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on export value addition in
tea subsector in Kenya**

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Full Length Research Paper

Effect of cost leadership on export value addition in tea subsector in Kenya

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The objective of the study sought to evaluate the effect of cost leadership on value addition for Kenyan tea exports. The study used a descriptive survey design. The target population was the entire cadre of employees in the top and middle level management in all the registered tea factories, tea exporters and tea packers in Kenya. The sampling frame for this study consisted of all the top and middle management employees of all registered tea factories, tea exporters and tea packers in Kenya. Data was collected from human resource departments of the sampled organizations. Two questionnaires were administered to randomly sampled employees in the cadres of senior management and middle management. Additionally, this study used stratified random sampling technique to categorize respondents from the three different subsectors so as to increase the chances of getting reliable and accurate information. Primary data through use of a likert scale questions was the main instrument of data collection which underwent pilot study to test the validity and reliability of the research instrument. After collecting data through questionnaires, it was prepared in readiness for analysis using statistical package for social sciences (SPSS) to generate descriptive and inferential statistics. Data was summarised using percentages, mean and standard deviation while F-tests was used to test the hypothesis. This was done using step by step method at 95% level of confidence. Pearson's product moment correlation (r) was derived to show the nature and strength of the relationship of the variables where Coefficient of determination (R^2) was used to measure the amount of variation in the dependent variable explained by the independent variable. All the analysis was done using SPSS statistical package. The study findings indicated that the management at tea subsector were concerned with attaining high profits and thus improved performance due to exportation of value added teas. The study findings indicated that cost leadership is a key driver in determining export value addition in tea subsector. This was evidenced by the responses from the respondents who indicated that their companies focused on cost control mechanisms and they bought products in bulk in order to cut costs. It therefore possible to conclude that for any firm to add value in its exports it must focus on cost control and cost reduction strategies to ensure that they keep their production costs per unit as low as possible. The study concludes that the tea subsector have put in place this strategy by ensuring that they buy packaging in bulk, they maintain shorter lead times, they practice economic order quantity and continuous monitoring of staff productivity cuts processing costs. It is recommended that the tea exporting companies invest more in environmental assessment to enable them gather adequate information which would enhance their response speed by minimizing uncertainties. The companies should also involve more workers in strategic issue management particularly the middle level and lower cadre workers. Further, they should democratize more the management by allowing more workers in decision making particularly by delegating decision making responsibilities thus harnessing the variable potentialities in them.

Key words: Cost leadership, Export Value Addition, Strategic Management Practices

INTRODUCTION

Tea is the second most popular non-alcoholic beverage in the world after water. Tea drinking originated from China in the sixth century BC. Tea is the leading foreign exchange earner in Kenya, contributing to about four (4%) percent of the country's Gross Domestic Product (GDP) (Kenya Tea Development Agency [KTDA], 2014).

Kenya earned from tea Kshs. 112 billion, representing 26% share of the total export earnings in 2012. Black tea in bulk constitutes to about 85% of tea exports and 15% in value added form. Value added tea earns more revenue than bulk tea to the producer and to the country and also helps to create employment, amongst other

benefits. There is, therefore, a strong case for tea value addition. This will also contribute to the realization of Kenya's Vision 2030 economic pillar that supports value addition by processing, packaging and blending the bulk of agricultural products, hence value addition will contribute to the growth of the economy which is expected to grow at a rate of 10% per annum (ROK, 2013).

In the period starting in the year 2000, global tea production has outstripped demand by about 2.4% annually while it is expected to grow at 1.8% yearly in the next decade. Tea production data shows that in the period 2005 to 2010 world production of tea grew by 3.5% per annum while consumption grew at 3% per annum (WTO, 2010). Due to the obvious oversupply of tea in the market, average global auction prices have been declining in real terms. Based on the Food and Agriculture Organization (FAO) composite index, the price of tea has been gradually rising. However longer term analysis shows that, after taking inflation into consideration, the real tea prices dropped substantially in real terms to about half what the producers used to receive 5 decades ago (KTDA, 2014). In order for businesses to be competitive in the market place, every company aims at reducing its costs as a way of producing products that are price competitive.

