks having better performance. Nepalese commercial banks have been applying this strategy to grab more market share and to prove themselves as significant players in the industry. They have given effort to provide a wide range of

service and to enhance corporate image by providing quality services.

Correlation between focus strategy and performance

Most of the previous research works assume cost leadership and differentiation strategies as the basic strategies. Porter has suggested this strategy as market oriented strategy, whereby an organization focuses itself to specific section or segment of market either following low cost profile or through differentiation of its services. Porter argues that focus strategy has positive impact on performance. The hypothesis that examines the impact of focus strategy on performance is:

H3: The focus strategy has significant impact on banking performance.

The analysis Spearman's of correlation coefficient of .195 calculated by using spss-13.0 along with significance (two-tailed) value of .091 shows although there is positive impact of focus strategy on performance, but is statistically not significant at 5 per cent level of significance. Thus, the null hypothesis is accepted that implies that focus strategy does not have significant impact on performance. Nepalese banks give less preference to focus strategy than other strategies, viz. two-cost leadership and differentiation strategies.

V. CONCLUSION

Despite its practical and theoretical implications, the strategy-performance relationship has not been previously examined in the Nepalese banking industry. This paper investigated the strategy-performance relationship in commercial banks through an empirical investigation. The findings suggest that there is a positive relationship between their competitive strategies and performance. The results suggest that pursuing cost advantage leads to better performance. Cost leadership strategy seems to have a stronger association with performance than the other generic strategies, which is consistent with the Porter's [1980] suggestion of a strong positive relationship between cost advantage and performance. However, efficiency and competitive prices are equally important as achieving economies of scale. Pursuing cost reduction intensively by the banks may be carried out at the expense of quality.

The results of this study indicate that differentiation is positively related to better performance. The relationship is strong and statistically significant, particularly for banks differentiating their service via providing unique and broader service range. This result supports findings of O'Farrell et al. [1993] who found that business service firms implementing a differentiation strategy have superior performance. The results of this study indicate that similar implications can be deduced for the banks under study. As already pointed out, a focus strategy is positively related to performance, but the association is not statistically significant. This may be attributed to the fact that the focus strategy may not be viable as a single strategy particularly for medium size and large banks. It is suggested, therefore, that high performing banks are more likely to pursue a combination of the generic strategies rather than pursuing one of the generic strategies in isolation.

VI. LIMITATIONS AND SUGGESTIONS FOR FURTHER STUDY

This study was limited to establishing the propositional presence of associations between competitive strategies and performance outcome dimensions in the context of banking industry of Nepal. The sample used, variables used to measure generic strategies and performance components are also limited. Primarily, the study and analysis have been based on only 76 responses received from bank managers concerned with strategy formulation as well as implementation. Besides these, since the questionnaire used in the study was not put in the pilot test, response may be bias to some extent. The banking industry is diverse in itself; hence the outcomes of this study may not be generalized in the whole banking industry.

Future research may explore the robustness of the proposed associations using justification- Competitive strategies and organizational performance. Other action-oriented researches are possible to conduct that can be put forward on the basis of this study. Further empirical research needs to be undertaken to evaluate the applicability of Porter's strategies in other industry contexts and to determine the type of competitive strategies that lead to improved performance.

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Appendix

Contents of the scales included in opinion survey

Generic strategy scales

Absolute cost advantage:

- We aim for cost reduction,
- We strive to achieve operating efficiency,
- We try to achieve economies of scale, and
- We strive to achieve competitive prices.

Differentiation:

- Our company has a strong differential advantage relative to competitors,
- Our differential advantage lies in our firm's service,
- Our differential advantage lies in our firm's reputation, and
- Our differential advantage lies in our wide service range.

Focus:

- We use market segmentation,
- We have clear segmentation and positioning strategies,
- We try to meet niche market needs, and
- We undertake extensive market research.
- We undertake competitor analysis

Perceived performance scales

Higher return on investment [PROI]
Increased earnings per share [PEPS]
Higher shareholder value [PSVA]
Increased cash flow [PCFL]
Higher revenue growth [PRGR]