Efficiency is an important factor of productivity growth as well as stability of production in developing agricultural economics. In view of slow growth and increasing instability in tea production in Kenya, the tea economy of Kenya is expected to be benefited to a great extent from the study on technical efficiency studies. Estimates on the extent of inefficiencies could help decide whether to improve efficiency or to develop cost leadership to raise tea productivity in Kenya. In an economy where recourses are scarce and opportunities for cost leadership are lacking, studies will be able to show the possibility of raising productivity by improving the industry's efficiency.

Statement of the problem

Despite Kenya taking the tea export leadership position in the world in terms of volume, it takes a second position in earnings after Sri Lanka (ITC/WTO, 2010). In 2010, Kenya earned US\$ 1.23 Billion from exports of 441 million kilograms of tea, while Sri Lanka earned US\$ 1.37 Billion (or 10% higher) from export of 314 million kilograms (or 29% lower volumes) owing to higher prices for Sri Lanka exports. This means that the average tea export price realization by Sri Lanka in 2010 was higher at US\$ 4.30 per kg compared to US\$ 2.80 on average realized by Kenya, a difference of 35% in terms of value realization (ITC/WTO, 2010). According to the International Trade Center (2010), Kenya records a 31% share of the value in US dollars of bulk tea exported, followed by Sri Lanka and India. Whereas in terms of non-bulk teas Sri Lanka, UK, India and the UAE top the list, but Kenya does not feature.

According to the Tea Board of Kenya (2014), the main reason for lower unit earnings from tea exports by Kenya is due to low export value attributed to selling tea in bulk form. Compared to Kenya, where bulk tea exports are over 90% of the total, Sri Lanka's bulk exports are lower at about 52%. Kenya tea exported in bulk to various markets is mostly blended and packed in packages of less than 3kgs and either sold within importing countries or re-exported for consumption in other countries. Assuming Kenya adopted similar levels of tea value addition like Sri Lanka (48%), and fetched similar average price of US\$ 4.30 per kg in tea export price in 2010, the country would have fetched Kshs 125 Billion in tea exports earnings, an addition of Kshs 28 Billion. This unfortunate scenario could be a result of poor management practices being applied by Kenya tea exporters.

A strategic management approach through market promotions, partnerships, product diversification, cost leadership and technological innovation is needed in the management of the entire Kenyan tea subsector which may be denying the country substantial amounts of revenue that is associated with value added tea exports (Kenya Tea Board, 2014). Ngore, Mshenga, Owuor and Mutai (2011) determined the technological factors influencing decisions by meat agribusiness operators to add value to their products. Christine (2010) carried out a study on distribution strategies used by Chai Trading Limited to penetrate the Middle East markets in bulk tea exports. Muthenya (2008) studied cost management strategies used by KTDA to grow the Gulf Region Markets. Biegon (2009) studied market expansion challenges facing the Kenyan tea industry in exporting of value-added (branded) tea.

As a consequence, this study has considered the least investigated practices for export value addition through technology. Value added tea earns more than bulk tea to the producer and to the country and also helps to create employment, amongst other benefits. There is, therefore, a strong case for tea value addition. This will also contribute to the realization of Kenya's Vision 2030 economic pillar that supports value addition by processing, packaging and blending the bulk of agricultural products, hence value addition will contribute to the growth of the economy which is expected to grow at a rate of 10% per annum (ROK, 2013). It is in this view that this study sought to establish the effects of cost leadership on export value addition in tea subsector in Kenya.

Purpose of the paper

The purpose of this paper was to establish the effect cost leadership on export value addition in tea subsector in Kenya.

Literature Review

Monitoring African Food and Agricultural policies (MAFAP) (2013) carried out a survey whose objective was to

Table 1: Sample Matrix

Category	Tea Factories	Tea Packers	Tea Exporters	Sample size
Senior Management	54	38	36	128
Middle Management	54	38	36	128
Total	108	76	72	256

establish how to make Kenya's tea more inclusive. MAFAP analysis suggests that KTDA smallholders receive prices close to their international market equivalent. This indicates that the Kenya tea market is functioning efficiently, with no distortions from domestic policies. However, the prices small holders receive may fail to reflect the high quality of, and international demand for, Kenyan tea. The research suggested that more efforts through pricing are needed to further develop and strengthen the Kenyan tea sector in the context of highly competitive international markets.

Muthenya (2008) studied relationship between value exchange and firms profitability. This study utilized secondary data from the Nairobi Stock Exchange. The study concluded that there exists a strong relationship between costs and profitability and value addition for tea exporting companies in Kenya. The study revealed that profitability from companies that engaged in value addition is higher compared to those of companies that did not engage in value addition.

De Silva and Herath (2011) investigated cost leadership as a source of competitive advantage in Sri Lanka Tea industry. It was found that some tea subsectors in the country is adopting a different strategy compared with the other firms in the study. In one of the tea company in Sri Lanka, the CEO recognizes his company as a marketing organization more than an exporter of value added tea. The firm is managed by a team in Sri Lanka, while the chairman is coordinating the business from Canada. They are very strongly established in the North American market. Their business is considered to be in the category of beverage industry rather than tea. Therefore, they concentrate on the marketing aspects of value added tea and have moved out of manufacturing. The company has taken a strategic decision not to run factories, as the company perceives it is not viable in Sri Lanka. Hence manufacturing has been outsourced to Akbar Brothers. From the CEO, the results show that there is no value addition in manufacturing.

METHODOLOGY

This study adopted a descriptive survey design. The target population comprised of all entities in the tea subsector. The study purposely concentrated on only tea subsector because it was expected the players would have the relevant and accurate information needed in this study. This study therefore comprised of 107 tea factories, 75 tea packers and 72 tea exporters from which the target and accessible population was drawn. Target and accessible population comprised of management

and supervisory employees in tea subsector in Kenya. The study concentrated on only tea factories because it was expected that the players have the relevant and accurate information needed in this study. The study used a systematic random sampling technique to come up with 50% of the target firms (127 firms). According to Mugenda and Mugenda (2003) a sample of 10% of the accessible population is considered as adequate sample. From the 127 firms the study chose two respondents, each drawn at random from top management and middle level management. A sample of 256 respondents was selected through stratified random sampling (table 1).

Data was collected, coded and analyzed using SPSS version 20.0. The findings were presented in form of tables and pie charts and discussions and interpretation of the same given.

RESULTS AND DISCUSSIONS

The objective of the study was to evaluate the effect of cost leadership on export value addition in tea subsector in Kenya. Results indicate that 91.2% of the respondents agreed that buying packaging in bulk cuts costs, 75.5% agreed that they maintain shorter lead times to cut costs and 70.4% agreed that they practice Economic Order Quantity to cut costs. Finally 81.7% of the respondents agreed that continuous monitoring of staff productivity cuts processing costs and 64.5% agreed that export prices are not negotiable.

The study findings are in agreement with the report of Monitoring African Food and Agricultural policies (MAFAP) (2013) that was carried out a survey whose objective was to establish how to make Kenya's tea more inclusive. MAFAP analysis suggests that KTDA smallholders receive prices close to their international market equivalent. This indicates that the Kenya tea market is functioning efficiently, with no distortions from domestic policies. However, the prices small holders receive may fail to reflect the high quality of, and international demand for, Kenyan tea. The research suggested that more efforts through pricing are needed to further develop and strengthen the Kenyan tea sector in the context of highly competitive international markets.

The results are in line with Muthenya (2008) who studied relationship between value exchange and firms profitability. The study utilized secondary data from the Nairobi Stock Exchange. The study concluded that there exists a strong relationship between costs and profitability and value addition for tea exporting companies in Kenya. The study revealed that profitability from companies that engaged in value addition is higher compared to those of

Table 2: Cost Leadership Descriptive

Statement	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree	Likert Mean
Buying packaging in bulk cuts costs	1.0%	1.6%	6.2%	46.4%	44.8%	4.32
We maintain shorter lead times to cut costs	0.0%	8.3%	16.1%	54.7%	20.8%	3.88
We practice Economic Order Quantity to cut costs	5.2%	5.2%	19.3%	49.0%	21.4%	3.76
Continuous monitoring of staff productivity cuts processing costs	1.6%	2.1%	14.6%	50.5%	31.2%	4.08
Export prices are not negotiable	7.8%	5.7%	21.9%	41.1%	23.4%	3.67
Average	3.1%	4.6%	15.6%	48.3%	28.3%	3.94

Table 3: Model Summary for Cost Leadership

Indicator	Coefficient
R	0.676
R Square	0.457
Adjusted R Square	0.454
Std. Error of the Estimate	0.37446

Table 4: Coefficients of Cost Leadership

Variable	Beta	Std. Error	t	Sig.
Constant	1.974	0.175	11.291	0.000
Cost Leadership	0.554	0.044	12.652	0.000

companies that did not engage in value addition.

Regression analysis was conducted to empirically determine whether cost leadership is a significant determinant of export value addition in tea subsector in Kenya. The coefficient of determination R^2 and correlation coefficient (r) shows the degree of association between the independent variable and export value addition. The results of the linear regression indicate $R^2 = .457$ and $R = .676$ as shown in table 2. This is an indication that there is a strong relationship between independent variable; cost leadership and the dependent variable export value addition.

From the model summary in table 3 adjusted R^2 was 0.454 this indicates that cost leadership explains 45.4% of variations in export value addition in tea subsector. Therefore further research should be conducted to investigate these other factors that affect export value addition in tea subsector in Kenya.

The cost leadership coefficients are presented in table 4. The results show that cost leadership contributes significantly to the model since the p-value for the constant and gradient are less than 0.05. The fitted equation is as shown below

$$Y = 1.974 + 0.554X_5$$

The findings imply that one positive unit change in cost leadership strategy led to a change in export value addition at the rate of 0.554. This confirms the positive effect of cost leadership on export value addition in tea subsector in Kenya. The study findings are in support of De Silva and Herath (2011) who investigated cost

leadership as a source of competitive advantage in Sri Lanka Tea industry. It was found that some tea subsectors in the country is adopting a different strategy compared with the other firms in the study. In one of the tea company in Sri Lanka, the CEO recognizes his company as a marketing organization more than an exporter of value added tea. The firm is managed by a team in Sri Lanka, while the chairman is coordinating the business from Canada. They are very strongly established in the North American market. Their business is considered to be in the category of beverage industry rather than tea. Therefore, they concentrate on the marketing aspects of value added tea and have moved out of manufacturing. The company has taken a strategic decision not to run factories, as the company perceives it is not viable in Sri Lanka. Hence manufacturing has been outsourced to Akbar Brothers. From the CEO, the results show that there is no value addition in manufacturing.

CONCLUSIONS AND RECOMMENDATIONS

Cost leadership was found to be statistically significant in explaining export value addition in tea subsector in Kenya. It is possible to conclude that for any firm to add value in its exports it must focus on cost control and cost reduction strategies to ensure that they keep their production costs per unit as low as possible. The study concludes that the tea subsector have put in place this strategy by ensuring that they buy packaging in bulk, they maintain shorter lead times, they practice economic order quantity and continuous monitoring of staff productivity cuts processing costs. This is in line with De Silva and Herath (2011) who investigated cost leadership as a source of competitive advantage in Sri Lanka Tea industry. It was found that some tea subsectors in the country is adopting a different strategy compared with the other firms in the study. Their business is considered to be in the category of beverage industry rather than tea. The study concentrated on the marketing aspects of value added tea and have moved out of manufacturing and failed to consider the entire value chain drivers. It further focused on general market expansion and failed to link benefits of cost leadership to value addition.

From the observations made in the course of this study, it is recommended that the tea exporting companies invest more in environmental assessment to enable them gather adequate information which would enhance their

response speed by minimizing uncertainties. The companies should also involve more workers in strategic issue management particularly the middle level and lower cadre workers. Further, they should democratize more the management by allowing more workers in decision making particularly by delegating decision making responsibilities thus harnessing the variable potentialities in them.

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